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Kevin Bress on Use of Prepaid Life Care Contracts in Medicaid Planning

2010 Emerging Issues 5301

Kevin Bress on Use of Prepaid Life Care Contracts in Medicaid Planning (E.S. v. Division of Medical Assistance and Health Services, 412 N.J. Super. 340, 990 A.2d 701 (App. Div. 2010))

By Kevin Bress

September 16, 2010

SUMMARY: Prepaid life care contracts between family members which are designed to act as a sponge for the remainder of a medicaid applicant's available resources are of particular risk of having the consideration paid thereunder assessed under the transfer penalty rules.

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ARTICLE: ***E.S. v. Division of Medical Assistance and Health Services, 412 N.J. Super. 340, 990 A.2d 701 (App. Div. 2010)***

Background

We shall refer to this case as the "E.S. Case." In the E.S. Case, the appellate division of the New Jersey Superior Court upheld the New Jersey Division of Medical Assistance and Health Services ("Division") imposing a Medicaid transfer penalty upon a Medicaid applicant, "E.S.," based on the payment by E.S. to her daughter, E.K., pursuant to a life care contract ("LCC") under which E.K. was to provide personal care services to her mother in exchange for a prepaid, lump sum amount of $56,550. Unique in this case is that the services were to be provided ***after*** the parent was residing in a nursing home. So the services to be provided under the life care contract ("LCC," often referred to as a "care management agreement") were to supplement the long-term care services being rendered at the facility, and the payment made under the contract was to immediately effect the Medicaid spend-down.

Use of a Life Care Contract in Medicaid Planning

The implementation of an inter-familial LCC between a parent and child, or other relative, has long been an effective planning mechanism for achieving Medicaid eligibility and staving off the exhaustion of all of the applicant's resources at a nursing facility. Under most LCC arrangements, a parent who is not yet in need of nursing home care, would compensate a family member who, legitimately, is providing care to the parent when such services might otherwise be rendered for a fee by a qualified care management company. Some LCCs may be structured as a lump-sum payment while others may call for periodic payments while services are being rendered. The lump-sum, up-front, payment arrangement, calls into question whether a contract of that nature should be respected since the services to be

performed may span many years, yet the compensation is all prepaid to the care provider.

In structuring any LCC, care is to be exercised to not have the payment to the care provider be deemed a gift under the Medicaid rules. The holding in the E.S. Case can be seen as a "shot across the bow" to elder law attorneys who may have thought such devices as the LCC were routine and widely accepted by state agencies enforcing the Medicaid rules. Perhaps the court was particularly disturbed by the structure of the LCC which was implemented after the parent was already in the nursing home as a way to effect an overnight spend-down of the remaining assets in exchange for the provision of future care services.

The Holding of the Court in the E.S. Case Identifies Certain LCC Provisions Which Could Prove Fatal To Having a Court Respect the Transaction as Arm's Length and as a Transfer for Adequate Consideration

The LCC was made non-assignable. While it seems nonsensical to expect that a contract that provides for personal services to be rendered to a particular individual would need to be freely assignable in order to substantiate that it has a fair market value on the open market, that is exactly what the court expected. E.S. was not permitted to assign the LCC. While the inclusion of an assignability clause will help clear this particular hurdle, one is still left with the dilemma of how to establish a fair market value for a personal services contract.

The caregiver's right to not devote full time and attention to the "Resident" (term used to describe E.S. under the LCC) was noted by the court. One can only assume that the judges were looking at the terms of the LCC to determine if they were one-sided in favor of the caregiver. Clearly, this particular provision should not be made in a care contract of this nature, nor was it really necessary in this particular case. Realistically, the effect of such a limiting clause in this case was stating the obvious: the services that were to be performed were limited to 15 hours per week. So the very "part time" structure of the agreement for the amount of services to be provided implied, without specific mention, that the caregiver would not be devoting full time and energies to the "business of the Resident."

The LCC permitted the caregiver to cancel the contract with 90-days' notice to the Resident. The full text of the LCC was not reprinted in the opinion and so it is unclear whether the LCC provided a mechanism for the Resident to be compensated if the prepaid LCC were to be prematurely terminated by the caregiver. Perhaps an obligation should be imposed under the LCC for the caregiver to first assign the LCC to a substitute caregiver (satisfactory to the Resident) who will fulfill the balance of the term of the LCC if the initial caregiver gives notice to terminate.

Payment shall be made whether or not services by the caregiver were actually performed. An LCC should be drafted in a fashion that this interpretation of its terms is not possible. There are numerous fixes that could be suggested. If the caregiver cannot perform the 15 hours per week called for under the agreement, the caregiver must hire a substitute caregiver, at its own expense, to fulfill the terms of the LCC. Or, the caregiver could be obligated to perform "an average" of 15 hours per week as measured monthly. There is simply no reason to draft a document that suggests the performance of services is within the caregiver's discretion.

While it seems wholly outside the realm of properly assessing an LCC in terms of whether a transfer penalty should be imposed under the Medicaid rules, the court criticized the LCC for failing to provide for the "two natural objects of petitioner's bounty" in that E.S.'s other daughter would not inherit once E.S executed the LCC and paid virtually every dollar she had left to E.K. pursuant to the terms of the LCC. Once again, the court seems to be blinded by its own determination to reach a certain result without employing basic logic. If E.S. is purchasing services for life-care at a price that consumes the balance of her life's savings, then any discussion of providing for the natural objects of her bounty is wholly moot. Nonetheless, to exercise caution a provision could be included, as silly as it would seem, to provide that upon the death of the Resident, under the LCC, any residuary amounts which may be found to be payable to the Resident shall be paid to the Resident's estate **so that the natural objects of the Resident's bounty** shall receive their distributive share. Silly, because the LCC will not expressly provide for any such payback.

The LCC should clearly set forth the nature of a "prepaid" contract which imposes significant risk upon the

caregiver that services may be provided well beyond the contemplated term; that being the Resident's life expectancy. While E.S. was 97 years old and her life expectancy was calculated to be only 2.9 years, there remained a possibility that E.S. could outlive her life expectancy by a couple years. If so, the caregiver would be obligated to provide services under the "life care" nature of the LCC and not be compensated for those particular hours of service. This risk is offset, presumably, by the potential windfall the caregiver could receive if E.S. were to have died before her 2.9-year life expectancy had run. Care should be taken to incorporate clear language in the LCC that elaborates on this type of agreement. There are "life care facilities" that offer similar terms when a person essentially turns over the bulk of their resources to live at a full service care community for the balance of the person's lifetime.

In writing this article, the attorney who represented E.S. was interviewed for some background. While the attorney declined to be quoted, it was learned that the consideration to be paid by the recipient of the life care services was carefully calculated using a formula designed to be actuarially sound.

How to Defend the Fair Market Value Argument

If the LCC was to be respected, the New Jersey appellate court might have been satisfied if E.S. could substantiate that not only was the fair market value of the services to be provided under the LCC equivalent to what was being paid for those services but also that if the LCC were to be assigned by the caregiver to a third party, the LCC would command a like price. In dealing with state agencies charged with the responsibility of enforcing the Medicaid rules, it is often beneficial to anticipate what aspects of an applicant's Medicaid application may be subject to challenge and come into the application process fully prepared to nip any potential problem in the bud. Often, the best approach is to have a document that can be used to substantiate the position that is being defended.

One lesson learned from the E.S. case is to anticipate that prepaid LCCs will be scrutinized heavily based on the "uncompensated transfer" provisions of the Medicaid rules based on a fair market value analysis. It may be worth contacting a home health agency to obtain an opinion that, if they were to enter into a similar contract, that agency would charge $X for those services. That may carry more weight than supplying one's own analysis of the value of the contract.

Similarly, to address the second component of establishing fair market value would be to have an opinion of what the value to the Medicaid recipient would be if that person's contract were to be assigned ("sold") to another party. Perhaps a certified appraiser can be educated on the nature of this very unique transaction, at least in terms of what the appraiser is accustomed to appraising, and would be comfortable placing a fair market value on such a contract. It will most likely result in a "discounted" valuation as compared with the initial contract price. Such a discount runs the risk of being deemed the transfer penalty portion of the transaction. One could either adjust the contract price accordingly, or consider using a "gift then return" strategy to address the gift. Generally, a return of a gift will mitigate a transfer penalty under the Medicaid rules.

So, for example, if the contract price under an LCC were $50,000, but an appraiser valued the contract in the hands of the nursing home resident at $40,000, there would be a $10,000 uncompensated transfer to the caregiver that will be penalized by the Medicaid agency imposing a waiting period (one month penalty for each amount transferred that equals the average cost of care in that state). To mitigate this penalty period, the caregiver returns approximately one half of the deemed gift, or $5,000, thereby reducing the transfer penalty. The nursing home resident pays the refunded portion to the nursing home and the penalty period expires in the interim (employing the "half a loaf" strategy universally adopted by elder law attorneys).

Conclusion

Prepaid life care contracts between family members which are designed to act as a sponge for the remainder of a Medicaid applicant's available resources are of particular risk of having the consideration paid thereunder assessed under the transfer penalty rules. Proceed with all due diligence before drafting and implementing such a strategy in the

Medicaid planning milieu. Look for administrative or appellate decisions in your state which might shed light on the "dos and don'ts" before drafting such a document. Paper your file with support for the valuations you intend to defend upon review and you might just stave off the unfavorable result in the E.S. Case.

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Kevin Bress on the "Class Act"

2010 Emerging Issues 5302

Kevin Bress on the Community Living Assistance Services and Support Act (the "Class Act")

By Kevin Bress

September 16, 2010

SUMMARY: As part of the Health Reform Bill signed into law by President Obama, Title VIII of the Patient Protection and Affordable Care Act establishes a government-run long-term care insurance program to be funded by payroll deductions from employees. Dubbed the "Class Act" this program becomes effective in 2011. This commentary analyzes some provisions and provides some planning concerns for those who may be considering long-term care insurance.

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ARTICLE: ***The Community Living Assistance Services and Support Act - The "Class Act" - under Title VIII of the Patient Protection and Affordable Care Act (H.R. 3590) ("The Health Reform Bill")***

Background

As part of the Health Reform Bill signed into law by President Obama, Title VIII of the Patient Protection and Affordable Care Act establishes a government-run long-term care insurance program to be funded by payroll deductions from employees. Now dubbed the "Class Act" (Community Living Assistance Services and Support Act), this program becomes effective in 2011. This commentary will analyze some of the provisions and provide some planning concerns for people who may be considering purchasing long-term care insurance.

Basic Structure of the Class Act

Under the Act, employees shall be automatically enrolled by their participating employers unless an employee affirmatively opts out of this new voluntary insurance program. Premiums will be collected through payroll deductions. It does not appear that the premiums to be paid under Class Act policies will be paid with pre-tax payroll deductions. The employee gets insured under a government-issued long-term care policy with fairly limited benefits designed to help with the cost of long-term care, but certainly not to cover the costs. Until regulations are promulgated by the Secretary of Health and Human Services that shed more light on how this program will work, here is what we understand thus far:

· No claim for benefits can be made until an insured has paid five years of premiums into the program

· The insured must be employed three of those first five years.

· There is no "pre-existing condition" limitation - so enrollment is open without medical underwriting.

· Premiums are currently projected to average $123 per month; lower for younger insureds and higher for older enrollees. The fewer enrollees in the program, the higher the premiums will be set. Premiums can increase over time.

· Since federal regulations detailing the plan are not required until October 2012, it is likely the program will not be operational until 2013.

· Policy benefits will be between $50 to $75 per day (with inflationary increases).

· Claims may be paid for a lifetime with no cap on the aggregate benefit.

· Premiums must be paid throughout employment, even if benefits are being paid under a claim.

· Upon attaining age 65, if the insured has paid premiums for 20 years, premiums cannot be increased any further.

· The terms of these plans can change as the government chooses to adjust them, so few guarantees exist.

Analysis

The Problem: Long-Term Care Insurance Is Viewed as "Too Expensive"

With baby boomers now reaching retirement age, there are literally millions of people who should be considering the costs of long-term care and how to finance the potential cost. Long-term care costs are now generally viewed as being prohibitively expensive for the average individual. The first line of defense against such costs would be to purchase a long-term care insurance policy. Given the premium cost for a long-term care policy, insurance salespeople struggle to convince shoppers that the cost is worth the benefit.

Few incentives have been offered by the government to encourage people to purchase this type of insurance.

Perhaps the most widely understood and effective incentive would be to have a dollar-for-dollar income tax deduction for the premium dollars paid for a policy. Instead, our convoluted income tax structure has people grappling with determining whether the tax deduction that is said to apply to the payment of premiums for long-term care insurance actually is realized on the bottom line of their tax form. With the "smoke and mirrors" built in to our tax forms, a claimed medical expense deduction can easily vanish in several ways: (1) the inability to itemize deductions; (2) the 7.5% floor on medical expense deductions; (3) the phase-out of itemized deductions; and (4) the alternative minimum tax.

The "Partnership Program" (discussed below) has been the government's first meaningful attempt since the introduction of long-term care insurance to provide an incentive for the purchase of a policy. This program does not reduce the cost of a policy, and so the main basis for a person to opt out of the insurance remains unresolved.

The Class Act As Competition

Unlike the Partnership Program which essentially makes a private long-term care insurance carrier an ally with the government and its Medicaid program, the Class Act will be seen as competition by the carriers. Already, producers of long-term care insurance companies are being supplied "talking points" to use when discouraging their customers from relying on the Class Act as even a partial solution to their long-term care needs. Nonetheless, a private carrier who refuses to insure a policy applicant because of health underwriting problems will almost certainly now steer that individual to seek coverage under the Class Act.

Sustainability of the Class Act

It may be that the Class Act program will simply be deemed a program for the uninsurable. While that may be a niche that Class Act proponents sought to fill, the government may find it nearly impossible to keep the program actuarially sound as required under the Act. For those who cannot afford the cost of a more comprehensive long-term care insurance product to cover the exorbitant cost of a nursing home, Class Act claimants who wind up in nursing homes may, nevertheless, seek Medicaid benefits to supplement the meager daily benefit under the Act.

Medicaid Waiver Programs

Residents of those states that have adopted a Medicaid Waiver program designed to pay the cost of "in-home" long-term care often find that the benefits provided under a waiver program have fallen short of funding all the services a stay-at-home participant may require. While formulated with good intent, these waiver programs often have obstacles built in such as: waiting lists for enrollment, limited benefits, income caps or rigid eligibility requirements. The Class Act may fulfill a need for financial assistance in this arena.

Medicaid and the Partnership Program

More frequently then ever, the middle class are turning to the Medicaid program for help with paying for long-term care. Given the numbers of people who will likely need long-term care in the next few decades, it seems the Medicaid system would not possibly be able to meet the demand if people do what has been called "Medicaid Planning."

Seniors who conclude they cannot afford the premiums for a long-term care insurance product or are simply ineligible due to pre-existing conditions, are likely to act in advance to position their assets to accelerate Medicaid eligibility without having to first expend those assets for the cost of long-term care. With the Deficit Reduction Act of 2005 ("DRA 2005"), Congress enacted numerous changes to the Medicaid rules to tighten loopholes (but not close them) as a way to deter folks from relying on Medicaid as their solution.

Until the passage of the Class Act, Congress' approach with the long-term care Medicaid program has been is to systematically layer restriction upon restriction for qualification as a way to limit the number of eligible Medicaid recipients. Yet, few alternatives have been proposed for those who may be boxed out because they have too many resources. Note that resources above $2,500 are deemed to be "too many" to qualify.

One positive incentive included in DRA 2005 to encourage people to purchase long-term care insurance was the "Partnership Program." States that enact this program can raise their current asset limit of $2,500 for qualifying for Medicaid to a much higher level which benefits the Medicaid applicant. The higher level under the Partnership Program would be equal to the amount of long-term care insurance that was paid by a Partnership Program approved policy on behalf of the Medicaid applicant.

So, for example, if Linda purchased and utilized all the benefits of her long-term care insurance policy, say $150,000, then she would be eligible to receive Medicaid benefits when her own assets were brought down to $150,000 and not the current $2,500 threshold. She would be able to keep $150,000 for her own needs or pass it on to her family at death, while retaining coverage under Medicaid.

Could Enrollment in the Class Act Be Counterproductive?

Until all the details of the Act emerge through regulation, we can only speculate about the virtues of the Class Act. Perhaps the most troubling result could be if consumers find that they are whipsawed into carrying two policies at more cost than just one better policy - and here's how.

The Class Act may first lure eligible employees into the program at younger ages because the pricing will be lower than a full long-term care policy. Employees may not fully grasp until later that the limited benefits that the Class Act

provides fall way short of what is recommended and often purchased when acquiring the traditional long-term care policy.

So later, when the employee realizes that more insurance coverage is advisable, he is faced with a dilemma: whether to purchase a second policy and continue the premiums into the Class Act program or drop the Class Act policy in favor of the more comprehensive one. If the employee opts to just layer the second policy over the Class Act policy, there may be a higher overall cost than if the employee had just acquired the full coverage policy from the beginning.

More disconcerting to the employee, perhaps, will be the realization that he will have spent thousands of dollars to fully vest (five years) in the Class Act policy only to be advised to walk away because that policy was never designed to provide full coverage.

We'll need to wait and see if private insurers will roll out a newly designed policy that would layer benefits on top of the Class Act program in a premium-efficient manner, much like the way carriers who issue private disability policies have designed policies to be more cost efficient because they layer benefits on top of possible Social Security Disability awards that may also be available to the insured.

Conclusion

With the introduction of Class Act policies in 2013, the overriding question will be whether someone should defer their decision to purchase a long-term care insurance policy now. The answer will depend on each person's particular circumstances. Waiting to purchase a policy now could make sense if either: (1) a person only seeks very limited coverage, such as $75 per day, to keep the premium very low; or (2) a person has a pre-existing medical condition which would drive up the premium on the policy being sought today. Rarely is it advisable to purchase so little coverage as the Class Act will offer. If a person qualifies now to purchase an affordable long-term care policy with more coverage than the Class Act is likely to provide, don't wait -- there are too many questions. It makes little sense to defer that purchase for the future purchase of a product that offers fewer benefits.

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What Elder Law Attorneys Need to Know About PPACA and Health Care Reform

2010 Emerging Issues 5170

Morgan, Frigon, and Zimring on What Elder Law Attorneys Need to Know About the Patient Protection and Affordable Care Act

By Rebecca C. Morgan, Bradley J. Frigon and Stuart D. Zimring

July 5, 2010

SUMMARY: Three prominent elder law attorneys describe changes to Medicare, Medicaid, and the tax laws, resulting from the Patient Protection and Affordable Care Act and related legislation, that are of interest to Elder Law attorneys. Rebecca C. Morgan, Bradley J. Frigon, and Stuart D. Zimring are co-authors of the new LexisNexis publication, Fundamentals of Special Needs Trusts, as well as other publications.

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ARTICLE: The President signed the Patient Protection and Affordable Care Act (PPACA) into law on March 23, 2010. n1 The Act makes changes throughout the health care system, with implementation of various provisions staggered over a number of years. This article focuses on changes to Medicare, Medicaid, and the tax laws that are of interest to Elder Law attorneys.

CHANGES TO MEDICARE

Some of the changes made to Medicare involve administration, including more emphasis on coordination of services. A number of the changes under PPACA do not go into effect immediately. The Centers for Medicare and Medicaid Services (CMS) is in the process of issuing regulations to implement the provisions of PPACA. CMS has sent beneficiaries a pamphlet that highlights the changes to Medicare and summarizes other changes of note. n2 In addition to the information available on the CMS web site, information may be found on the official Medicare site for beneficiaries, www.medicare.gov, on the government's health reform web site, www.healthreform.gov, and from the Center for Medicare Advocacy, www.medicareadvocacy.org. Some of the significant changes affecting the elderly are outlined below.

Beneficiary Premiums

Higher-income beneficiaries already pay a higher premium for their Part B coverage. n3 The income thresholds used to determine the increased premium rates will remain at the 2010 level through 2019. n4 Starting in January 2011, higher-income beneficiaries who pay increased Part B premiums will also pay higher Part D premiums. n5

Changes to Medicare Part D

Part D is the portion of Medicare that provides prescription drug plans for beneficiaries. Part D is perhaps most widely known for the issues beneficiaries faced every year when they reached the coverage gap (also known as the "donut hole"), when beneficiaries were required to pay 100% of prescription costs until they passed through the coverage gap. One of the most publicized changes in PPACA is the gradual closure of the coverage gap over the next ten years. In 2010, a beneficiary who reaches the coverage gap and who is not already receiving assistance (known as "Extra Help"), will receive a $250 rebate. n6 The rebate is only for those beneficiaries who reach the coverage gap in 2010. Rebate checks have been mailed to eligible beneficiaries who have already reached the coverage gap. The beneficiaries do not have to apply to receive the rebate checks; they are automatically sent to beneficiaries when they reach the coverage gap in 2010. n7 In subsequent years, additional provisions to close the coverage gap will go into effect until the gradual closure of the coverage gap is complete in 2020, when the beneficiaries will just have their 25% co-pay. n8 For example, starting January 1, 2011, drug companies will provide a 50% discount on name-brand prescriptions filled when the beneficiary is in the coverage gap and beneficiaries will be responsible for 93% of the cost of generic drugs (instead of 100%) when they are in the coverage gap. n9

As noted above, higher income beneficiaries will have higher premiums for their Part D plans. Another change to Part D concerns the annual coordinated election period. Starting in 2012, it will run from October 15th through December 7th. n10 There are additional changes made to Part D, including changes regarding low-income beneficiaries. n11

Changes to Medicare Advantage Plans

Medicare beneficiaries will see several significant changes to Medicare Advantage Plans. First, the amount paid to the plans, which is currently higher per beneficiary than under original Medicare, will be reduced. n12 The 2011 payment amount per beneficiary will be the same as in 2010. n13 Although this may not seem to have a direct impact on beneficiaries, it will likely impact some of them, as plans may reduce the additional benefits that they have offered to beneficiaries in the past and/or increase the beneficiaries' premiums and cost-sharing, and some plans may leave a particular geographic area. n14

The second significant change is the change in enrollment and election dates. Starting in 2012, the annual coordinated election period for Medicare Advantage plans will run from October 15th to December 7th. n15 Beginning January 1, 2011, those beneficiaries already enrolled in Part C will have 45 days from January 1 to change their elections from Part C to original Medicare. n16

One change to Medicare Advantage plans that will save beneficiaries money is the requirement that the plans may not charge beneficiaries a higher cost-sharing than that under original Medicare for certain items, including chemotherapy, renal dialysis and administrative services and skilled nursing services. n17

Changes to Medigap Plans

A Medigap plan can be very important to certain Medicare beneficiaries in original Medicare. Although not a result of the PPACA, some changes to Medigap policies went into effect June 1, 2010. Plans E, H, I and J will no longer be sold, but two new Medigap plans, M and N, are available. PPACA did address Medigap plans, requiring that HHS ask the National Association of Insurance Commissioners to examine the standards for plans C and F and revise them to add requirements for nominal cost-sharing, with a target date of January 1, 2015 for the revised benefits. n18

Preventative Care

PPACA has several provisions regarding preventative care for Medicare beneficiaries. Medicare already offers a one-time "welcome to Medicare" physical for those beneficiaries new to Medicare. n19 PPACA adds, in 2011, a free health risk wellness assessment and a personalized plan of care for beneficiaries. n20 Further, starting in 2011, beneficiaries will not have out-of-pocket costs for certain preventative care services. n21

CHANGES TO MEDICAID

PPACA significantly expands the number of people eligible for Medicaid. n22

New Eligibility Group

The Act establishes a new eligibility group. This new group is designed to fill in the gaps in Medicaid eligibility that currently exist by extending eligibility to very-low-income individuals who are not otherwise eligible for Medicaid under current mandatory categories. These people are described under the new law as those who are *not*:

- Age 65 or older;
- Pregnant;
- Entitled to or enrolled in benefits under Medicare Part A;
- Enrolled under Medicare Part B; or
- Described in any of the other mandatory groups in the statute such as certain parents, children or people eligible based on their receipt of benefits under the SSI program. n23

The law provides that all states participating in Medicaid must cover this new eligibility group by January 2014. n24 However, the new law permits states to begin to cover this group in April 2010 or to begin to phase in coverage based on income commencing on the same date. n25

The Congressional Budget Office estimates that an additional 16 million individuals will be covered by this expansion. This is accomplished by extending eligibility to a national floor of 133% of poverty ($24,350 for a family of 3 in 2010) or the individual state's eligibility level for Medicaid as of March 23, 2010, whichever is higher. n26

Generally speaking, to help reduce state-by-state variations in Medicaid eligibility requirements, the new law expands and makes uniform eligibility for the new group to a national floor of 133% of poverty. For most Medicaid enrollees income will be based on modified adjusted gross income without an asset or resource test. n27

Benefits Available

PPACA requires that individuals included in the new eligibility group receive the benchmark coverage described in the Act unless the individual is exempt from mandatory enrollment in a benchmark benefit plan. n28

"Benchmark coverage" includes:

- Federal Employees Health Benefits Program-equivalent coverage. The standard Blue Cross/Blue Shield preferred provider option service benefit plan;
- State employee coverage, i.e., a health benefits coverage plan that is offered and generally available to State employees in the State involved;
- Coverage through an HMO; or
- Coverage approved by the Secretary of Health & Human Services pursuant to an application from a state. n29

Long-Term Services and Support

PPACA authorizes a Medicaid "Balancing Incentive Payment Program," which will provide participating states with additional federal financial assistance if they commit to shifting more of their Medicaid Long-Term Services and Support spending toward noninstitutionalized care.

In addition, the Act creates a new community-based option for people who would otherwise be eligible for institutional care. There are additional options created to enhance the Home and Community Based Services waiver programs created by the Deficit Reduction Act of 2005.

As a result, there should be an increased choice of settings in which individuals with chronic conditions can receive services provided by Medicaid. n30

Community Living Assistance Services and Supports (CLASS)

Although not part of Medicare or Medicaid, it is important for elder law attorneys to know about the Community Living Assistance Services and Supports, or CLASS, program. Starting in January 2011 (although, in actuality, it will likely take longer for the program to be put into place), individuals will have an opportunity to participate in the CLASS program. n31 CLASS is a voluntary insurance program designed to pay for non-medical services that will help to keep the individual in the community. Premiums are paid through payroll deductions, allowing individuals to pay into CLASS while working. Employers agree to participate in the payroll deduction process, but employees may choose to opt out of CLASS. Participating individuals must pay into CLASS for a minimum of five years and work for three of those five years. n32 The cost of the premiums for the CLASS program is not yet known. Determination of a participant's eligibility to receive benefits is tied to an inability to perform two or three ADLs with an expected duration of at least 90 days. n33 If an individual has paid into CLASS for the requisite time period and is determined eligible to receive benefits, those benefits may be paid daily or weekly. n34 This cash benefit will allow an eligible individual to buy non-medical community services and supports that will help keep the individual in the community. n35 The amount of the benefit is yet to be determined but will be at least $50, and may vary based on an individual's level of disability. There is no ceiling on the amount of benefits that can be paid out. n36 Because the program must be solvent, the cost of premiums may change, although certain individuals are exempt from increases. n37 Benefit payments under CLASS are not expected to start until 2017. n38

CHANGES TO TAX LAW

Few tax provisions of PPACA are directed specifically at the elderly, yet the provisions applicable to deduction of medical expenses and treatment of group insurance and insurance for low-income individuals are likely to affect many seniors.

Medicare Tax

Beginning in 2013, PPACA will impose a new Medicare tax on individuals equal to the lesser of 3.8% of net investment income or any excess of modified adjusted gross income over $250,000 for taxpayers filing joint returns, $125,000 for married taxpayers filing separately, and $200,000 for all other taxpayers. n39

Medical Expense Deduction

Also effective for taxable years beginning in 2013, only medical expenses exceeding 10% of adjusted gross income are deductible. n40 If a taxpayer or the taxpayer's spouse turns 65 before the end of the taxable year, then the threshold remains at 7.5% for taxable years ending after December 31, 2012 and before January 1, 2017. Effective for taxable years beginning after December 31, 2012, the special extension of the 7.5% of AGI threshold for seniors does not apply when computing alternative minimum taxable income (i.e., when computing alternative minimum taxable income, the 10% of AGI threshold applies to all taxpayers starting in 2013). n41

For taxable years ending after December 31, 2013, a credit will be available to low-income individuals for a portion of premiums paid for qualified health insurance coverage. n42 The credit will be available only to individuals and families whose income is between 133% and 400% of the federal poverty level. n43 The credit is not available to a taxpayer who is eligible for other coverage (not including coverage in the individual market) unless the taxpayer's employer plan coverage requires the taxpayer to contribute more than 9.8% of household income (determined using a "modified gross income") or the plan's share of the total allowed costs of benefits provided under the plan is less than 60%, in which case the employee is eligible for the credit. n44

The PPACA expanded the ability of parents to cover a dependent under an existing group health plan. For plan years beginning on or after September 23, 2010, a group health plan or health insurance issuer offering health insurance coverage that provides coverage of dependent children generally must make the coverage available to an adult child until the child reaches age 26. n45 One question that has come up is whether the definition of "dependent" is the same under the new health insurance rules as it is for tax purposes.

The IRS issued temporary regulations generally applicable to group health plans and group health insurance issuers for plan years beginning on or after September 23, 2010, and to individual health insurance issuers for policy years beginning on or after September 23, 2010. n46 Under the regulations, a plan cannot impose eligibility restrictions on children under the age of 26 by defining dependent other than in terms of a relationship between a child and a participant. Thus, the regulations provide that tests for dependency (such as financial dependency, residency, employment and student status) cannot apply. n47

The regulations indicate that the child under age 26 may be married or unmarried, but the plan is not required to cover the child's spouse or children. n48 If an adult child is eligible for coverage under the employer plans of both parents, neither plan may exclude the adult child from coverage based on the adult child's eligibility to enroll in the plan of the other parent's employer. n49

CONCLUSION

The Patient Protection and Affordable Care Act is extensive, with a significant number of provisions. This article summarizes a few of the more significant changes affecting elderly clients. Expect regulations to be issued frequently as the changes are implemented, some already available, some to be issued soon, and some releasing over the next few years, until all provisions of the PPACA are implemented.

Return to Text

n1 The Patient Protection and Affordable Care Act, Pub. L. No. 111-148, *124 Stat. 119* (Mar. 23, 2010), as amended by Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, § 1101, *124 Stat. 1029* (Mar. 30, 2010).

n2 *See Medicare and the New Health Care Law - What It Means for You: A Message from Kathleen Sebelius, Secretary of Health & Human Services*, Centers for Medicare and Medicaid Services (May 2010), http://www.medicare.gov/Publications/Pubs/pdf/11467.pdf; *see also Health Reform for American Seniors: The Affordable Care Act Gives America's Seniors Greater* Control Over Their Own Health Care, The White House, http://www.whitehouse.gov/sites/default/files/rss_viewer/health_reform_seniors.pdf.

n3 *42 U.S.C. § 1395r(i)*.

n4 The Patient Protection and Affordable Care Act, Pub. L. No. 111-148, § 3402, *124 Stat. 119* (Mar. 23, 2010), adding *42 U.S.C. §1395r(i)(6)*.

n5 Pub. L. No. 111-148, § 3308, *124 Stat. 119* (Mar. 23, 2010), *amending 42 U.S.C. § 1395w-113(a)(1)(F), adding 42 U.S.C. § 1395w-113(a)(7)* and *amending 26 U.S.C. § 6103*.

n6 Pub. L. No. 111-152, § 1101, *124 Stat. 1029* (Mar. 30, 2010), *amending 42 U.S.C. § 1395w-102*; *see also Closing the Prescription Drug Coverage Gap--You Could Be Eligible For A $250 Rebate This Year to Help with Your Medicare Drug Costs*, Center for Medicare and Medicaid Services, Pub. No. 11464 (May 2010).

n7 *Closing the Prescription Drug Coverage Gap--You Could Be Eligible For A $250 Rebate This Year to Help with Your Medicare Drug Costs*, Center for Medicare and Medicaid Services, Pub. No. 11464 (May 2010).

n8 Pub. L. No. 111-152, § 1101, *124 Stat. 1029* (Mar. 30, 2010).

n9 The Patient Protection and Affordable Care Act, Pub. L. No. 111-148, § 3301, *124 Stat. 119* (Mar. 23, 2010) as amended by Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, § 1101, *124 Stat. 1029* (Mar. 30, 2010); *see also*, Notices: Department of Health and Human Services, Centers for Medicare and Medicaid Services, *Medicare Program; Medicare Coverage Gap Discount Program Model Manufacturer Agreement and Announcement of the June 1, 2010 Public Meeting, 75 Fed. Reg. 29,555-29,601* (May 26, 2010); Vicki Gottlich, *Affordable Care Act and Medicare: 5 Points Elder and Special Needs Law Attorneys Should Know*, 22 NAELA News 12-13 (June 2010).

n10 The Patient Protection and Affordable Care Act, Pub. L. No. 111-148, § 3204, *124 Stat. 119* (Mar. 23, 2010), *adding 42 U.S.C. § 1395w*[#8209]21(e)(3)(B)(v); *see also 42 U.S.C. § 1395w*-101(b)(1)(B)(iii).

n11 *See* The Patient Protection and Affordable Care Act, Pub. L. No. 111-148, §§ 3301-3315, *124 Stat. 119* (Mar. 23, 2010),

n12 See Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, § 1102, *124 Stat. 1029* (Mar. 30, 2010). See also Explaining Health Reform: Key Changes in the Medicare Advantage *Program*, Issue Brief, Kaiser Family Foundation (May 2010), http://www.kff.org/healthreform/upload/8071.pdf.

n13 *See Explaining Health Reform: Key Changes in the Medicare Advantage Program*, Issue Brief at 2, Kaiser Family Foundation (May 2010), http://www.kff.org/healthreform/upload/8071.pdf.

n14 *See* Austin Frakt, *Medicare Advantage: You Get What You Pay For*, Kaiser Health News (June 14, 2010), http://www.kaiserhealthnews.org/Columns/2010/June/061410Frakt.aspx; Vicki Gottlich, *Affordable Care Act and Medicare: 5 Points Elder and Special Needs Law Attorneys Should Know*, 22 NAELA News 14-16 (June 2010).

n15 Pub. L. No. 111-148, § 3204, *124 Stat. 119* (Mar. 23, 2010), *amending 42 U.S.C. 1395w*[#8209]21.

n16 The Patient Protection and Affordable Care Act, Pub. L. No. 111-148, § 3103, *124 Stat. 119* (Mar. 23, 2010), *amending 42 U.S.C. § 1395w*[#8209]21(e)(2)(C).

n17 The Patient Protection and Affordable Care Act, Pub. L. No. 111-148, § 3202, *124 Stat. 119* (Mar. 23, 2010), effective January 1, 2011, amending *42 U.S.C. § 1395w-22(a)(1)(B)*.

n18 The Patient Protection and Affordable Care Act, Pub. L. No. 111-148, § 3210; *124 Stat. 119* (Mar. 23, 2010), adding *42 U.S.C. § 1395ss(y)*. For a discussion of the changes to Medigap plans and a list detailing the changes, see Health Reform Mandates Changes for Medigap Policies, Center for Medicare Advocacy; http://www.medicareadvocacy.org/InfoByTopic/Medigap/10_05.27.ChangesFor2010.htm

n19 *42 U.S.C. §1395y(a)(1)(K)*.

n20 Pub. L. No. 111-148, § 4103; *124 Stat. 119* (Mar. 23, 2010), adding *42 U.S.C. §§ 1395x(s)(2)(FF), 42 U.S.C. § 1395x(hhh)*.

n21 Pub. L. No. 111-148, § 4104; *124 Stat. 119* (Mar. 23, 2010), amending *42 U.S.C. §§ 1395l, 1395x*.

n22 The Patient Protection and Affordable Care Act, Pub. L. No. 111-148, *124 Stat. 119* (Mar. 23, 2010), as amended by Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, §10201, *124 Stat. 1029* (Mar. 30, 2010).

n23 The Patient Protection and Affordable Care Act, Pub. L. No. 111-148, *124 Stat. 119* (Mar. 23, 2010), §2001(a)(1) and §10201 as amended by Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, *124 Stat. 1029* (Mar. 30, 2010).

n24 The Patient Protection and Affordable Care Act, Pub. L. No. 111-148, *124 Stat. 119* (Mar. 23, 2010), §2001(a)(1) and §10201 as amended by Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, *124 Stat. 1029* (Mar. 30, 2010).

n25 The Patient Protection and Affordable Care Act, Pub. L. No. 111-148, §2001(a)(4), *124 Stat. 119* (Mar. 23, 2010). This section adds a new subsection (k)(2) to §1902 of the Social Security Act permitting the earlier coverage.

n26 *See A Summary of the Health Reform Law,* Families USA (Apr. 2010), http://www.familiesusa.org/assets/pdfs/health-reform/summary-of-the-health-reform-law.pdf and *Medicaid and Children's Health Insurance Program Provisions in the New Health Reform Law*, Issue Brief, Kaiser Family Foundation (Apr. 2010), http://www.kff.org/healthreform/upload/7952-03.pdf.

n27 *Medicaid and Children's Health Insurance Program Provisions in the New Health Reform Law*, Issue Brief, Kaiser Family Foundation (Apr. 2010), http://www.kff.org/healthreform/upload/7952-03.pdf.

n28 PPACA §1937(b)(1), (2). *See also Medicaid and Children's Health Insurance Program Provisions in the New Health Reform Law*, Issue Brief, Kaiser Family Foundation (Apr. 2010),

http://www.kff.org/healthreform/upload/7952-03.pdf.

n29 *42 U.S.C. §1396u-7(b)*.

n30 *See Health Care Reform and Low-Income Older Adults: An Overview*, National Senior Citizens Law Center (Apr. 2010), http://www.nsclc.org/areas/medicare-part-d/health-reform-overview/at_download/attachment.

n31 The Patient Protection and Affordable Care Act, Pub. L. No. 111-148, § 8001, *124 Stat. 119* (Mar. 23, 2010), *creating 42 U.S.C. § 300ll et seq*.

n32 The Patient Protection and Affordable Care Act, Pub. L. No. 111-148, § 8002, *124 Stat. 119* (Mar. 23, 2010), *creating 42 U.S.C. § 300ll et seq*.

n33 *Health Care Reform and the CLASS Act*, Kaiser Family Foundation (Apr. 2010), http://www.kff.org/healthreform/8069.cfm. Public Health Service Act (*42 U.S.C. § 201* et seq.) § 3203(a)(1)(C)), added by The Patient Protection and Affordable Care Act, Pub. L. No. 111-148, § 8002, *124 Stat. 119* (Mar. 23, 2010).

n34 Public Health Service Act (*42 U.S.C. § 201* et seq.) § 3203(a)(1)(D), added by The Patient Protection and Affordable Care Act, Pub. L. No. 111-148, § 8002, *124 Stat. 119* (Mar. 23, 2010).

n35 Public Health Service Act (*42 U.S.C. § 201* et seq.) § 3205, added by The Patient Protection and Affordable Care Act, Pub. L. No. 111-148, § 8002, *124 Stat. 119* (Mar. 23, 2010).

n36 Public Health Service Act (*42 U.S.C. § 201* et seq.) § 3203(a)(1)(D), added by The Patient Protection and Affordable Care Act, Pub. L. No. 111-148, § 8002, *124 Stat. 119* (Mar. 23, 2010), and creating *42 U.S.C. § 300ll et seq.; see also Health Care Reform and the CLASS Act*, Kaiser Family Foundation (Apr. 2010), http://www.kff.org/healthreform/upload/8069.pdf.

n37 Public Health Service Act (*42 U.S.C. § 201* et seq.) § 3203(a)(b), added by The Patient Protection and Affordable Care Act, Pub. L. No. 111-148, § 8002, *124 Stat. 119* (Mar. 23, 2010), *creating 42 U.S.C. § 300ll et seq*. For a discussion of the viability of the program, see Richard S. Foster, Chief Actuary, *Estimated Financial Effects of the "Patient Protection and Affordable Care Act," as Amended*, CMS Office of the Actuary (April 22, 2010); https://www.cms.gov/ActuarialStudies/Downloads/PPACA_2010-04-22.pdf.

n38 *Health Care Reform and the CLASS Act*, Kaiser Family Foundation (Apr. 2010), http://www.kff.org/healthreform/8069.cfm.

n39 The Health Care and Education Reconciliation Act of 2010, Pub. l. No. 111-152, § 1402, *creating I.R.C. § 1411*.

n40 The Patient Protection and Affordable Care Act, Pub. L. No. 111-148, § 9013, *124 Stat. 119* (Mar. 23, 2010), *amending I.R.C. §§ 213, 56*.

n41 The Patient Protection and Affordable Care Act, Pub. L. No. 111-148, § 9013, *124 Stat. 119* (Mar. 23, 2010), *amending I.R.C. §§ 213, 56*.

n42 The Patient Protection and Affordable Care Act, Pub. L. No. 111-148, § 9013, *124 Stat. 119* (Mar. 23, 2010), *amending I.R.C. §§ 213, 56*.

n43 The Patient Protection and Affordable Care Act, Pub. L. No. 111-148, § 9013, *124 Stat. 119* (Mar. 23, 2010), *amending I.R.C. §§ 213, 56*.

n44 The Patient Protection and Affordable Care Act, Pub. L. No. 111-148, § 9013, *124 Stat. 119* (Mar. 23, 2010), *amending I.R.C. §§ 213, 56*.

n45 The Patient Protection and Affordable Care Act, Pub. L. No. 111-148, § 1401, 10105, *124 Stat. 119* (Mar. 23, 2010), *creating* I.R.C. § 36B and *amending I.R.C. § 280C*.

n46 *I.R.S. Notice 2010-38, 2010-20 I.R.B. 682, 2010 IRB LEXIS 258.*

n47 *I.R.S. Notice 2010-38,* Section II, *2010-20 I.R.B. 682, 2010 IRB LEXIS 258.*

n48 *I.R.S. Notice 2010-38,* Example (4), *2010-20 I.R.B. 682, 2010 IRB LEXIS 258.*

n49 *I.R.S. Notice 2010-38, 2010-20 I.R.B. 682, 2010 IRB LEXIS 258.*

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Information referenced herein is provided for educational purposes only. For legal advice applicable to the facts of your particular situation, you should obtain the services of a qualified attorney licensed to practice law in your state.

Morgan on Special Needs Trusts

2010 Emerging Issues 5084

Rebecca C. Morgan on Special Issues in Establishing and Administering Special Needs Trusts, reprinting Chapter 7 of Zimring, Morgan, Frigon, Fundamentals of Special Needs Trusts

By Rebecca Morgan

June 3, 2010

SUMMARY: Special Needs Trusts can provide an enhanced quality of life to individuals with disabilities without impairing their public benefits. Prof. Rebecca Morgan, former President of NAELA, examines some special issues that can be encountered in this area, such as working with a structured settlement broker, the "sole benefit" rule, and the beneficiary's role in decision-making.

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ARTICLE: CHAPTER 7

Special Issues in Establishing and Administering Special Needs Trusts

SYNOPSIS

[4] The Beneficiary Who Works

[5] The Beneficiary's Role in Decision-Making

[6] The Sole Benefit Rule

[7] Financial Issues

[8] Family Issues

[9] The Beneficiary's Education

§ 7.01 Summary of This Chapter

§ 7.02 Special Issues in Establishing the SNT. SNT attorney may need to work with personal injury attorney and structured settlement broker, as well as deal with issues of subrogation, liens and set-asides.

§ 7.03 Special Issues in Administration. In SNT administration there are issues involving expenditures, working beneficiaries, child support, alimony, education, decision-making and more.

§ 7.02 Special Issues in Establishing the SNT

[1] Working with the Personal Injury Attorney

In some instances, especially in the case of a (d)(4)(A) trust, the source of funds for the SNT will be the settlement or award in an injury case. See § 3.02. In such instances there will be a personal injury attorney who has represented the injured party. That attorney may be the person who contacts the SNT attorney about setting up the SNT. See §§ 2.04, 4.04. In some instances, the SNT attorney may be brought into the case before settlement, and other times, the SNT attorney is brought into the case at a very late stage. It is critical to establish at the beginning some of the issues that the SNT attorney will face.

- Consider who is the beneficiary and what role public benefits will play in his or her future.
- Consider the alternatives to a SNT.
- Who is hiring the SNT attorney?
- Who is the client, and who will sign the engagement letter?
- How will the SNT attorney get paid?
- Will the SNT attorney have access to the beneficiary or the family or will she have to go through the personal injury attorney?
- Does the settlement address liens, repayment issues, and allocation of expenses?

See §§ 2.04, 2.08, 3.05, 4.03, 4.04, and 4.08 for a discussion of these issues. n1

In other situations, the SNT attorney will be contacted after the fact to reform a SNT that was not properly established. The SNT attorney is then faced with revising the SNT in order to preserve or re-establish the beneficiary's eligibility for public benefits. Although reformation may be possible in certain circumstances, there is no guarantee that a court will allow reformation. n2 See § 3.03.

The participation of the SNT attorney may avoid significant problems in establishing and funding the SNT. For example, in *Chen v. Chen Qualified Settlement Fund*, n3 the plaintiff's attorney filed a motion to approve the settlement in a medical malpractice birth case, which included payment of over $400,000 in attorney fees and $1,700,000 to be placed in the SNT. The attorney filed an unspecific list of services that he had rendered in support of his fee petition, but provided no documentation to the court about the child's current condition, which was needed for the court to adequately consider the appropriateness of the settlement. The attorney had failed to have a life care plan prepared even though the child was young and the resulting disability was expected to be of long duration. n4

The capacity of the proposed beneficiary is a key element of special needs planning. If working with a personal injury attorney who is not experienced or not pursuing the right course of action and the beneficiary is unable to protect his or her own interests, the SNT attorney should consider seeking the appointment of an intermediary, whether a guardian ad litem or other, to protect the beneficiary's interests.

A case from the Montana Supreme Court also illustrates the importance of the SNT attorney's involvement in injury cases. Although *Redies v. Attorneys Liability Protection Society* involved the liability of a malpractice carrier, the underlying action was filed because of an attorney's alleged failure to advise the client about an option to create a SNT. n5 Ms. Redies was in an accident, comatose for two weeks, had a slow recovery and needed substantial medical care. The conservator and attorney Addy (whom the conservator used in management of the estate) met with Ms. Redies' sister and the court-appointed attorney ad litem about Ms. Redies' eligibility for Medicaid. Although filing bankruptcy was discussed as an option, there was no discussion at this meeting about establishing a SNT for Ms. Redies. Subsequently, the conservator successfully negotiated reductions in some of the encumbrances on Ms. Redies' property, liquidated her assets and applied them to her care, and ultimately qualified her for SSI and Medicaid. n6

As Ms. Redies improved, she hired an attorney who notified attorney Addy and the attorney ad litem that a malpractice action would be filed, alleging negligence in the failure to establish a trust to protect Ms. Redies' assets. n7 Ms. Redies' expert had concluded that a SNT would have allowed her to preserve most of her assets, use the income from those assets for supplemental needs, and qualify her for SSI and Medicaid. n8

[2] Working with Structured Settlement Brokers

In injury cases, many times the settlement will be "structured," meaning that the settlement funds will be exempt from income taxation under *I.R.C. § 104(a)(1)* and (2), whether paid in a lump sum, or over a period of years. See §§ 4.04, 4.08. It is common that the settlement include both a lump-sum payment and the purchase of one or more annuities because, while a lump-sum payment will be subject to income tax on its growth in the years after it is first received, growth in annuities is protected from income taxation. There will almost always be a structured settlement broker involved, in addition to the personal injury attorney. See §§ 2.04, 4.02, 4.04, and 4.08.

Structured settlement brokers are specialists in understanding both annuity products and the tax issues involved. To determine which broker is best for the case, the SNT attorney needs to ask a number of questions of the broker, including:

- For whom does the broker work-the injured party or the defense?
- What are the broker's interests?
- How, and how much, does the broker get paid?
- Was more than one proposal obtained?
- What is the life expectancy of the beneficiary?
- Is the broker selling a product rather than looking at the best arrangement for the client?

It is important that a life care plan be done for the beneficiary, as this will be critical in evaluating the proposed settlement. n9 It is not unusual for both sides to have a life care plan done and it is often appropriate and wise to obtain more than one company to perform an assessment.

Determining whether to structure a settlement should be a decision made with input from all the parties involved, including the SNT attorney. Among other things, the SNT attorney should consider the needs of the individual who has a disability, the care plan, the cash flow which the trustee will need to put the care plan into effect in the first years, the projected medical needs, and the anticipated life expectancy of the beneficiary. For a discussion of the use of structured settlements in SNTs, see § 4.08.

[3] Liens and Repayments

The (d)(4)(A) and (C) trusts, unlike the third-party trusts, carry a payback provision. See Chapter 1. When a

beneficiary has received Medicaid, the state may need to be repaid for the amount of assistance before the SNT is funded. On the beneficiary's death, there may be a lien that needs to be repaid through estate recovery. See § 11.09.

In *Arkansas Department of Health and Human Services v. Ahlborn*, n10 the United States Supreme Court addressed the issue of whether a state's Medicaid lien statute, in cases of third-party liability, allowed the state to recover the entire amount it paid for the beneficiary's care, even if that amount is in excess of the percentage of the award for medical expenses. n11 Arkansas sought recovery of the entire amount it had paid, rather than that portion of the settlement that represented recovery for the medical payments. The Court held that the anti-lien statute prevents a state from attaching or encumbering settlement proceeds beyond that amount of the settlement which is attributed to medical care. n12 At the beneficiary's death, in certain cases, the state may seek recovery from the beneficiary's estate. See § 11.09.

§ 7.03 Special Issues in Administration

[1] Spending Issues

Many trust expenditures are commonplace-caregiving services, assistive devices, technology, travel, clothing, etc. Often, however, a trustee will receive unusual requests for spending from the SNT. In addition to the issues involving continuing eligibility for public benefits, the sole benefit rule and the rules regarding in-kind support and maintence (ISM), the trustee needs to consider, among other things, the amount of money in the SNT, market conditions, the continued availability of family caregivers (if any), the unique needs of the beneficiary and the life expectancy of the beneficiary. Budgeting is an important part of determining expenditures and can provide a framework for the trustee in reviewing expenditure requests.

[2] Quality of Life

The beneficiary may be able to engage in social activities that would enhance the beneficiary's quality of life. The trustee may be asked to pay for vacations, dues in organizations, movie tickets, hobby supplies, companionship, therapies and more. n13 Reasonable expenses for such would be appropriate. The trustee should include these expenses in developing the budget.

With vacations, the trustee needs to determine if the expenses are reasonable, the trip will be appropriate for the beneficiary (such as whether the venue is accessible), how the beneficiary will travel (car, plane, etc.), and whether the trust can pay for someone to accompany the beneficiary on the vacation. Usually the trust will need to arrange for direct payment of vacation costs, including pre-paid hotels, airfares and other transportation costs, and even meals. One common issue that the trustee will face is when the family asks that the trust pay their expenses on vacation as well. The logic of this, from the family's perspective, is usually that since this is a family vacation, they all need to accompany the beneficiary on vacation (perhaps to provide care for the beneficiary) or the beneficiary wants them to be there. The trustee would be able to pay for reasonable expenses for a vacation for a beneficiary. n14 In the case of a (d)(4)(A) SNT, there may be a limit on the number of companions whose expenses may be paid by the trust, depending on the beneficiary's needs. n15 The impact that such expenditures may have on public benefits eligibility must be considered, as well as the treatment of such expenditures, if not done correctly. See § 6.07[2][a].

Additional issues may occur when a beneficiary has attained the age of majority and wants to date or marry. The SNT's existence is not affected by the beneficiary marrying, but the beneficiary's eligibility for SSI and other means-tested programs may be affected, depending on whether the spouse has assets and income and/or is eligible for benefits. The trustee needs to review the deeming rules and may need to revise the SNT budget. Furthermore, the marriage may affect any public benefits the SNT beneficiary is receiving on a parent's record.

The beneficiary may be able to develop independent living skills. The caregiver should help the beneficiary develop these skills. The budget should include reasonable and necessary expenditures for developing these skills and the trustee should assist the beneficiary in accessing any program that may lead to the beneficiary's improvement.

The beneficiary may want to regain control of the money or make spending decisions, although this may be at the urging of the girl/boyfriend or new spouse. In addition, the beneficiary's living expenses may increase upon marriage and the birth of children, but none of these occurrences will alter the sole benefit rules which the trustee must follow if the beneficiary is on SSI. Even if the beneficiary is unable to manage money, it is still helpful to get the beneficiary's input, to the extent possible, in spending decisions.

It may be appropriate to obtain a low-balance credit card for the beneficiary, although there is a risk that the beneficiary on SSI may use the card to purchase food (or less likely, shelter). Using the card for cash withdrawals is another risk. n16 Another option may be to set up an account for the beneficiary for shopping at stores for allowable items, or billing so that the beneficiary may not spend SNT money for inappropriate expenditures. Gift cards that are convertible to cash (sold) or used to purchase food or shelter would be considered income in the month that they are received and any balance in the following month would be a resource for those beneficiaries receiving SSI. n17 See § 6.07[3][c].

[3] Vehicles

There are a number of serious issues involved in the question of the SNT buying a vehicle and the beneficiary, family member or caregiver driving it. The issues that must be resolved include:

- whether to purchase (or lease) a vehicle;
- who should do so;
- who would be the owner of the vehicle;
- whether the trust will retain (or be required to retain) a lienholder's interest in the vehicle;
- who should be the driver-the parent, the caregiver or the beneficiary;
- how the vehicle will be insured (see § 6.05); and
- whether the beneficiary is capable of driving and whether the beneficiary has been evaluated as being capable of driving.

A beneficiary may have a valid driver's license from prior to an accident or injury, but without any subsequent evaluation of driving ability. The life care plan is a good starting point to answer many of these questions.

Assuming that purchase of a vehicle is appropriate, the next issues to be resolved include what type of vehicle is needed and whether and how it should be modified. Again, the care plan would be a helpful starting point. Knowing about the various types of possible modifications is important. For the beneficiary's quality of life and to minimize the risk of injury or liability, it is important that the appropriate modifications are made.

The purchase price and associated costs are not the only costs to consider. Upkeep and repair, fuel costs, and insurance all factor into the operation of a vehicle. A vehicle owned by the trust but under the control of a caretaker or family member may not be maintained or appropriately used. So consider whether the SNT can afford to purchase and maintain the appropriate vehicle.

A beneficiary who is being considered as a driver should probably be evaluated for driving in light of the beneficiary's medical condition, functional abilities and mobility; this may involve a "professional evaluation and assessment by a Driver's Rehabilitation Specialist." n18 An occupational therapist may also be helpful in evaluating a beneficiary's ability to drive and the appropriate modifications to be made to any vehicle.

The vehicle must be insured, and it is wise to buy extra coverage through an umbrella policy. Ownership may affect who can insure the vehicle. The trustee must be sure that the insurance is paid on time. The SNT budget needs to include not only the vehicle's purchase, but upkeep and maintenance, and subsequent replacement costs. Consider the vehicle's use and make sure that the beneficiary's needs and use of the vehicle are documented. n19

SSI exempts one car, regardless of value, if "it is used for transportation for the individual or a member of the individual's household." n20 Often the family will use the vehicle to transport the beneficiary, as well as others, so

consider whether there will be an issue with the sole benefit rule. If the beneficiary isn't able to drive, a decision will need to be made as to who will drive the vehicle. The designated driver's record should be reviewed and a decision made on whether the driver will be compensated for driving. See § 6.05 for an extensive discussion of vehicles.

[4] The Beneficiary Who Works

Sometimes a beneficiary may wish to work. There are a number of issues to be explored. If the beneficiary is not going to volunteer, and is going to work for pay, there may be an impact on the beneficiary's continued receipt of public benefits and on whether the beneficiary will continue to meet the Social Security definition of disabled (see § 1.05[2]). Consider the advantages to the beneficiary of working, including self-esteem and socialization. SSI benefits are reduced by earned income and although there is no reduction in the amount of Social Security Disability benefits, there is a limit on earnings before the beneficiary's continuing disability is questioned.

A Plan to Achieve Self-Support (PASS), is an SSI program to help individuals with disabilities return to work. n21 The beneficiary may be under a Plan to Achieve Self-Support. In such instances, income and resources are excluded when the beneficiary needs the income and resources "to fulfill an approved Plan to Achieve Self-Support." Thus, the income and resources are not counted to determine the beneficiary's SSI eligibility or payment. Earned income under PASS will not "affect the amount of earnings considered for the purposes of a substantial gainful activity determination, if needed." n22 A PASS plan must:

- be designed specifically for the individual, in writing, approved by SSA;
- contain a specific feasible employment goal ("reasonable likelihood of achieving") with a plan for achieving the goal that is "viable and financially sustainable," and limited to one goal for employment;
- show how the goal will result in enough income to either end or significantly reduce the individual's reliance on SSI or SSDI;
- have a start and end date with target dates for progress toward the goal;
- contain necessary expenses for achieving the employment goal;
- show the money the individual has or will be receiving as well as how the money will be applied toward achieving the employment goal;
- show how the individual will cover the individual's living expenses; and
- show how the money the individual sets aside under this plan will be separated from other funds of the individual. n23

Additionally, the individual must identify a "reasonable ending date for [the individual's] PASS," which SSA may subsequently adjust depending on the progress toward the employment goal. If the individual's goal is self-employment, a detailed business plan must be included. n24 The individual's progress is reviewed at least once a year to ensure compliance with the PASS. n25 SSA will begin to count the individual's earned and unearned income that would otherwise be excluded under PASS during the month when the individual fails to follow the plan, abandons the plan, completes the timeline under the plan or reaches the plan's goal. n26

The beneficiary may be eligible for a program that allows the beneficiary to re-enter the workforce while retaining public benefits for a period of time (see Chapter 9 for a description of those programs). A beneficiary may be eligible to work in a "sheltered workshop" program, the wages for which would be treated as earned income. n27 Even non-cash benefits from employment will be considered earned income. n28 Even if a SNT beneficiary does begin to work, that does not mean that the SNT will terminate.

[5] The Beneficiary's Role in Decision-Making

The beneficiary may want, and be able to have, a role in decision-making. See § 4.03. This somewhat depends on the beneficiary's ability to participate, express preferences, and give input. The care plan may be instructive in delineating the beneficiary's decision-making abilities. Wherever possible, the trustee should include the beneficiary in decision-making, and especially when decisions directly impact quality-of-life. If the beneficiary is a ward under

guardianship, conservatorship or other protective legal status, it is important to consider whether there are limits on the protective arrangement and whether the applicable state statute requires the fiduciary to honor the ward's preferences when possible. Although the beneficiary may have a role, and the trustee should encourage active participation, the trustee still must keep in mind the trustee's duties in decision-making.

[6] The Sole Benefit Rule

In determining expenditures, the trustee of a self-settled trust must continue to determine compliance with the "sole benefit" rule for the purpose of some public benefits programs, such as SSI. This often comes up when a purchase is made for the beneficiary, but others may be using the item purchased. For example, if the trustee purchases a house for the beneficiary, owned by the trust, but the family lives in the house with the beneficiary, the benefit to other family members is obvious. If the beneficiary moves or dies, the family may have to vacate the house or enter into a fair market value lease with the SNT trustee if the family owns no beneficial interest in their home. The trustee needs to make a decision about whether to require those who also benefit from the purchase to pay an appropriate percentage as their share. For example, the trustee may decide to have the family pay rent and/or some share of the shelter expenses. In some cases, rent may be able to be offset by caregiver services which are being provided by others in the home. This should be addressed in the trust document and thoroughly discussed with the family before the home is purchased. The discussion should be followed up with a letter to the family documenting the discussion. See §§ 6.03, 6.04. Similar considerations come into play when reviewing other proposed purchases and expenditures.

Consider how CMS and SSA define and apply the sole benefit rule to SNTs. Although there is a difference in wording between (d)(4)(A) ("for the benefit of") and (d)(4)(C) ("solely for the benefit of"), the State Medicaid Manual uses only the phrase "sole benefit" in that context for both types of first-party trusts. n29 Although SSA notes that distinction in rulemaking and the POMS references, for practical purposes it considers the terminology to be the same and generally uses "sole benefit." State Medicaid agencies vary in their interpretation and application of "sole benefit" to distributions. n30 The most recent revision of the POMS sheds some light on understanding the SSI sole benefit rule interpretation:

F. Policy-For The Benefit Of/On Behalf Of/For The Sole Benefit Of An Individual

1. Trust Established for the Benefit of/on Behalf of an Individual

Consider a trust established **for the benefit** of an individual if payments of any sort from the corpus or income of the trust are paid to another person or entity so that the individual derives some benefit from the payment.

Likewise, consider payments to be made **on behalf of,** or **to or for the benefit of** an individual, if payments of any sort from the corpus or income of the trust are paid to another person or entity so that the individual derives some benefit from the payment.

For example, such payments could include purchase of food or shelter, or household goods and personal items that count as income. The payments could also include services for medical or personal attendant care that the individual may need which does not count as income.

NOTE: These payments are evaluated under regular income-counting rules. However, they do not have to meet the definition of income for SSI purposes to be considered to be made **on behalf of,** or **to or for the benefit of** the individual.

If funds from a trust that is a resource are used to purchase durable items, e.g., a car or a house, **the individual (or the trust) must be shown as the owner of the item** in the percentage that the funds represent the value of the item. When there is a deed or titling document, the individual (or trust) must be listed as an owner. Failure to do so may constitute evidence of a transfer of resources.

2. Trust Established for the Sole Benefit of an Individual

Consider a trust established **for the sole benefit of** an individual if the trust benefits no one but that individual, whether at the time the trust is established or at any time for the remainder of the individual's life. However, the trust may provide for reasonable compensation for a trustee(s) to manage the trust, as well as reasonable costs associated with investment, legal or other services rendered on behalf of the individual with regard to the trust. In defining what is reasonable compensation, consider the time and effort involved in providing the services involved, as well as the prevailing rate of compensation for similar services considering the size and complexity of the trust.

...

Do not consider a trust that provides for the trust corpus or income to be paid to or for a beneficiary other than the SSI applicant/recipient to be established for the sole benefit of the individual. However, payments to a third party that result in the receipt of goods or services by the individual are considered for the sole benefit of the individual. The following disbursements or distributions are also permitted:

reimbursement to the State, after the individual's death, for medical expenses paid on the individual's behalf (see SI 01120.203B.1.f. and SI 01120.203B.2.g.);

upon death of the beneficiary, retention of a certain percentage of the funds in a "pooled trust" established through the actions of a nonprofit association in accordance with the trust agreement (see SI 01120.203B.2.); and

transfer of the remaining trust corpus to a residual trust beneficiary after the individual's death. n31

Consider as well the applicable state trust codes, Medicaid programs and state agencies' rules. n32 In those states where the state Medicaid agency uses a more narrow definition of "sole benefit," an argument may be made using the federal statutory "comparability" standard.

[7] Financial Issues

There may be times when decisions have to be made about whether the home purchased by the SNT should be purchased through a mortgage (see above), whether to lease a car or rent a home, or to sell the home, car, etc. See §§ 6.03-6.07. Another question involves whether it is appropriate for a SNT to make a loan to a family member or other individual. The applicable prudent investment standards must be considered when managing trust funds.

The case of *Estate of Hicks v. Commissioner* *n33* concerned an unusual arrangement concerning a loan *from* the father *to* the injured child's SNT and whether the loan created a legitimate deduction from the child's estate for estate tax purposes. As a result of the 1994 settlement of the child's personal injury case, two separate trusts were created, a (d)(4)(A) trust funded by $1 million of the total settlement and a separate Settlement Fund Management Trust funded by a $1 million loan from the child's father (from his loss of consortium claim proceeds) and secured by a note paying interest only and callable upon the child's death or failure to qualify for medical insurance. n34

After the child died, her estate filed an estate tax return that reported as assets the full value of the (d)(4)(A) trust and the Settlement Fund Management Trust. Liabilities included the loan from the child's father. The IRS took the position that the loan was not a *bona fide* transaction or, even if it was, the "substance-over-form doctrine" would allow them to disregard the note as a sham transaction. In a Memorandum Decision, the Tax Court ruled that the note was a legitimate transaction, and that the parties had acted as though this was an enforceable agreement. n35

Tax and other financial professionals should be consulted when establishing the SNT to be sure that the best plan is developed for the beneficiary. n36 See Chapters 8 and 12.

[8] Family Issues

Family issues may crop up in a variety of ways. The beneficiary's parents may get divorced, so there may be issues of custody and child support. The beneficiary may get married, divorced or become a parent. These issues are addressed by state law (trust and family law), but tax laws and public benefits laws also apply.

Support is considered unearned income for the purpose of the POMS. n37 Under state law a beneficiary's parent may be obligated to pay child support for the beneficiary. The attorney representing the parent must consider the best way to handle support payments for a beneficiary: for example, whether to have the support paid directly to the SNT pursuant to a court order, as direct payments for expenses that are specifically excluded as countable income for SSI, or to have the support payments paid to the parent for the child. n38 Absent a state statute to the contrary, child support may be paid directly to the SNT.

The expenses incurred by caring for the beneficiary may be a factor in the division of assets in a divorce. n39 In some instances, child support obligations may continue after the beneficiary attains majority. In some jurisdictions, that continued support obligation may depend on whether the beneficiary was disabled before the age of majority. Remember that these issues are covered by the state family law statutes, trust statutes, tax laws and public benefits laws. Applicable state laws should be consulted for a resolution to a question. A detailed discussion of the various family law issues is beyond the scope of this chapter, but some of the issues need to be briefly discussed here.

Alimony and child support are considered unearned income by SSI. n40 Child support is defined as "a payment from a parent to or for the child to meet the child's needs for food and shelter. Child support can be in cash or in-kind. It can be voluntary or court-ordered." n41 SSI considers child support for a child on SSI to be unearned income, and thus "[o]ne-third of the amount of a child support payment made to or for an eligible child by an absent parent is excluded." n42

If child support is paid directly to the child or the custodial parent rather than into the SNT, then one-third of that amount of child support is excluded from income while the balance is treated as in-kind support and maintenance (ISM), and the presumed maximum value (PMV) is applied. n43 For Medicaid purposes, child support may be treated as income for the entire family, so it is important to consult the applicable state Medicaid laws. n44

Thus, child support paid to a SNT, if (1) allowable under state law, and (2) a judge will order the payments made to the SNT, for purposes of SSI, is not considered income. n45 The type of SNT (first- or third-party) may be a factor as well. n46 However, in-kind distributions from the SNT may count as income to the child if used for food and shelter expenses.

The amount of child support to be paid may be a significant issue. Child support guidelines are used in many states. The question then is whether the state statute allows a deviation from the guidelines and for what grounds. n47 Argument may be made that a child with special needs will have greater needs and thus the amount of child support should be greater than for a child without special needs. n48 Also, there may be additional expenses for the child as a result of the divorce. n49 The care plan is helpful in identifying the current and future needs of the child. The parents may need to obtain an evaluation of the child's needs and costs for care, including the life expectancy of the child. n50

The trustee may have to argue that the existence of the SNT will not affect the amount of the child support obligation, since the SNT is to supplement, not supplant what is covered by SSI and Medicaid, and child support usually includes the everyday living expenses. n51 As noted by the court in *Lewis v. Department of Social Services*, "[w]hether the income from a trust should be included in determining the appropriate amount of child support depends upon the type of trust involved and the intent of the settlor" and since the trust was a SNT, "[t]o find that this trust is available for the ordinary support and maintenance of [the beneficiary's] everyday expenses would be contrary to the intent and purpose of [the] trust." n52 An appellate court in Arkansas refused to substitute the SNT monies for a parent's obligation to pay child support. The court characterized the father's position as "essentially ... asking that the children be ordered to support themselves from their own funds instead of his being required to do so." In affirming the trial court, the appellate court held that "[t]he funds were not earned by appellant and are not a substitute for his earnings because

of a disability. They are the result of an award of damages for the benefit of the children ... [and] will be needed to support the children throughout the rest of their lives ... A parent has a legal and moral duty to support and educate his child and to provide the necessities of life even though the child has sufficient property to do so." n53 The type of government benefits the beneficiary is receiving may affect the result.

Sometimes the parent must continue to pay child support for the child with special needs, even though the child has attained majority and may not be in college. State law determines when a child support obligation ends, although a parent could agree to continue to pay support. However, the applicable law may require a court order for the continuing support to be an enforceable obligation and to have the support paid into the SNT. n54 Under SSI, child support payments to an adult child would be considered income for that adult child. n55

Less clear is whether a SNT may be used in the calculation of, or possibly even required to pay, the beneficiary's alimony or child support obligation, and it may be answered differently from state to state. The first question to be answered is whether the state trust law allows an order of support to be paid from the SNT. n56 For example, South Carolina's statute for a child support exception to a spendthrift provision would prohibit the payment of child support from a SNT if doing so would destroy the SNT's unavailability for the purpose of the beneficiary's eligibility for or receipt of public benefits. n57 Assuming state trust law would allow the SNT monies to be used to pay periodic support, the next question involves the sole benefit rule. n58 Although it would appear that paying support would not be for the beneficiary's "sole benefit," it could be argued that if the beneficiary has been ordered by the court to pay support, it would be in the beneficiary's sole benefit for the support to be paid, rather than the beneficiary to be found in contempt or even jailed on civil contempt for a failure to pay support. If there is another option, that should be pursued before trying the argument.

Whether the SNT may be used in calculating the amount of the support obligation was addressed by a court in Pennsylvania. In *Mencer v. Ruch*, n59 the plaintiff filed a paternity action against the beneficiary of a self-settled SNT (established in New York under New York law). The beneficiary was the recipient of monthly annuity income. The trial court declined to consider the SNT income in calculating the beneficiary's child support obligation, and the plaintiff appealed. The appellate court reversed, ruling that the domestic relations court must consider "all forms of income" in setting support levels. The beneficiary argued that state law prohibited payments from a SNT for the benefit of anyone other than the beneficiary, which argument the appellate court discounted since the trust had made previous child support payments. However, the calculation was not an order that payment must come from the trust, but rather only a determination that trust distributions should be counted as income in making the calculation. The appellate court did not decide "whether the trust principal can be attached for purposes of any arrearages that may accrue as the result of our decision herein." n60

The court noted that the beneficiary had elected to work just a few hours a day in order to prevent any reduction of his public benefits. Rather than trying to support his child, he "chose to do nothing, while enjoying the benefits of cable television and a cellular telephone" provided by his SNT. n61

A brief discussion of alimony is needed, although there may be similarities between alimony and child support. SSI treats alimony as unearned income. n62 SSI defines "[a]limony or spousal support (sometimes called "maintenance") [as] an allowance for support made by a court from the funds of one spouse to the other spouse in connection with a suit for separation or divorce." The payments are "cash or in-kind contributions to meet some or all of a person's needs for food and shelter" and may be either voluntary or made pursuant to a court order and are considered unearned income to the recipient spouse. n63 If the spouse to receive alimony has special needs, then a similar argument for an increased amount of alimony or for permanent alimony may be made, but the success will depend on state law.

In the case of *J.P. v. Division of Medical Assistance and Health Services n64* the court held that alimony paid to a SNT was not income for Medicaid share-of-cost calculations. As part of her divorce settlement, nursing home resident J.P. petitioned for a court-created SNT. Her petition stated that she was "capable of enjoying an enhanced quality of life

if I had the funds to support activities and allow for purchases which would allow me to enrich the quality of my life." n65

Since most of the other residents suffered from dementia, her chances for a social life were family visits and trips outside of the nursing home. The state Medicaid agency was given notice and although the agency did not appear or respond, the agency did send J.P.'s attorney a letter with suggestions on how to set up a trust. The letter also indicated that income such as alimony could not be assigned to a SNT. The judge agreed to establish the SNT and, among other things, ordered J.P.'s husband to pay $1,550 per month in alimony to the SNT. n66

Although J.P. qualified for Medicaid, the State Medicaid agency directed that the alimony be paid to her nursing home as part of her share of cost. On appeal, an ALJ ruled that the alimony was not part of J.P.'s income because she had no right to receive it, but the agency reversed the ALJ's determination, pointing out that the settlement agreement provided that the alimony would be "taxable income" to J.P. and deductible to her husband. J.P. appealed. n67

The appellate court reversed, finding that the SNT is a legitimate Medicaid planning tool allowed under both federal and state law and the agency's effort "to distinguish between alimony and equitable distribution placed in the trust" was without a legal or rational basis. n68 Although the issue of property division may also occur, it is not discussed here. n69

[9] The Beneficiary's Education

The Individuals with Disabilities Education Act (IDEA) n70 provides a federal platform for the education of children with disabilities. The law's purpose is to make sure that children with disabilities have "free appropriate public education" that stresses special education and related services that focus on the children's particular needs as well as to "prepare them for further education, employment, and independent living"; to ensure protection of the rights of the children and their parents; to help states, cities, school districts and federal agencies provide "education of all children with disabilities"; to assist states in implementing "a statewide, comprehensive, coordinated, multidisciplinary, interagency system of early intervention services for infants and toddlers with disabilities and their families"; to ensure that parents and educators have the tools that they need to enhance the educational results for the children through support of system improvements; to coordinate research and preparation of educational personnel, technical assistance; "and technology development and media services"; and to analyze and ensure the success of the educational efforts. n71 The IDEA provides for the Office of Special Education Programs within the Department of Education's Office of Special Education and Rehabilitative Services. n72 The Department of Education makes grants to states to assist them in providing special education to children with disabilities. n73 The child must be initially evaluated to determine if the child meets the definition of a child with a disability and to identify the child's educational needs. The regulations set out a process for the evaluation and the time frame for completion. n74 An individualized program, known as an individualized education program (IEP) is developed for each child with a disability. This written statement must include, among other things, a statement about the child's current level "of academic achievement and functional performance"; annual, measurable goals; a method and time for measuring progress; a list of "the special education and related services and supplementary aids and services ... to be provided to the child," along with the supports and program modifications provided; an explanation of whether (and to what extent) the child will not participate in regular class and certain described activities; a statement of specific appropriate needed accommodations to measure the child's academic achievement and functional performance; and a timeline. n75 Note that there may be state programs as well as the federal program covering educational opportunities for the beneficiaries. In addition, consider whether there are affordable educational opportunities outside of the local school system that would benefit the beneficiary.

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n1 See, e.g., In the *Matter of Hudelson, 196 P.3d 905 (Idaho 2008);* In the *Matter of Abraham XX, 900 N.E.2d 136 (N.Y. 2008).*

n2 Note that there are also cases involving reformation of third-party SNTs.

n3 *Chen v. Chen Qualified Settlement Fund, 552 F.3d 218 (2d Cir. 2009).*

n4 *Chen v. Chen Qualified Settlement Fund, 552 F.3d 218 (2d Cir. 2009).*

n5 *Redies v. Attorneys Liability Protection Society, 150 P.3d 930 (Mont. 2007).*

n6 *Redies v. Attorneys Liability Protection Society, 150 P.3d 930, 932-33 (Mont. 2007).*

n7 *Redies v. Attorneys Liability Protection Society, 150 P.3d 930, 933 (Mont. 2007).*

n8 *Redies v. Attorneys Liability Protection Society, 150 P.3d 930, 934 (Mont. 2007).* During litigation, the defense raised the question of whether the privity defense was available under state law and the trial court ultimately ruled that, as a matter of law, the attorney owed a duty to Ms. Redies when he rendered legal advice to the conservator. Shortly thereafter, the parties settled the lawsuit. Ms. Redies then sued the malpractice carrier under various theories and because the privity doctrine was not formally adopted in Montana until a subsequent state supreme court case, the court granted the carrier's motion for summary judgment which was affirmed on appeal.

n9 *See, e.g., Chen v. Chen Qualified Settlement Fund, 552 F.3d 218 (2d Cir. 2009); In re Matter of Hudelson, 196 P.3d 905 (Idaho 2008).*

n10 *Arkansas Dep't. of Health & Human Servs. v. Ahlborn, 126 S. Ct. 1752 (2006).*

n11 *Arkansas Dep't. of Health & Human Servs. v. Ahlborn, 126 S. Ct. 1752 (2006).*

n12 *Arkansas Dep't. of Health & Human Servs. v. Ahlborn, 126 S. Ct. 1752 (2006).*

n13 See POMS SI 001120.201.I.

n14 *20 C.F.R. § 416.1149*; POMS SI 001120.50, 001120.201; Allison J. Bren, A. William Main, & Scott Stebler, *Ten Challenges in Special Needs Trust Administration*, Fundamentals of Trust Administration webinar, Stetson University College of Law (April 2009).

n15 POMS SI 001120.201.I.c.

n16 See *20 C.F.R. § 416.1103(f)* (Money you borrow or money you receive as repayment of a loan is not income. However, interest you receive on money you have lent is income. Buying on credit is treated as though you were borrowing money and what you purchase this way is not income."). SI POMS 01120.201.I.1.d:

"If a trust pays a credit card bill for the trust beneficiary, whether the individual receives income depends on what was on the bill. If the trust pays for food or shelter items on the bill, the individual will generally be charged with in-kind support and maintenance up to the PMV. If the bill includes non-food, non-shelter items, the individual usually does not receive income as the result of the payment unless the item received would not be a totally or partially excluded non-liquid resource the following month.

For example, if the credit card bill includes restaurant charges, payment of those charges results in ISM. If the bill also includes purchase of clothing, payment for the clothing is not income."

n17 POMS SI §§ 01120.201.I.1.e; 00830.522.

n18 Kate & William Dussault, *Accessible Vehicle Transportation Disbursement*, Special Needs Trusts X CLE (Stetson University College of Law Oct. 17, 2008).

n19 *See* Gary Mazart and Regina M. Spielberg, *Trusts for the Benefit of Disabled Persons Understanding the Differences Between Special Needs Trusts and Supplemental Benefits Trusts*, N.J. Law. 23, 28-29 (Feb. 2009).

n20 *20 C.F.R. § 416.1218*; SI POMS 01130.200.

n21 http://www.socialsecurity.gov/disabilityresearch/wi/pass.htm.

n22 *20 C.F.R. §§ 416.1112(c)(9), 416.1124(c)(13), 416.1161, 416.1180*-1182; POMS SI 00870.001 *Plans to Achieve Self-Support-Overview*.

n23 *20 C.F.R. § 416.1181(a)*; POMS SI 001130.200.

n24 *20 C.F.R. § 416.1181(b)*, (c).

n25 *20 C.F.R. § 416.1181(d)*.

n26 *20 C.F.R. § 416.1182*.

n27 *20 C.F.R. §§ 416.1110(d), 416.1111(c)*; POMS SI 00820.300 *Payments for Services Performed in a Sheltered Workshop or Work Activities Center*.

n28 See *Continuing Benefits and Recipient Status Under Sections 1619(A) and 1619(B) for Individuals Who Work*, POMS SI 02302.001-.320. *See also 20 C.F.R. § 416.1110* (note: earned income can include *in-kind* earned income: "[Wages] may also include the value of food, clothing, or shelter, or other items provided instead of cash. We refer to this as in-kind earned income." *20 C.F.R. § 416.1110(a)*); *but see 20 C.F.R. § 416.1112(c)(3)* (earned income not counted if the beneficiary is "under age 22 and a student who is regularly attending school as described in [*20 C.F.R.] § 416.1861*"); Program Operations Manual (POMS) SI 00810.015

Types of Income (A)(2):

"**Earned Income**

Earned income consists of the following types of payments:

- wages
- net earnings from self-employment
- payments for services performed in a sheltered workshop or work activities center
- royalties earned by an individual in connection with any publication of his/her work and any honoraria received for services rendered."

See also POMS SI 00820.530-00820.560 for a discussion of work expenses exclusions.

n29 State Medicaid Manual § 3257.B(6):

"Similarly, a trust is considered to be established for the sole benefit of a spouse, blind or disabled child, or disabled individual if the trust benefits no one but that individual, whether at the time the trust is established or any time in the future. However, the trust may provide for reasonable compensation, as defined by the State, for a trustee or trustees to manage the trust, as well as for reasonable costs associated with investing or otherwise managing the funds or property in the trust. In defining what is reasonable compensation, consider the amount of time and effort involved in managing a trust of the size involved, as well as the prevailing rate of compensation, if any, for managing a trust of similar size and complexity.

A transfer, transfer instrument, or trust that provides for funds or property to pass to a beneficiary who is not the spouse, blind or disabled child, or disabled individual is not considered to be established for the sole benefit of one of these individuals. In order for a transfer or trust to be considered to be for the sole benefit of one of these individuals, the instrument or document must provide for the spending of the funds involved for the benefit of the individual on a basis that is actuarially sound based on the life expectancy of the individual involved. When the instrument or document does not so provide, any potential exemption from penalty or consideration for eligibility purposes is void.

An exception to this requirement exists for trusts discussed in § 3259.7. Under these exceptions, the trust instrument must provide that any funds remaining in the trust upon the death of the individual must go to the State, up to the amount of Medicaid benefits paid on the individual's behalf. When these exceptions require that the trust be for the sole benefit of an individual, the restriction discussed in the previous paragraph does not apply when the trust instrument designates the State as the recipient of funds from the trust. Also, the trust may provide for disbursal of funds to other beneficiaries, provided the trust does not permit such disbursals until the State's claim is satisfied. Finally, "pooled" trusts may provide that the trust can retain a certain percentage of the funds in the trust account upon the death of the beneficiary."

n30 *See, e.g., Hobbs ex rel. Hobbs v. Zenderman, 542 F. Supp. 2d 1220 (D.N.M. 2008), aff'd, 579 F.3d 1171 (10th Cir. 2009).*

n31 POMS SI 01120.201.F. *See also* POMS SI 01150.120.B.8 and C:

"[a] transfer is considered to be for the sole benefit of a person if the transfer is arranged so that no other person or entity can benefit from the transferred resources at the time of the transfer or for the remainder of that person's life. This rule applies to transfers made to:

- the transferor's spouse;
- the transferor's blind or disabled child; or
- a blind or disabled individual.

POLICY-SOLE BENEFIT OF ANOTHER INDIVIDUAL

C. A transfer is considered "for the sole benefit" of another individual only if established using a written agreement that legally binds the parties and clearly expresses that the transfer is for the sole benefit of that individual. Without such a document, a transfer cannot be determined to be for the sole benefit of the individual. Without the document, there is no way to establish that only the specified individual will benefit from the transfer.

Examples of legally binding written agreements are a trust, a deed that establishes that the person getting the resource is the sole owner, or a legally enforceable contract that shows that the transfer is for the sole benefit of the individual. The sole benefit requirement is applicable to certain of the exceptions in SI 01150.121 and SI 01150.123."

n32 Note that HCFA Transmittal No. 64 added to the State Medicaid Manual the language spouse, blind or disabled child" as individuals who are covered under sole benefit, which would appear to be an expanded view of sole benefit. State Medicaid Manual § 3256.B(6). For an extensive analysis of the sole benefit rule, see Neal A. Winston, *The Sole Benefit Rule For First Party Trusts*, The Fundamentals of Special Needs Trust Administration CLE, Stetson University College of Law Center for Excellence in Elder Law Webinar (Apr. 24, 2009).

n33 *Est. of Hicks v. Commissioner, Internal Revenue Service, T.C. Memo 2007-182,* http://www.ustaxcourt.gov/InOpHistoric/hicks.TCM.WPD.pdf (July 10, 2007).

n34 *Est. of Hicks v. Commissioner, Internal Revenue Service, T.C. Memo 2007-182,* http://www.ustaxcourt.gov/InOpHistoric/hicks.TCM.WPD.pdf at 7-10 (July 10, 2007).

n35 *Est. of Hicks v. Commissioner, Internal Revenue Service, T.C. Memo 2007-182,* http://www.ustaxcourt.gov/InOpHistoric/hicks.TCM.WPD.pdf at 11-14, 18-22 (July 10, 2007).

n36 As an example, see *Est. of Hicks v. Commissioner, Internal Revenue Service, T.C. Memo 2007-182,* http://www.ustaxcourt.gov/InOpHistoric/hicks.TCM.WPD.pdf (July 10, 2007).

n37 *20 C.F.R. § 416.1121(b)*:

"Alimony and support payments. For SSI purposes, alimony and support payments are cash or in-kind contributions to meet some or all of a person's needs for food or shelter. Support payments may be made voluntarily or because of a court order. Alimony (sometimes called maintenance) is an allowance made by a court from the funds of one spouse to the other spouse in connection with a suit for separation or divorce."

Program Operations Manual (POMS) SI 00810.015 *Types of Income* (A)(3):

"**Unearned Income**

Unearned income is all income that is not earned income. Some types of unearned income are:

- annuities, pensions, and other periodic payments
- alimony and support payments
- dividends, interest, and royalties (except for royalties mentioned in 2. above).
- rents
- benefits received as the result of another's death to the extent that the total amount exceeds the expenses of the deceased person's last illness and burial paid by the recipient
- prizes and awards in-kind support and maintenance (ISM)."

n38 *See* Neal A. Winston, *Divorce American Style: Divorce, Child Support, & SNTs-The Sequel*, Special Needs Trust X: The National Conference (CLE) (Stetson Univ. College of Law Oct. 17, 2008); POMS SI 00830.455.C.1.a.

n39 *See, e.g. Staley v. Staley, 144 Wash. App. 1016,* (unpublished) (Wash. Ct. App. Apr. 28, 2008) (majority of assets in divorce to husband based on children's special needs).

n40 POMS SI 00810.015.3 Types of Income: Unearned income is all income that is not earned income. Some types of unearned income are: ... annuities, pensions, and other periodic payments[;] ... alimony and support payments ... ."

n41 POMS SI 00830.420.A. *See also 20 C.F.R. § 416.1121*.

n42 POMS SI 00830.420.B.1.

n43 POMS SI 00830.420.B.2.

n44 Neal A. Winston, *Divorce American Style: Divorce, Child Support, & SNTs-The Sequel*, Special Needs Trust X: The National Conference (CLE) (Stetson Univ. College of Law Oct. 17, 2008).

n45 POMS SI 01120.200.G.1.d. **Assignment of Income**

"A legally assignable payment (see SI 01120.200G.1.c for what is **not** assignable), that is assigned to a trust, is income for SSI purposes **unless** the assignment is irrevocable. For example, child support or alimony payments paid directly to a trust as a result of a court order, are not income. If the assignment is revocable, the payment is income to the individual legally entitled to receive it."

See also Neal A. Winston, *Divorce American Style: Divorce, Child Support, & SNTs-The Sequel*, Special Needs Trust X: The National Conference (CLE) (Stetson Univ. College of Law Oct. 17, 2008).

n46 *See* Neal A. Winston, *Divorce American Style: Divorce, Child Support, & SNTs-The Sequel*, Special Needs Trust X: The National Conference (CLE) (Stetson Univ. College of Law Oct. 17, 2008); POMS SI 01120.201.

n47 *See, e.g.,* Margaret Pegi" S. Price, *The Special Needs Child & Divorce: A Practical Guide to Evaluating & Handling Cases*, ch. 5, especially 124-161, ch. 6, 164-165 (ABA 2009).

n48 *See* Fla. Stat. § 61.30(11)(a):

"The court may adjust the total minimum child support award, or either or both parents' share of the total minimum child support award, based upon the following derivation factors:

1. Extraordinary medical, psychological, educational, or dental expenses.

2. Independent income of the child, not to include moneys received by a child from supplemental security income ...

6. *Special needs, such as costs that may be associated with the disability of a child, that have traditionally been met within the family budget even though the fulfilling of those needs will cause the support to exceed the presumptive amount established by the guidelines."* (emphasis added).

See also Mo. Stat. § 452.340:

"In a proceeding for dissolution of marriage, legal separation or child support, the court may order either or

both parents owing a duty of support to a child of the marriage to pay an amount reasonable or necessary for the support of the child, including an award retroactive to the date of filing the petition, without regard to marital misconduct, after considering all relevant factors including:

(1) The financial needs and resources of the child;

(2) The financial resources and needs of the parents;

(3) The standard of living the child would have enjoyed had the marriage not been dissolved;

(4) *The physical and emotional condition of the child, and the child's educational needs*;

..." (emphasis added)

Among other things, Minnesota's statute provides for deviation from the guidelines based on the extraordinary financial needs and resources, physical and emotional condition, and educational needs of the child to be supported" Minn. Stat. § 518A.43.1(2).

See also Nev. Stat. Ann. § 125.200; Ohio Stat. § 3109.05 (medical needs); Utah Stat. §§ 78B-12-102(7)(c) (definition of child), 78B-12-202(3)(e) (ability of an incapacitated adult child to earn, or other benefits received by the adult child or on the adult child's behalf including Supplemental Security Income") and 78B-12-202(3)(f) (needs of the child); Margaret Pegi" S. Price, *The Special Needs Child & Divorce: A Practical Guide to Evaluating & Handling Cases*, 128-129 (ABA 2009).

n49 *See, e.g.*, Margaret Pegi" S. Price, *The Special Needs Child & Divorce: A Practical Guide to Evaluating & Handling Cases*, chs. 3 and 4 (ABA 2009).

n50 See, e.g., Margaret Pegi" S. Price, *The Special Needs Child & Divorce: A Practical Guide to Evaluating & Handling Cases*, chs. 6 and 11 (ABA 2009) for sample worksheets and documents.

n51 *See* Neal A. Winston, *Divorce American Style: Divorce, Child Support, & SNTs-The Sequel*, Special Needs Trust X: The National Conference (CLE) (Stetson Univ. College of Law Oct. 17, 2008), *citing Lewis v. Dept. of Soc. Servs., 61 S.W.3d 248 (Mo. App. 2001); Lee v. Lee, 233 S.W.3d 698 (Ark. App. 2006); In re Rogiers, 933 A.2d 971 (N.J. Super. 2007); Mencer v. Ruch, 928 A.2d 294 (Pa. Super. 2007).*

n52 *Lewis v. Dept. of Soc. Servs., 61 S.W.3d 248, 257*-58 (Mo. App. 2001).

n53 *Lee v. Lee, 233 S.W.3d 698, 702 (Ark. App. 2006). But see In re Rogiers, 933 A.2d 971 (N.J. Super. 2007)* (retroactive unpaid child support).

n54 *See, e.g.*, Margaret Pegi" S. Price, *The Special Needs Child & Divorce: A Practical Guide to Evaluating & Handling Cases*, 128-29 (ABA 2009).

n55 POMS SI 00830.420.C.1:

"Child support payments (excluding arrearages) received for an adult child by a parent after an adult child stops meeting the definition of a child are income to the adult child. The support payments are income to the adult child whether or not the adult child lives with the parent or receives any of the child support payment from the parent. Such support payments are not subject to the one-third reduction."

See POMS SI 00830.420.C.2 for a discussion of arrearages paid for an adult child.

See also POMS SSI § 01120.201.C.2:

"A disabled SSI recipient over age 18 receives child support which is assigned by court order directly into the trust. Since the child support is the SSI recipient's income, the recipient is the grantor of the trust and the trust is a resource unless it meets an exception in SSI 01120.203. If the trust meets an exception and is not a resource, the child support is income unless it is irrevocably assigned to the trust, per SI 01120.201J.1.d. In this example, the court ordered the child support to be paid directly into the trust, so we consider it to be irrevocably assigned to the trust."

POMS SI 01120.201J.1.d provides that [a] legally assignable payment (see SI 01120.201J.1.c for what is not assignable), that is assigned to a trust, is income for SSI purposes **unless** the assignment is irrevocable. If the assignment is revocable, the payment is income to the individual legally entitled to receive it."

n56 *See, e.g.*, Az. Rev. Stat. § 14-10503; N.H. Rev. Stat. § 564-B:5-504; N.D. Century Code § 59-13-03; S.C. Code Ann. § 62-7-503.

n57 S.C. Stat. 62-7-503 provides:

"(b) Even if a trust contains a spendthrift provision, a beneficiary's child who has a judgment or court order against the beneficiary for support or maintenance may obtain from a court an order attaching present or future distributions to or for the benefit of the beneficiary.

(c) The exception in subsection (b) is unenforceable against a special needs trust, supplemental needs trust, or similar trust established for a disabled person if the applicability of such a provision could invalidate such a trust's exemption from consideration as a countable resource for Medicaid or Supplemental Security Income (SSI) purposes or if the applicability of such a provision has the effect or potential effect of rendering such disabled person ineligible for any program of public benefit, including, but not limited to, Medicaid and SSI."

n58 For a discussion of the issues, see David Lillesand, Florida Special Needs Law Blog, *Special Needs Trust Sole Benefit Rule" and Support of Spouse and Children,* http://www.floridaspecialneedslaw.com/2008/07/articles/special-needs-trusts/special-needs-trust-sole-benefit-rule-and-support-of (posted July 11, 2008).

n59 *Mencer v. Ruch, 928 A.2d 294 (Pa. Super. 2007). See also Myers v. DeVore, 2006 Ohio 5360, 2006 Ohio App. LEXIS 5333* (Oct. 6, 2006) (unreported).

n60 *Mencer v. Ruch, 928 A.2d 294, 298*-99 (Pa. Super. 2007).

n61 *Mencer v. Ruch, 928 A.2d 294, 300 (Pa. Super. 2007).*

n62 POMS SI 00830.418 Alimony and Spousal Support.

n63 POMS SI 00830.4.2.

n64 *J.P. v. Div. of Medical Assistance & Health Servs., 920 A.2d 707 (N.J. Super. 2007).*

n65 *J.P. v. Div. of Medical Assistance & Health Servs., 920 A.2d 707, 709 (N.J. Super. 2007).*

n66 *J.P. v. Div. of Medical Assistance & Health Servs., 920 A.2d 707, 713 (N.J. Super. 2007).*

n67 *J.P. v. Div. of Medical Assistance & Health Servs., 920 A.2d 707, 710 (N.J. Super. 2007).*

n68 *J.P. v. Div. of Medical Assistance & Health Servs., 920 A.2d 707, 715 (N.J. Super. 2007).*

n69 For a discussion of the property issues in divorces as they pertain to SNTs, see Neal A. Winston, *Divorce American Style: Divorce, Child Support, & SNTs-The Sequel*, Special Needs Trust X: The National Conference (CLE) (Stetson Univ. College of Law Oct. 17, 2008).

n70 *20 U.S.C. § 1400* et seq; 34 C.F.R. Part 300.

n71 *20 U.S.C. § 1400 (d).*

n72 *20 U.S.C. § 1402*.

n73 *20 U.S.C. § 1411* et seq.

n74 *34 C.F.R. §§ 300.301, 300.304*.

n75 *34 C.F.R. §§ 300.320*-300.323.

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Harkness on Milburn v. Life Investors Ins. Co.

2008 Emerging Issues 2405

Donna Harkness on Milburn v. Life Investors Insurance Co. of America and Long Term Care Insurance Coverage Issues

By Donna S. Harkness

June 25, 2008

SUMMARY: Consumers purchase long term care insurance, believing that they will be covered when the need arises. However, language in the insurance contract may severely limit the available coverage. Here, the 10th Circuit upheld policy language that restricted coverage to care provided in a nursing home, thus precluding any benefits for the insured, who was in an assisted living facility. Common restrictions are highlighted in this Commentary.

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ARTICLE: *Milburn v. Life investors Insurance Co. of America, 511 F. 3d 1285, 2008 U.S. App. LEXIS 448 (10th Cir. 2008)* (Jan. 9, 2008) involves interpretation of a long term care insurance policy. Specifically, the case deals with construction of the policys nursing home benefit clause, and whether coverage under the clause extended to long term care provided in an assisted living facility.

(1) Whether the Nursing Home Benefit Extends to Care Provided in an Assisted Living Facility. Following discharge from the hospital, the plaintiff in the *Milburn* case required assistance with all activities of daily living and needed help in taking prescribed medication. This care was provided by the assisted living facility in which he resided for an additional fee, and the plaintiff filed a claim with Life Investors pursuant to the nursing home benefit clause in his long term care policy. Life Investors denied the claim on the grounds that the care was not provided in a nursing home. As defined within the policy, a nursing home is any facility that provides 24 hour-a-day nursing service, has a physician on call for emergencies, a nurse available on the premises or on call at all times, keeps medical records and has policies and procedures in place for providing the required care. *Id. at 1287*. Further, the facility must be one licensed by the appropriate licensing agency to engage primarily in providing nursing care and related services *Id.* The district court construed this definition to include the assisted living facility, as it was licensed by the appropriate agency to license assisted living facilities and was authorized pursuant to that licensure to provide the long term nursing care that was provided to the plaintiff. *Id. at 1285*. Defendant Life Investors tried to introduce the applicable Oklahoma state laws and regulations pertaining to licensure of nursing homes, but the court found consideration of these to be unnecessary because the contract language was clear and unambiguous, and thus not in need of extrinsic evidence to facilitate its construction. On appeal, Life Investors continued to seek admission of the state laws and regulations, this time on the grounds that interpretation of the appropriate licensure language was meant to refer solely to licensure of those institutions that provide nursing home care as their primary enterprise. The Court of Appeals referred to *Gillogly v.*

General Electrical Capital Assurance Co., 430 F.3d 1284, 2005 U.S. App. LEXIS 27097; 30 A.L.R. 6th 713 (10th Cir. 2005) (Dec. 12, 2005), which had been decided while the *Milburn* case was still pending on appeal. The Court found defendants argument to be compelling, observed that the facility in which the plaintiff received the subject care was not licensed as a nursing facility, but instead was licensed as an assisted living facility, having as its primary aim provision of services that were fundamentally different from those provided by a nursing facility. In their concurring opinion, Justices Henry and Murphy note that such a reading interjects within the policy language the requirement that the facility both provide the requisite nursing home care to the policy holder and be licensed as a nursing home by the appropriate licensing agency. *Id. at 1293*. The problems with this approach are well stated in the concurrence; first of all, the regulations can and do change frequently, thus unavoidably and unpredictably altering the expectations of parties to long term care contracts and secondly, the complexity of the licensure process is such that insureds can hardly be held accountable for knowing the differences between and among the various types of long term care facilities. Finally, as the concurring Justices note, this complexity and variety can only be expected to increase in the coming decades.

(2) Advising Prospective Purchasers of Long Term Care Insurance. The denial of coverage experienced by plaintiff in the *Milburn* case only adds to the sense of insecurity that elderly clients have when considering the prospect of institutional care in a nursing home. *See Anthony Szczygiel, Long Term Care Coverage: The Role of Advocacy, LEXSEE 44 U. KAN. L. REV. 721, 723-24 (July 1996).* The *Milburn* case is illustrative of the pitfalls that await unsuspecting policyholders when they finally file a claim for long term care benefits. Advocates seeking to assist clients in reviewing long term care policies prior to purchase should advise clients concerning the effect that certain provisions are likely to have on the availability of coverage. The nursing home benefit provision dealt with in *Milburn* and *Gillogly* restricts the policys coverage to nursing home care provided within a facility that is licensed as a nursing home. Given the natural preference of most people to reside in non-institutional settings, and given the increasing trend toward accommodating that desire through home and community based long term care as a cost savings measure, the likelihood that a policyholders long term care will be furnished outside of a nursing home at least for initial care is great. *Id. at 725-6*. If coverage under the policy is restricted to the nursing home setting, then benefits will be denied, and, as can be seen from *Gillogly* and *Milburn*, that denial will be upheld. Clients should be advised to shop for a policy that covers long term care, regardless of the setting in which it is provided.

However, even if the setting for care is unrestricted, availability of coverage may still be illusory if the definition of long term care is restricted to skilled nursing care as opposed to long term custodial care. Skilled nursing care is defined by the Medicare program as care so inherently complex that it can be safely and effectively performed only by, or under the supervision of, professional or technical personnel. *42 C.F.R. §409.32(a)*. This level of care is funded at least temporarily by Medicare, which will pay the entire cost of such care for the first 20 days, and then, for the 21st through 100th day, pay all amounts over an initial co-pay of $128.00 per day. *See Centers for Medicare and Medicaid Services, Medicare and You 2008,* p. 111, *available at* http://www.medicare.gov/

Publications/Pubs/pdf/10050.pdf (accessed 3/24/08). Medicare coverage ceases at the 101st day, making private insurance a necessity after that point even for coverage of skilled nursing care. Custodial long term care is not covered at all by Medicare. Clients should purchase policies including a wide range of medical, personal and social services within their definition of long term care, encompassing both acute and skilled or long term custodial care. *National Association of Insurance Commissioners, Consumer Alert* at *1, *available at* http://www.naic.org/documents/consumer_alert_ltc.htm (accessed 3/24/08).

Advocates should carefully review the policy for the presence of other barriers to coverage. Such barriers may include a requirement of prior hospitalization. Such policy provisions may require that the patient remain in the hospital for at least three days followed by admission to the nursing home within a certain number of days, similar to the requirements of Medicare. *42 U.S.C.S. §1395x(i)* (2007). The nursing home admission must be for care associated with the same condition that necessitated the hospitalization. A plaintiffs attempt to avoid this requirement in a private long term care contract by arguing that it was against public policy proved fruitless in *Brock v. Guaranty Trust Life Ins. Co., 175 Ga. App. 275, 333 S.E.2d 158, 1985 Ga. App. LEXIS 2077 (Ga.Ct. App. 1985)* (June 28, 1985). Coding of hospital

admission by emergency room physicians can thus become very important. For example, suppose an elderly client that was seen at the Emergency Room and retained for observation over the weekend for a broken collarbone was written up in the medical chart as though she had not been admitted to the hospital as an inpatient. Such an omission might lead to denial of her claim for Medicare coverage of her stay in the skilled nursing care wing of the hospital, even though she was admitted immediately following her discharge from the three days of emergency room observation due to complications. Simple recoding of the emergency room record to document her actual admission to the hospital is all that would be required for coverage. Unfortunately, this action wasnt taken until the client appealed the denial to Medicare. Within the Medicare context, the provider had no choice but to work with the client to solve the problem, because the provider failed to give notice that the claim might not be covered by Medicare. *Centers for Medicare and Medicaid Services, Beneficiary Notices Initiative, Overview, available at* http://www.cms.hhs.gov/BNI/01_overview.asp#TopOfPage (accessed 3/25/08). This oversight precluded any recovery from the client by the provider for any amounts Medicare wouldnt pay. In the case of private insurance, the providers incentive to be cooperative in resolving the insurance dispute might not be so great. Insurers may also raise issues of pre-existing claims, medical necessity, and other definitions associated with eligibility or may simply delay processing claims as a means of discouraging use of benefits. *Szczygiel, Long Term Care Coverage, supra, 780-81; Metropolitan Life Insurance Co., v. Conger, 396 F. Supp. 2nd 777, 2005 U.S. Dist. LEXIS, 396 F. Supp. 777, 2005 U.S. Dist. LEXIS 39465.*

Conclusion. *Milburn v. Life Investors* illustrates the way in which coverage of nursing home benefits has been restricted by insurers to only those services provided in and by facilities licensed as nursing homes. A number of other barriers to coverage may be found within many long term care insurance policies. Advocates should review long term care policies closely to insure that clients receive the broadest coverage possible for long term care that includes medical, personal and social services provided within in home as well as institutional settings.

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Donna Harkness on Preneed Funeral Contracts, Provider Insolvency and Bankruptcy

2008 Emerging Issues 2404

Donna Harkness on Preneed Funeral Contracts, Provider Insolvency and Bankruptcy

By Donna S. Harkness

June 23, 2008

SUMMARY: Paying for funeral goods and services in advance through preneed funeral contracts attempts to assure that the services will be available when needed. However, consumers may find their contracts unenforceable if the funeral home files for Chapter 11 bankruptcy relief by virtue of the automatic stay in bankruptcy. The Bankruptcy Court has supported statutory exceptions to the stay to help protect consumers in this situation.

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ARTICLE: Do purchasers of preneed funeral contracts have any recourse when the funeral home from which the contract was purchased files for Chapter 11 bankruptcy relief? The cases of *In re: Iams Funeral Home, 2007 Bankr. LEXIS 4023, 49 Bankr. Ct. Dec. 76 (Bankr. Ct. N.D. Va. 2007)* (Dec. 6, 2007) and *In re: Forest Hill Funeral Home and Memorial Park-East LLC, et al., 364 B.R. 808, 2007 Bankr. LEXIS 967, 48 Bankr Ct. Dec. 11 (Bankr. Ct. E.D. Ok. 2007)* (Mar. 26, 2007) raise the spectre of funeral home insolvency and whether state law action brought by the states attorney general against a funeral home to protect consumer rights can be maintained despite the filing of a bankruptcy petition.

(1) Exemption From the Automatic Stay in Bankruptcy. A preneed funeral contract is one where a party contracts to pay now for an agreed package of funeral goods and services that will be furnished free of any additional cost when the party dies. *See* Judith A. Frank, *Preneed Funeral Plans: The Case for Uniformity, 4 Elder L. J. 1, 5 (Spring, 1996).* The state attorney general in the *Iams* case had brought an action in state court against the Iams Funeral Home for numerous violations of the states laws relating to preneed funeral contracts. *In re: Iams, supra* at *3-5. Within the context of that litigation, the attorney general sought an order to enjoin Iams from engaging in further business as a funeral home, and to transfer all its preneed contracts to another funeral home. *Id.* At *5. Defendant Iams filed for Chapter 11 bankruptcy relief in federal court, triggering an automatic stay of the states enforcement action. *Id.* The attorney general then filed a motion seeking a declaration of exemption from the stay pursuant to *11 U.S.C. §362(b)(4)*, which provides that the automatic stay does not apply to actionby a governmental units.. police and regulatory power. *Id.* at *5-6.

In discussing this statutory exception to the operation of the automatic stay, the court noted that the police and regulatory power in question referred to state laws affecting the health, welfare, morals, and safety of the public, and not just to the financial, or pecuniary, interests of the state. *Id.* at *7. In trying to determine whether a law affects health and

welfare, some courts have looked to whether or not the law is one urgently needed, as a matter of public policy, to protect public health and safety concerns, and have exempted only those from the automatic stay authority of the bankruptcy court. *9B Am. Jur. 2d Bankruptcy §1831.* Where the states enforcement primarily constituted an adjudication of private rights under contract, for example, the exemption was not held to apply. *Compare In re: McMullen, 386 F.3d 320, 2004 U.S. App. LEXIS 21792, Bankr. L. Rep. (CCH) P80, 180 (1st Cir. 2004)* (Oct. 20, 2004) *with Diamond v. Premier Capital, Inc., 346 F.3d 224, 2003 U.S. App. LEXIS 20615, Bankr. L. Rep. (CCH) P78, 929, 41 Bankr. Ct. Dec. 283 (1st Cir. 2003)* (Oct. 9, 2003). The dispute in the *McMullen* case involved a realtors failure to return a substantial escrow deposit placed with her before she filed her bankruptcy petition. Although the purchasers were aware of the bankruptcy proceeding, they nevertheless filed a complaint against the realtor with the requisite state agency that regulated real estate agents. The bankruptcy court in that case found the states interest in regulating the conduct of real estate agents to advance a sufficiently important public policy so as to trump the competing interests fostered by the automatic stay. *McMullen at 325*. In the *Diamond* case, by contrast, the automatic stay was violated because the private party in that case threatened the bankruptcy petitioner during settlement negotiations with the filing of a real estate board complaint if the petitioner were to proceed to seek to discharge the debt owed to that party, thus engaging in arguably harassing and coercing acts in violation of the stay. *Diamond at 228*. In the *Forest Hill* case, the state was not seeking to harass or coerce the defendants nor to collect any amounts owed to it and had no pecuniary interest in the value of the[funeral homes]preneed contracts, or in terminating the[funeral homes]...business. *Forest Hill at 813*. The states action to enforce the law on behalf of consumers was therefore exempted from the operation of the automatic stay in bankruptcy.

(2) Dismissal of Bankruptcy Petition Filed in Bad Faith. An increasing number of funeral and cemetery related scandals have come as a shock to the public, and led to enhanced consumer protection regulation of both the funeral and the preneed funeral contract industry. *See* Ashley Hunt, *There Is a New Trend of Corporate Death Care: Let the Buyer Beware, 27 Nova L. Rev. 449, 449-50. In re: Forest Hill Funeral Home & Memorial Park-East, LLC* recounts one such scandal, involving the acquisition of a Tennessee funeral business by an individual who proceeded to siphon off all the assets that were supposed to guarantee performance of approximately 13,500 preneed funeral contracts that had been sold to persons in the Memphis area***.*** *Forest Hill at 812-815*. In an effort to stop the flow of assets streaming out of Forest Hill Funeral Homes possession, the Tennessee Department of Commerce and Insurance (TDCI) instituted an action in state court seeking a temporary restraining order to prevent further removal of assets and appointment of a receiver to manage the funeral home. *Id.* at 815. In response, the defendants filed a petition in bankruptcy in another jurisdiction, Oklahoma. The TDCI filed a Motion with the Oklahoma bankruptcy court, seeking dismissal of Forest Hills case pursuant to *11 U.S.C.S. §1112(b)***,** on grounds that the debtors had filed their Chapter 11 petition in bad faith. As with any other motion, the burden of proving a motion for dismissal is on the movant, but once the TDCI managed to put forth a prima facie case of bad faith, the burden of establishing that the case was in fact filed in good faith rests with the non-movant. *Id.* at 819. The grounds for bad faith established by the courts examine the realistic need for reorganization. A company with one asset, for example, would not seem to require or be able to benefit from reorganization, so a petition in bankruptcy seeking such relief might be viewed with suspicion. Evidence that the party has engaged in unsavory or illegal conduct before the petition was filed in bankruptcy court may indicate bad faith, as may a paucity of unsecured creditors. In the case of *Forest Hill,* the most compelling indicator was the fact that the parties now seeking bankruptcy relief constituted the new ownership of the business and had transferred significant assets out of the prior business into wholly separate enterprises; their efforts to shield their activities from governmental oversight and intervention through the filing in bankruptcy was definitely suggestive of bad faith. The new owners argued that prior to the filing of the bankruptcy, they had relinquished management of the funeral home business to a well-respected certified public accountant with extensive professional experience in managing and reorganizing troubled businesses. *Id.* at 816. Because the new owners had made the decision to file bankruptcy before they transferred management authority to the CPA, the court found the transfer of authority to be insufficient to allow the court to overlook the motives and unsavory conduct of the new owners in making its determination about the presence of bad faith.

(3) Abstention And Dismissal Of Bankruptcy Petition Pursuant To *11 U.S.C.S. §305(a)(1)*. Although the court

had already ruled in TDCIs favor on the issue of dismissal, based on bad faith filing, it went on to also rule that dismissal based on abstention would be appropriate as well. Abstention under *11 U.S.C.S. §305* is discretionary and is to be applied narrowly and is only proper in extraordinary circumstances. *Id*. at 824. The factors to be considered by the bankruptcy court in deciding whether abstention is appropriate are motivation of the parties, availability of another avenue to adequately protect all parties interests or whether there is already an action pending in state court; judicial and administrative economy and efficiency and whether or not any party will be harmed. *Id.* Considering the facts of the *Forest Hill* case in light of these factors, the court found that abstention was clearly appropriate. The interests of the creditors of the funeral home, which included all consumers holding preneed funeral contracts, were specifically mentioned as being best served by dismissal of the Iams bankruptcy petition and continuation of the Tennessee state court proceedings already initiated by the state attorney general on behalf of TDCI.

Conclusion. The *Iams* and *Forest Hill* cases are illustrative of the strategies that can be used to prevent funeral homes from utilizing bankruptcy court protection as a shield against the application of state consumer protection laws and regulations designed to eliminate fraud and overreaching in the funeral home industry, including the mismanagement of preneed funeral contracts. Exemption of state court regulatory actions from the automatic stay, dismissal of bankruptcy petitions filed in bad faith and dismissal based on abstention may be operative in appropriate situations.

For Further Information Concerning State Regulation of PreNeed Funeral Contracts, *see* Federal Trade Commission, Funeral Industry Practices Rule, *16 C.F.R. §§453.1--453.9* and Tracie M. Kester, *UNIFORM ACTS Can the Dead Hand Control the Dead Body? The Case for a Uniform Bodily Remains Law*, *29 W. New Eng. L. Rev. 571 (2007).*

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Harkness on Use of § 1983 to Enforce Rights to Medicaid Benefits

2008 Emerging Issues 2055

Harkness on Use of § 1983 to Enforce Rights to Medicaid Benefits

By Donna S. Harkness

May 6, 2008

SUMMARY: Donna S. Harkness comments on the use of *42 U.S.C.S. § 1983* to enforce the rights of Medicaid beneficiaries to benefits, and notes that recent emphasis on individual rights to notice and choice created by the Medicaid statute appears sufficient to establish the existence of a privately enforceable right under *42 U.S.C.S. § 1983.*

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ARTICLE: Cite as: Harkness, Donna S. Use of *42 U.S.C.S. § 1983* to Enforce Rights to Medicaid Benefits: *Monez v. Reinertson* and *Westside Mothers v. Olszewski*. LexisNexis Expert Commentary, *(Insert date you accessed the document online)*.

In both *Monez v. Reinertson, 140 P.3d 242, 2006 Colo. App. LEXIS 544*, (Co. App. Ct. 2006) (Apr. 20, 2006) and *Westside Mothers v. Olszewski, 454 F.3d 532, 2006 U.S. App. LEXIS 17957, 2006 FED. App. 0247P (6th Cir. 2006)* (July 17, 2006), plaintiffs assert a private right of action for Medicaid benefits that is enforceable using *42 U.S.C.S. § 1983*. Plaintiffs were successful in the former case, but not the latter; advocates seeking to use § 1983 for enforcement purposes must establish that the Medicaid statute confers an individual right in order to prevail. Use of § 1983 as an enforcement tool has been of particular interest for those seeking to broaden the availability of home and community based services as an alternative to institutional nursing home care.

1. The Tripartite Test for Enforcement Under *42 U.S.C. § 1983*. Enforcement under *42 U.S.C. § 1983* is available when a person has been deprived of rights created by the Constitution or other federal law. To determine whether or not an enforceable individual right has been created, advocates must look at the operative structure of the federal statute in question. In *Blessing v. Freestone, 520 U.S. 329, 117 S. Ct. 1353; 137 L. Ed.2d 569, 1997 U.S. LEXIS 2506* (Apr. 21, 1997), the United States Supreme Court established three criteria for deciding when a statute operates to confer a legal right that is enforceable through means of a private right of action using *42 U.S.C. § 1983*. The criteria are as follows: 1) the statute must have been intended by Congress to benefit individuals like the plaintiff; 2) the benefit or right conferred must be specific and definable; and 3) the obligation to provide the benefit or right must be clear. *Blessing at 340-41*. In *Gonzaga University v. Doe, 536 U.S. 273; 122 S. Ct. 2268; 153 L.Ed. 2d 309; 2002 U.S. LEXIS 4649 (2002)* (June 20, 2002), these criteria were further refined when the Court considered whether or not a student could avail himself of §1983 in order to redress a wrongful release of his student records in violation of the Family Educational Rights and Privacy Act of 1974 (FERPA), *20 U.S.C.S § 1232g*. FERPA prohibits disclosure of individual

student records without proper consent. *20 U.S.C.S. § 1232g(b)(1)* & (d). From this, one might conclude that individual students have a right, under the statute, to enforce this prohibition in the event that records are disclosed without proper authorization and to recover damages in the event that harm results. Not so, according to the Supreme Court, because FERPA was enacted pursuant to Spending Clause power and as it is structured, it simply authorizes the Secretary of Education to regulate educational institutions that receive federal funds and to set up an investigatory office and review board to judge alleged FERPA violations. Educational institutions found not to be in substantial compliance with FERPA requirements may lose federal funding. *Gonzaga at 278-79*. The statute does not, however, establish any mechanism or avenue of individual enforcement. After examining this structure, the Court concluded that Congress did not intend, through the passage of FERPA, to establish any individual right on the part of students to privacy of their student records. *Id.* In the absence of such an individual right, the Court further found that plaintiffs had no cause of action under *42 U.S.C.S. § 1983*. *Id. at 283-84*.

Within the Medicaid context, *Wilder v. Virginia Hospital Assn, 496 U.S. 498; 110 S. Ct. 2510; 110 L. Ed. 2d 455; 1990 U.S. LEXIS 3143 (1990)* (June 14, 1990) decided before both *Blessing* and *Gonzaga*, did allow plaintiff health care providers to enforce the Medicaid statutes former requirement, pursuant to *42 U.S.C.S. § 1396a(13)(A)* (now repealed), that reimbursement rates be calculated using reasonable methods. *Wilder at 509-10*. Although this right might seem somewhat undefined and subjective, the Court found there that expert knowledge could be brought to bear on the issue of reasonable rate calculation methodology which would render the issue sufficiently definite to be within the courts sphere of competence. *Id. at 514-15*. Thus a private cause of action under *42 U.S.C. § 1983* could be maintained. *Id. at 521*.

Likewise, the Colorado Court of Appeals in *Monez v. Reinertson* determined that the Medicaid statutes requirement of the provision of a fair hearing at *42 U.S.C.S. § 1396a(a)(3)* created a similarly enforceable right that satisfied the first *Blessing* criterion. *Monez at 246*. Just as courts were able to discern the reasonableness of a calculation methodology, they could also determine the fairness or adequacy of a hearing from the standpoint of due process, and thus satisfy the second prong of the *Blessing* test. *Id. at 247*. Finally, the statutory language of § 1396a(a)(3) was clearly mandatory, creating an unmistakable obligation on the part of the state, thus satisfying the third prong of *Blessing.*

By contrast, the plaintiffs in *Westside Mothers v. Olszewski*, found themselves unable to persuade the Court that *42 U.S.C.S. §§ 1396a(a)(8)* and *1396a(a)(10)* of the Medicaid statute created rights entitling children to certain early medical screening services (EPSDT) which was sufficient to enable them to mount a challenge to the Pennsvylvanias decision not to provide coverage for such services to children whose parents were unable to afford either medical insurance or cash payment. *Westside Mothers at 541*. The Court held that the early and periodic screening, diagnosis and treatment services described under the Medicaid Act, while intended to benefit plaintiffs, as required by the first prong of *Blessing*, were not something that plaintiffs were entitled to enforce under the Act as a right because the statute focuses on the state as payor and not actual provider of medical services. *Id. at 540*. Rather than requiring states to furnish the actual medical services, the Medicaid Act simply requires states to provide medical assistance in the form of financial payment for such services. *Id*. *But see Bryson v. Shumway, 308 F.3d 79, 81, 88-89 (1st Cir. 2002)* and *Doe v. Chiles, 136 F.3d 709, 714 (11th Cir. 1998)* as treating the term medical assistance as requiring provision of actual services by the state. The absence of a statutory directive establishing an individual right to receive EPSDT services by the children to be served led the Court in *Westside Mothers* to conclude that Congress did not intend to create an obligation enforceable by use of *42 U.S.C. § 1983. Id at 542-43*.

2. Couching a Claim in the Language of Entitlment. Further analysis of the *Westside Mothers* case reveals two instances where the plaintiffs arguably prevailed in persuading the Sixth Circuit that the Medicaid Act did create rights enforceable by means of *42 U.S.C. § 1983*. First, the Court did note parenthetically that plaintiffs had argued that the actual unavailability of EPSDT services to indigent children was occurring because the reimbursement rate offered by the state was too low to attract sufficient providers to provide the services. *Westside Mothers at 540*. The Court was willing to concede that Congress might well have intended to create an enforceable right among plaintiffs to expect the state to set reimbursement rates that would actually result in the availability of the services to the plaintiffs. *Id*. In dicta, the Court held out the possibility that the plaintiffs might amend the lawsuit to allege this claim and proceed under *42*

U.S.C. § 1983. *Id. at 541*.

Secondly, the plaintiffs had raised a notice issue alleging that *42 U.S.C. § 1396a(a)(43)(A)* required the States medical assistance plan to informall personsunder the age of 21eligible for medical assistanceof the availability of early and periodic screening, diagnostic and treatment services as described in section 1396(r) *Id. at 543*. Although the lower court had ruled against plaintiffs, the Sixth Circuit further referenced the applicable regulations found at *42 CFR 441.56* in determining how to interpret and apply this notice requirement and found a requirement that the plaintiffs be effectively informed that medical assistance was available through the Medicaid program. *Id.* The Court held that this requirement created a federal right which the plaintiffs were entitled to enforce using *42 U.S.C. § 1983*. *Id. at 544*.

The foregoing suggests that federal rights that are privately enforceable under § 1983 must be specifically directed to the individuals who are then to receive actual benefits. When the statutory rights in question have been created pursuant to the spending power, like those created under the Medicaid Act, the difficulty of parsing out whether a benefit has the status of right has become manifest in the split among the circuits addressing the issue of whether *42 U.S.C. § 1396a(a)(30)(A)*, the section of the statute that deals with reasonable reimbursement rates for services, may be enforced by means of a 1983 action. The creation of a system of financial assistance to pay for services is generally not sufficient to establish a privately enforceable right. *See Mandy R. v. Owens, 464 F.3d 1139, at 1148, 2006 U.S. App. LEXIS 24014* (10th Cir. Ct. App) (Sept. 21, 2006), cert denied *2007 U.S. LEXIS 3592* (Mar. 26, 2007). But in the case of reasonable reimbursement rates, the intent is clearly to benefit providers and the challenge is to the system and methodology of establishing the payments. As has already been discussed in the *Wilder* case above (which dealt with the repealed provision establishing reimbursement rates for healthcare providers), this interest has been held to be a private right which is enforceable under 1983. In the Owens case, which dealt with setting reasonable reimbursement rates for home and community based services, however, the Tenth Circuit Court of Appeals declined to find a federal right that was privately enforceable because the statute identifies no discrete class of beneficiaries. *Owens at 1148*. Other circuits to hold the same include the First Circuit, in *Long Term Pharmacy Alliance v. Ferguson, 362 F.3d 50, 57, 2004 U.S. App. LEXIS 5002 (1st Cir. 2004) (Mar. 2004);* the Sixth Circuit in *Westside Mothers v. Olszewski*, already discussed above, at 542-43; and the Ninth Circuit in *Sanchez v.Johnson, 416 F.3d 1051, 1059, 2005 U.S. App. LEXIS 15821; 17 Am. Disabilities Cas. (BNA) 54 (9th Cir. 2005)* (Aug. 2, 2005) The only Circuit to hold otherwise is the Eighth Circuit, which in *Pediatric Specialty Care, Inc. v. Ark. Dept of Human Serv., 443 F.3d 1005, 1015-16, 2006 U.S. App. LEXIS 9564* (8th Cir, 2006) (Apr. 17, 2006) found a privately enforceable right on the part of both providers and recipients.

This stacking of the circuits against the availability of a private right of action in cases involving reasonable reimbursement rates for providers of Medicaid services seems fairly formidable. Nevertheless, advocates representing those seeking home and community based alternatives to nursing home care have not been deterred by this uneven split in the circuits. The good news is that their persistence has resulted in a positive ruling from the Ninth Circuit where the issue was couched in terms of each Medicaid recipients right to free choice among the types of long term care services that they will receive. *42 U.S.C.S. § 1396n(c)(2)(C)*; *42 U.S.C.S. § 1396n(d)(2)(C)*. In *Ball v. Rodgers, 492 F.3d 1094, 2007 U.S. App. LEXIS 16939 (9th Cir. 2007)* (July 17, 2007), the Ninth Circuit held that the Medicaid Act creates two privately enforceable rights for elderly and disabled Medicaid beneficiaries: 1) to be fully informed of the available home and community based alternatives to nursing home care in an institutional setting; and 2) to be entitled to freely choose the care alternative that best fits their needs and situation. *Ball at 1113-14*.

Conclusion. Use of *42 U.S.C.S. § 1983* to enforce rights of Medicaid beneficiaries to benefits, such as fair hearings, to notice and to choice of home and community based services, requires plaintiffs to pass the three prong test first established by *Blessing* and refined by *Gonzaga*. The first prong, the existence of an identifiable right, has proven to be a significant stumbling block. However, the holding in *Ball* suggests that emphasis on individual rights to notice and choice created by the Medicaid statute is sufficient to establish the existence of a privately enforceable right under *42 U.S.C.S. § 1983*.

For Other Sections of the Medicaid Statute Found to Create Rights Enforceable Under *42 U.S.C.S. § 1983*,

see Bryson v. Shumway, 308 F.3d 79, 88, 2002 U.S. App. LEXIS 21492 (1st Cir. 2002) (Oct. 15, 2002, as corrected Oct. 16, 2002), dealing with *42 U.S.C.S. §1396a(a)(8)*; *Watson v. Weeks, 436 F.3d 1152, 2006 U.S. App. LEXIS 3011* (9th Cir., 2006) (Feb. 8, 2006), *cert denied Goldberg v. Watson, 2006 U.S. LEXIS 8641 (2006)* (U.S. Nov. 13, 2006) , *Sabree ex rel. Sabree v. Richman, 367 F.3d 180 (3d Cir. 2004), 2004 U.S. App. LEXIS 9180* (May 11, 2004), *S.D. ex rel. Dickson v. Hood, 391 F.3d 581, 2004 U.S. App. LEXIS 23900 (5th Cir. 2004)* (Nov. 15, 2004), dealing with *42 U.S.C.S. §1396a(a)(10)*; and *Rabin v. Wilson-Coker, 362 F.3d 190, 201-02, 2004 U.S. App. LEXIS 5712 (2d Cir. 2004)* (Mar. 26, 2004, as amended Apr. 16, 2004), dealing with *42 U.S.C.S. §1396r-6*.

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Harkness on Acceptance of Agent's Authority Under Durable Power of Attorney

2008 Emerging Issues 2056

Harkness on Acceptance of Agent's Authority Under Durable Power of Attorney

By Donna S. Harkness

May 6, 2008

SUMMARY: The utility of a durable power of attorney is seriously undermined when financial institutions and other third parties refuse to honor the authority conferred on the agent. Donna S. Harkness comments on the Uniform Power of Attorney Act (2006), which is intended to address this situation by imposing some measure of liability on third parties for unjustified refusals to acknowledge an agents authority under a general durable power of attorney.

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ARTICLE: Cite as: Author Last, Author First. Acceptance of an Agents Authority Under a Durable Power of Attorney Pursuant to Section 120 of the Uniform Power of Attorney Act (2006). LexisNexis Expert Commentary, *(Insert date you accessed the document online).*

A durable power of attorney is intended to function as a less intrusive and restrictive alternative to a guardianship or conservatorship. By executing a power of attorney, the principal chooses the person who will act as the agent and determines the extent of the authority the agent will possess. Unfortunately, the utility of a durable power of attorney is seriously undermined when financial institutions and other third parties refuse to honor the authority conferred on the agent. Section 120 of the *Uniform Power of Attorney Act (2006)* is intended to address this situation by imposing some measure of liability on third parties for unjustified refusals to acknowledge an agents authority under a general durable power of attorney. *See* National Conference of Commissioners on Uniform State Laws (NCCUSL), *Uniform Power of Attorney Act* (2006), *available at* http://www.law.upenn.edu/bll/archives/ulc/dpoaa/2006final.txt (last visited October 19, 2007).

1. Duty to Accept Acknowledged Power of Attorney. The *2006 Uniform Power of Attorney Act* is a response to the findings of a national survey conducted by the Joint Editorial Board for Uniform Trust and Estate Acts (hereafter referred to as the JEB survey), which revealed a consensus among at lest 70% of those responding that existing laws did not adequately address remedies and sanctions for refusal of other persons to honor a power of attorney. *Prefatory Note, Survey Response (11), Uniform Power of Attorney Act (2006).* In dealing with such refusal, the new Uniform Act recognizes that the reluctance to honor durable powers of attorney sometimes stems from legitimate concerns with the potential for misuse and abuse of the powers granted by such documents, as well as the potential for liability on the part of third parties honoring them, issues which surfaced among those articulated in the responses to the JEB survey. *Id.* at *Survey Responses* 8 & 10. Section 120 therefore incorporates an accrediting requirement as a prerequisite for the

creation of a duty to accept or honor a durable power of attorney. A third party has a duty to accept a durable power of attorney only if the document has been properly acknowledged pursuant to Section 119 of the Act. Pursuant to Section 119, a durable power of attorney is properly acknowledged if it is verified by the principal in front of a notary public. *See* Section 119(a).

In addition to the requirement of acknowledgement, the Uniform Act also offers jurisdictions the option of a second alternative version of Section 120, Alternative B, that restricts the duty to accept to those powers of attorney that are drafted and executed in accordance with the statutory form set out in Section 301 of the Uniform Act or in accordance with military powers of attorney, as set out in *10 U.S.C.S. § 1044b*.

Under either Alternative A or B, if the third party is not satisfied with the authenticity of the document or has questions concerning its scope or contents, he or she has seven days from the day the durable power of attorney is presented to request a certification, translation or an opinion of counsel, pursuant to Section 119(d)(1)-(3). If the request is made within the seven day window, the cost of translating the document into English or of providing a legal opinion from counsel must be paid by the principal. Section 119(e). Once the requested item is received, the third party has five business days within which to accept the power of attorney. Third parties are not entitled to require that an acknowledged power of attorney be re-executed using another form preferred by the third party. *See* Section 120(a)(3) (Alternative A) or Section 120(b)(3) (Alternative B).

2. Circumstances Under Which Refusal to Accept an Acknowledged Power of Attorney Are Justified. The Uniform Act lists six circumstances where a third party is justified in refusing to accept an acknowledged power of attorney. *See* Section 120(b)(1)- (6)(Alternative A) or Section 120(c)(1) (6) (Alternative B). A third party need not accept a power of attorney in connection with any transaction where the third party would not be required to engage in that transaction with the principal. Section 120(b)(1)(Alternative A) or Section 120(c)(1)(Alternative B). Thus, if the principal would not qualify for a mortgage loan, the bank is not required to transact the mortgage loan with the agent pursuant to the power of attorney. A third party is justified in refusing to accept the power of attorney in any situation where the transaction would violate federal law, such as an attempt to purchase a gun if the principal is a felon. Section 120(b)(2) (Alternative A) or Section 120(c)(2) (Alternative B). A third party is justified in refusing to accept a power of attorney where the third party has actual knowledge of the termination of the agents authority to act pursuant thereto. Section 120(b)(3)(Alternative A) or Section 120(c)(3)(Alternative B). The third party is justified in refusing to accept a power of attorney if the agent refuses to provide a certification, translation or opinion of counsel upon request. Section 120(b)(4)(Alternative A) or Section 120(c)(4)(Alternative B). The most problematic of the justifications allowed by the Uniform Act for refusal to accept a power of attorney is that of a third partys good faith belief that the power of attorney is invalid or lacks proper authority, a refusal which may be maintained even in the face of a certification, translation and opinion from legal counsel. Section 120 (b)(5)(Alternative A) or Section 120 (c)(5)(Alternative B). The Uniform Act does not provide any criteria for evaluating good faith; if all that is required is the sincere belief of the third party, refusal will be possible even where no rational basis exists to support it. For example, the teller at the principals bank, who always waited on the principal, may have developed a personal dislike to the principals daughter because she is pushy and rude. When the daughter comes to exercise her authority under her mothers power of attorney, the bank teller may sincerely believe that this pushy daughter is overstepping her bounds, even though she has no hard evidence to support her belief. Given the literal reading of the justification for refusal section, the daughter will not even be entitled to maintain a lawsuit to establish her authority under the power of attorney, as the refusal will not be in violation of the statute if it has been done in good faith.

Finally, a third party may refuse to honor a power of attorney in the even that the third party makes or has personal knowledge that someone else has made a good faith report of physical or financial abuse, neglect, exploitation, or abandonment by the individual that has been appointed to act as agent under the durable power of attorney. Section 120(b)(6)(Alternative A) or Section 120(c)(6)(Alternative B). This ground for refusal appears perfectly reasonable, at least until the report has been investigated by the appropriate agency and the individual cleared of wrongdoing.

3. Penalties for Refusal to Accept an Acknowledged Power of Attorney. In the event that a third party refuses to

honor an acknowledged power of attorney in accordance with Section 120, an action may be brought in court against the third party directing that the party accept the power of attorney and further holding the third party liable for reasonable attorneys fees and costs associated with bringing the action. *See* Section 120 (c)(1) & (2)(Alternative A) or Section 120(d)(1) & (2)(Alternative B). The Uniform Act lists the following parties as having standing to file such a lawsuit: the principal or agent, a guardian, conservator, or other fiduciary, a person authorized to make health care decisions, principals spouse, parent, or descendant, any presumptive heir of the principal, any beneficiary with an interest in the principals estate under any will, contract, or trust, governmental agency with regulatory authority or any party asked to accept the power of attorney. Section 116(a)(1) (9). An even broader grant of standing might include anyone relying on the agents authority to their detriment, as it may now be that their interests depend on the further recognition of the document as legitimate, or anyone with knowledge or interest in the situation.

The Uniform Act also does not provide for damages sustained by the principal in addition to those incurred in bringing the lawsuit to enforce recognition of the power of attorney, although a state can supplement remedies provided by the Act pursuant to Section 123. It is easy to envision a situation where the dilatory response of a third party might very well jeopardize significant rights and interests of the principal, such as situations where payment for expensive prescription medication, a mortgage payment or utility bill are at issue, and a bank refuses to honor the power of attorney, thereby depriving the principal of funds needed to acquire these necessary services. Where the withholding of acceptance is without statutory justification, compensation for reasonably foreseeable damages that would arise from such a deprivation only seems just. It is not clear why the drafters of the Uniform Act chose not to include them; advocates in states seeking to adopt the 2006 should press for inclusion of compensatory damages and enhanced damages as well in those cases where the withholding of acceptance is deemed to be unreasonable. *See* Burns Ind. Code Ann. § 30-5-9-9(a)(1) (3) (2007).

For Other State Laws Establishing Liability for Third Party Refusal to Honor Durable Powers of Attorney, *see* Alaska Stat. § 13.26.253(c)(2007); Cal. Prob. Code § 4306(a)(2007); Fla. Stat. § 709.08(11)(2007); 755 ILCS 45/2-8 (2007); Minn. Stat. § 523.20 (2006); NY CLS Gen. Oblig. § 5-1504(3)(2007); N.C. Gen. Stat. § 32A-41(a)(1)(2007); and 20 Pa. C.S. § 5608 (2007).

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Harkness on Medicaid Estate Recovery and In re Estate of Serovy

2008 Emerging Issues 2057

Harkness on Medicaid Estate Recovery and In re Estate of Serovy

By Donna S. Harkness

May 6, 2008

SUMMARY: Donna S. Harkness comments on In re Estate of Serovy, a case that involves Medicaid estate recovery and illustrates the importance of aggressive advocacy, to ensure that estate recovery is contained within lawful parameters, and careful Medicaid planning to avoid unintended, and in this case, unfair, depletion of a familys assets to repay the state for Medicaid benefits received by one member of the family to pay for care in a nursing home.

PDF LINK: Click Here for Enhanced PDF of Commentary

ARTICLE: Cite as: Harkness, Donna S. Medicaid Estate Recovery and *In re Estate of Serovy*. LexisNexis Expert Commentary, *(Insert date you accessed the document online)*.

In re Estate of Serovy, 711 N.W.2d 290, 2006 Iowa Sup. LEXIS 39 (2006), involves Medicaid estate recovery and illustrates the importance of aggressive advocacy, to ensure that estate recovery is contained within lawful parameters, and careful Medicaid planning to avoid unintended, and in this case, unfair, depletion of a familys assets to repay the state for Medicaid benefits received by one member of the family to pay for care in a nursing home.

1. Estate Recovery Extent of Interest. Pursuant to federal law, states must make an effort to recoup amounts expended for medical assistance to people aged 55 and over to pay for nursing facility services, home and community-based services, and related hospital and prescription drug services *42 U.S.C.S. § 1396p(b)(1)(B)(i)*. The federal law outlines two main avenues of collection: 1) real property liens, *42 U.S.C.S. § 1396p(a)(1)(B)(i)* & (ii); and 2) estate recovery, *42 U.S.C.S. § 1396p(b)(1)(B)*. The real property lien is placed on the home while the recipient is still alive if the recipients condition is of such severity that he or she is not expected to be able to return home to live**.** *42 U.S.C.S. § 1396p*(1)(B)(ii). Some states, like Tennessee, do not participate in the lien program; Tennessee, in fact has passed a law to prohibit placement of a lien on real property for correctly paid medical assistance while the Medicaid recipient is still alive. *See* T.C.A. § 71-5-116(a) & (b). Estate recovery may either be restricted to the assets normally included in probate under the states laws, or the assets subject to collection may be augmented to include any other real and personal property and other assets in which the individual had any legal title or interest at the time of death (to the extent of such interest), including such assets conveyed to a survivor, heir, or assign of the deceased individual through joint tenancy, tenancy in common, survivorship, life estate, living trust, or other arrangement. *42 U.S.C.S. § 1396p(b)(4)(B)*. States are not required to expand the definition of assets available to estate recovery beyond assets normally available in probate. Advocates must therefore consult state law to determine whether or not their particular

state has elected to do so. *See* David G. Lupo, *Medicaid--Long Term Care in Missouri: An Update Since OBRA 1993, 62 J. Mo. B. 188, 191-92* (July/Aug. 2006); Wesley E. Wright, *et al., Dramatic Changes to Medicaid Funding of Long-Term Care, 43 Houston Lawyer 28, 28-29* (May/June 2006).

Mary Serovy was a widow and, like most people, it was her wish to live independently in her own home for as long as possible. In order to accomplish this goal, her son and daughter-in-law agreed to build an addition on to Marys home, at their own expense, to provide sufficient living space for themselves and their daughter. In return, Mary deeded the property to her son, his wife and herself as joint tenants with right of survivorship. All this was accomplished by 1989 and for the next eight years, Mary was able to remain in her home. Finally, in 1997, Marys condition deteriorated to the point where she had to be placed in a nursing home. She remained there until she died in 1998. Medicaid assistance was required in order to help defray the cost of her care. In order for Mary to be eligible for Medicaid, her non-exempt resources had to be less than $2000 in value. 441 IAC 75.1(7)(a)(4)(249A) (2007). Her probate estate was thus extremely limited and after her death, her son attempted to probate her will without opening an administration.

A few months later, however, the Iowa Department of Human Services filed a claim with the probate court against the estate for $28,707.54 for the medical assistance paid on behalf of Mary Serovy. The Iowa DHS further petitioned for administration of the estate and the states representative was appointed as executor. Because there were no appreciable assets in the estate out of which to satisfy the states claim, the state sought authority to sell the home, despite the fact that its ownership had automatically passed to Marys son and daughter-in-law outside of probate by operation of law by reason of the joint tenancy. The probate court authorized the sale pursuant to Iowas enactment of a statute allowing for recovery of Medicaid claims against decedents estates from assets outside those normally included within a probate estate**.** Iowa Code § 249A.5 (2006). The enlarged group of assets included any real property, personal property, or other asset in which the recipient, spouse or child had any legal title or interest at the time of the recipients spouses or childs death, to the extent of such interest in jointly held property, retained life estates and interests in trust. *Id.*

For those states that adopt this expanded definition, property that may be attached can include joint tenancy property, life estates, or living trust assets, etc. Advocates must ensure that the state only attaches and sells property in which the decedent actually had an interest at the time of death. *See In re Estate of James Clifford Smith, 2006 Tenn. App. LEXIS 715* (Nov. 1, 2006). In the *Serovy* case, the court had correctly determined that only Mary Serovys one-third interest in the property was subject to the states Medicaid claim. Despite this finding, the court went on to order the sale of the entire house, with the instruction that only one-third of the proceeds were to be used to satisfy the claim and the other two-thirds were to be distributed to Mary Serovys son and daughter-in-law. The Court of Appeals found that just as the states claim was limited to the decedents one-third interest, so was the administrators power to sell limited to Mary Serovys one-third interest. The holding below was thus upheld with this modification.

Although not a total victory, the limitation on the administrators power to sell at least required the administrator to either restrict the sale to the one-third tenancy in common interest or to file a petition for a partition sale of the entire property. The practical difficulties of finding a buyer under such circumstances may enhance the prospects for settlement, through negotiation of a buyout of the estates interest by the remaining owners at a reasonable price.

2. Estate Recovery Valuation of Interest. Other cases have raised the issue of proper valuation of the decedents interest in the property against which recovery is sought. Valuation of a life estate interest has been particularly problematic, as one would think logically that the value of a life estate at the point of the decedents death would be zero. Paul S. Lee, *The Common Disaster: The Fifth Circuits Error in Estate of Carter v. United States and the Glitch in the The Tax on Prior Transfer Credit in Valuing Life Estates Created in a Common Disaster, 40 Emory L.J. 1269, 1276-77* (Fall, 1991). Obviously, the state will argue against this valuation, and the state will generally propose a valuation based on the applicable life expectancy tables for a person the same age and gender as the deceased at the time of death. Such a valuation will generally yield a figure far in excess of the zero value that the life estate actually possesses. There is already case law in Iowa, *Department of Human Services v. Laughead, 696 N.W.2d 312, 2005 Iowa Sup. LEXIS 51*

(Apr. 15, 2005), and Oregon, *State ex rel. Department of Human Services v. Willingham, 206 Ore. App. 156, 136 P.3d 66, 2006 Ore. App. LEXIS 730* (May 31, 2006), adopting the life expectancy table rationale, so advocates may experience an uphill battle in challenging it, but in states where that rationale has not been adopted, advocacy in favor of a zero valuation can only benefit the estate.

3. Estate Recovery Medicaid Planning. From a Medicaid planning standpoint, the whole regrettable situation in the *Serovy* case could have been avoided had the property been deeded outright to Mary Serovys son, pursuant to the exception under Medicaid law that allows for transfer of real property to an adult child who has lived with the Medicaid recipient for at least two years and who has thereby assisted her in remaining out of a nursing home. *42 U.S.C.S. § 1396p(c)(2)(A)(iv)*. Such arrangements save the taxpayers money, and strengthen the fabric of society; they should be encouraged and supported by the Medicaid laws. Had the state attempted to execute on a lien pursuant to *42 U.S.C.S. § 1396p(a)(1)(B)*, another section of the statute would have prevented execution on the lien so long as Marys son continued to live there, since he had been residing in the home for a period of at least two years immediately before the date Mary was admitted to the nursing home and his presence there kept her out of the nursing home. *42 U.S.C.S. § 1396p(b)(2)(B)(ii)*. Query also as to why sale of the home was not deemed an undue hardship pursuant to *42 U.S.C.S. § 1396p(b)(3)*, unless the son and his wife had gone back to live on the farm where they had lived before coming to stay with Mary. Unfortunately, in the Serovy case, the investment of time and money on the part of the son in caring for his mother was not undergirded and rewarded, but was instead penalized. The son and daughter in law were in effect deprived of their survivorship interest in Mary portion of the house as that was going to be exhausted in order to enable the estate to satisfy the states claim. To the extent that their investment enhanced the value of the house overall, the estate was unjustly enriched by the increase in value to Mary Serovys one-third interest in the property and the estates creditors were enriched as well, as the improvements undoubtedly increased the marketability and overall value of the home.

Other Medicaid planning issues that elder law advocates should be aware of and which may be impacted by estate recovery:

1. Spousal disinheritance. Clients should be advised not to use spousal disinheritance to avoid estate recovery. Attempts to eliminate a spouses interest in ones estate are doomed to failure, because the elective share allows the spouse to elect against the disinheritance. Tim Takacs & David McGuffey, What to Tell Your Clients About Tenncare Medicaid Estate Recovery, *43 Tenn. B.J. 16, 20* (July, 2007). Where Medicaid estate recovery is at issue, the surviving spouse may refrain from electing against the will only to have the state make the election and thereby obtain assets sufficient to pay the Medicaid claims.

2. Transfer on Death. In states that have authorized so-called beneficiary deeds or transfer on death accounts, the property in question passes outside of probate and thus will not be available for estate recovery by the state unless the state has enacted legislation to expand its Medicaid estate recovery effort beyond ordinary probate assets. In general, if the state has adopted the provisions of the Uniform Nonprobate Transfers on Death Act, then the transferee of the property will ordinarily be liable to the decedents estate for lawful claims filed against it. *See* Elaine H. Gagliardi, Remembering the Creditor at Death: Aligning Probate and Nonprobate Transfers, *41 Real Prop. Prob. & Tr. J. 819, 852-53* (Winter, 2007).

Conclusion. The *Serovy* case demonstrates the increasingly aggressive efforts states are making using estate recovery to recoup Medicaid payments after the recipient of those benefits has died. Advocates should vigorously defend against state attempts to attach property not actually owned by the beneficiary at the time of death, or to overvalue the property that the beneficiary did own. Advocates should engage in Medicaid planning to help elder clients and their families to lawfully achieve the goal of both caring for the elderly person and of preserving assets for the family.

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Harkness on Enforceability of Nursing Home Arbitration Agreements

2008 Emerging Issues 2058

Harkness on Enforceability of Nursing Home Arbitration Agreements

By Donna S. Harkness

May 6, 2008

SUMMARY: Donna S. Harkness comments on arbitration that is being used by long term care providers as a means to keep malpractice and other negligence claims from coming before a jury. Inclusion of arbitration agreements within nursing home admissions contracts is a growing trend, and has given rise to litigation challenging the validity of such agreements on grounds of contractual invalidity, public policy, and unconscionability.

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ARTICLE: Cite as: Harkness, Donna S. Grounds for Challenging Enforceability of Nursing Home Arbitration Agreements: *Lacey v. Healthcare and Retirement Corp. of America* and *Bedford Care Center-Monroe Hall, LLC v. Lewis*. LexisNexis Expert Commentary, *(Insert date you accessed the document online).*

Arbitration is being used by long term care providers as a means to keep malpractice and other negligence claims from coming before a jury. Inclusion of arbitration agreements within nursing home admissions contracts is a growing trend, and has given rise to litigation challenging the validity of such agreements on grounds of contractual invalidity, public policy, and unconscionability. *See Lacey v. Healthcare and Retirement Corp. of America, 918 So.2d 333; 2005 Fla. App. LEXIS 18807; 30 Fla. L. Weekly D. 2681* (Nov. 30, 2005); and *Bedford Care Center-Monroe Hall, LLC v. Lewis, 923 So.2d 998; 2006 Miss. LEXIS 27* (Jan. 12, 2006). Nursing homes have attempted to uphold such arbitration agreements on grounds that state laws are preempted by the Federal Arbitration Act, *9 U.S.C.S. §§1 et seq.*

1. Lack of Valid Agreement to Arbitrate. Although there is strong public policy in favor of arbitration, the conceptual framework of arbitration presupposes knowing and voluntary agreement by the parties to engage in such alternative dispute resolution. Richard A. Bales, Contract Formation Issues in Employment Arbitration, *44 Brandeis L.J. 415, 418-420* (Winter, 2006). Thus, where one of the parties has knowingly refused to sign the arbitration agreement, there can be no valid agreement to arbitrate. *Bedford Care Center-Monroe Hall, LLC* at 1001. The *Bedford* case illustrates how difficult it may be, however, for the average nursing home consumer to decline to accept an arbitration clause contained within a nursing home admission contract. The admissions contract in the *Bedford* case

consisted of seven typewritten pages. The arbitration clause was found on the fifth and sixth pages, with a signature line at the bottom of page five, right below a bold print statement of waiver of the residents right to adjudicate in court any disputes that might arise between the resident and the nursing home. *Id.* The nursing home had highlighted the signature line but the residents conservator refused to sign it. She did sign the signature line for the entire admission agreement found on page seven. *Id.* A bold print statement above that signature line referred to the Arbitration Agreement and stated that the residents signature would constitute acknowledgement by the resident of having read the Arbitration Agreement and receipt of a copy. *Id.* The contract also contained a provision, located on page six, to the effect that acquiescing to arbitration was not required in order to receive care at the nursing home, a provision mandated by the Centers for Medicare and Medicaid Services out of concern that requiring residents to sign such agreements as a condition of admission might have an adverse impact on quality of care. *See* Centers for Medicare & Medicaid Services, Binding Arbitration in Nursing Homes, Policy Memorandum S&C-03-10 (Jan. 9, 2003) available at http://www.cms.hhs.gov/SurveyCertificationGenInfo/downloads/SCLetter03-10. When the conservator returned the admission contract to the facility with page five unsigned, she received a call from an employee of the nursing home, who pointed out to her that the agreement had not been signed everywhere, and who discussed with her the provisions of the admissions contract. *Id. at 1001*. The conservator said that she would sign the agreement correctly and return it. *Id.* The admissions agreement was again sent out to the conservator, who still refused to sign the signature line on page five, but who did initial page five at the top to indicate that she had in fact read the Arbitration Agreement. *Id.*

Given these facts, the nursing home still tried to argue that the conservators signature at the end of the agreement constituted approval of the arbitration clause because of the language in the last sentence of the bold print paragraph above the signature line for the admissions contract, which indicated that each of the parties voluntarily consents to and accepts all its terms. *Id.* The Court found that despite this language, the conservator had very carefully declined to sign off on the arbitration agreement, and thus had not agreed to arbitration. To hold otherwise would be to make it virtually impossible for anyone to enter into an admissions agreement with a nursing home without agreeing to arbitration, and would make a mockery of the provision within the nursing home contract stating that signing the arbitration clause was not a precondition to admission or provision of care.

The holding in *Bedford* is in contrast to the holding by the Massachusetts Supreme Court in a case involving an agents decision to sign an arbitration clause without carefully reading it word for word. *Miller v. Cotter, 448 Mass. 671, 863 N.E.2d 537, 2007 Mass. LEXIS 189 (Mass. 2007)* (Mar. 30, 2007). Where a properly authorized agent is negligent in the exercise of his or her duties, the principals remedy is to sue the agent; the complained of conduct does not vitiate the agreement in the absence of fraud.

Of course, where the arbitration agreement is signed by a representative of the resident, rather than by the resident, the issue of the representatives authority to contract on behalf of the resident may affect the validity of the agreement. In *Sikes v. Heritage Oaks West Retirement Village, 2007 Tex. App. LEXIS 7769 (Tex. App. 2007)* (Sept. 26, 2007), the Texas Court of Appeals refused to enforce an arbitration agreement signed by the residents wife where the resident had done nothing to signify to the nursing home that she had authority to act as his agent. *See also Grenada Living Center, LLC v. Coleman, 961 So. 2d 33, 2007 Miss. LEXIS 407 (Miss. 2007)* (July 26, 2007); *Ashburn Health Care Center, Inc. v. Poole, 286 Ga. App. 24, 648 S.E.2d 430, 2007 Ga. App. LEXIS 678, 2007 Fulton County D. Rep. 2002 (Ga. App. 2007)* (June 20, 2007); *Noland Health Services, Inc. v. Wright, 2007 Ala. LEXIS 79 (Ala. 2007)* (May 4, 2007); *Flores v. Evergreen at San Diego, LLC, 148 Cal. App. 4th 581, 55 Cal. Rptr. 3d 823, 2007 Cal. App. LEXIS 348, 2007 Cal. Daily Op. Service 2674 (Cal. App. 2007)* (Mar. 13, 2007). For a contrary approach, advocates should also be aware of the case of *Necessary v. Life Care Centers of America, Inc. d/b/a/ Life Care Center of Jefferson City, 2007 Tenn. App. LEXIS 698 (Tenn. Ct. App. 2006)* (Nov. 16, 2007), where the residents wife, acting under oral authority from the resident, signed the paperwork relating to his admission to the nursing home. The wife did not request nor obtain from the resident any authority to agree to arbitration, despite the fact that the resident was still mentally competent and thus could have granted her such authority. *Id*. at *7-8. Based on this omission, the trial court found that the wife did not have the authority to bind her husband. *Id*. at *9-10. The Court of Appeals, however, held differently, noting that the husband had basically given the wife blanket authority to act on his behalf with respect to the execution of the

paperwork relating to his admission to the nursing home. *Id.* at *14. The Court found that the husbands delegation of decision making power related to this matter was akin to the delegation of authority found in the durable health care power of attorney at issue in the case of *Owens v. National Health Corp., 2007 Tenn. LEXIS 1003 (Tenn. 2007)* (Nov. 8, 2007). In that case, the agent executed a nursing home admissions contract containing an arbitration agreement pursuant to his authority as a healthcare agent. *Owens* at *7-9. In attempting to avoid enforcement of the arbitration agreement, the plaintiff in *Owens* argued that the agent under a durable power of attorney for health care was not authorized to enter into legal decisions such as whether or not to sign an arbitration agreement waiving the principals right to a jury trial. *Id*. at *15. The Tennessee Supreme Court declined to follow that line of reasoning, noting that any attempt to delineate between health care decisions and legal decisions within this context would be untenable. *Id.* at *18-19. Similarly, the *Florida Court of Appeals in Alterra Healthcare Corp. v. Estate of Linton, 953 So. 2d 574, 2007 Fla. App. LEXIS 2727, 32 Fla. L. Weekly D. 574 (Fla. Dist. Ct. App. 1st Dist. 2007)* (Feb. 28, 2007) reh. denied *2007 Fla. App. LEXIS 7340 (Fla. Dist Ct. App. 1st Dist. 2007)* (Apr. 17, 2007) rev. denied *2007 Fla. LEXIS 1837 (Fla. 2007)* (Sept. 24, 2007), found that a resident was bound by an arbitration clause in an admission agreement signed by her son, despite the fact that the son had no durable power of attorney or other authority to enter into such decisions on her behalf. *Id. at 576*. The Court held that the resident was a third party beneficiary of the contract between the nursing home and her son, and as such, she was bound by the contract terms. See also *Trinity Mission of Clinton, LLC v. Barber, 2007 Miss. App. LEXIS 550 (Miss. App. 2007)* (Aug. 28, 2007).

2. Whether Arbitration Agreements Are Against Public Policy. In *Lacey v. Healthcare and Retirement Corp. of America, 918 So. 2d 333, 2005 Fla. App. LEXIS 18807, 30 Fla. L. Weekly D. 2681 (Fla. App. 2005)* (Nov. 30, 2005), plaintiffs were faced with an arbitration agreement that limited the amount of non-economic damages that they could claim to $250,000 and which further waived any claim for punitive damages. *Id. at 334*. Both provisions were in violation of the Florida Nursing Home Residents Act, § 400.0060 *et seq.* Fla. Stat. (2004) which specifically allowed for unlimited compensatory and punitive damages. The Florida Appeals Court determined that the entire arbitration agreement was rendered void as a matter of public policy, due to the lack of any severability clause. *Id. at 335*.

However, advocates cannot count on the court voiding an entire arbitration agreement simply because of the presence of clauses that are illegal or void as against public policy. This is especially true where the arbitration agreement contains a severability clause. Such a provision specifically authorizes the elimination of any clause which is found to be illegal or unenforceable from the contract as a whole, which then allows the contract to be enforced as it stands without the offending clause. *See Alterra Healthcare Corp. at 579*.

3. Whether The Federal Arbitration Act Preempts State Law With Respect To Arbitration Agreements. In *Bruner v. Timberlane Manor, 2006 OK 90, 155 P.3d 16, 2006 Okla. LEXIS 94* (Ok, 2006) (Dec. 12. 2006) *reh. denied 2007 Okla. LEXIS 6 (Ok. 2006)* (Jan. 29, 2007), the arbitration agreement at issue was in violation of Oklahomas Nursing Home Care Act, 63 O.S. 2001, SI-1939(D) & (E). The nursing home defendants attempted to avoid application of the state law by asserting preemption by the Federal Arbitration Act, and defendants introduced proof to establish the impact of nursing home operations on interstate commerce. *Bruner at 28*, fn. 21. The Court in *Bruner* did not find the activity alleged to be of a nature substantial enough to invoke federal preemption in this case, noting that the main interstate nexus asserted by the defendants, that of federal payment through the Medicare and Medicaid programs, was generated by Congress pursuant to the Spending Powers and not the Commerce Clause power. *Id. at 31-32*. The Court then observed that the Medicare and Medicaid programs themselves were replete with references to state law as governing much of the regulation that surrounds quality of care in nursing homes. Finally, the arbitration agreement itself made reference to Oklahoma law as governing, a fact that the Court found to be compelling, whether or not the Federal Arbitration Act was applicable. Where the agreement itself references state law, the pre-emption question is moot. *See also Owens v. National Health Corp.* at *13-14.

The Court did reference a split among state courts on the issue of whether or not Medicare and Medicaid payments were enough to constitute interstate commerce, with courts in Texas, Alabama and Mississippi finding in favor of the existence of the interstate commerce connection, cases which the Oklahoma court declined to follow. *See In re Nexion Health at Humble, Inc., 173 S.W.3d 67, 2005 Tex. LEXIS 422, 48 Tex. Sup. J. 805 (Tex. 2005)* (May 27, 2005);

McGuffey Health and Rehab Center v. Jackson, 864 S.2d 1061, 2003 Ala. LEXIS 145 (Ala. 2003) (Feb. 11, 2004) and *Vicksburg Partners, L.P. v. Stephens, 911 So.2d 507, 2005 Miss. LEXIS 607 (Miss. 2005)* (Sept. 22, 2005).

4. Whether Pre-Dispute Contracts To Arbitrate Are Unconscionable As Contracts Of Adhesion. Requiring residents and/or their representatives to sign pre-dispute arbitration agreements as part of the process of admission to a nursing home raises serious public policy issues concerning whether or not such contracts can ever be entered into voluntarily by the party that is desperately in need of medical treatment. The American Arbitration Association has adopted a policy of declining to arbitrate cases concerning disputes over healthcare provided to individuals unless the agreement to arbitrate was entered after the dispute arose. *See* American Arbitration Association Healthcare Policy Statement (effective 01/01/03) *available at* http://www.adr.org/sp.asp?id=32192 (last visited Nov. 20. 2007). Although admission to a nursing home does not rise to the level of emergency treatment, the circumstances of admission are usually stressful and the lack of choices as to alternative care might be such that a party presented with an arbitration clause within the context of the nursing home admission process might feel he or she had no choice but to sign it. Considering this possibility, the court in *Owens* remanded that case back to the trial court to explore whether the nursing home arbitration contract was so one-sided under the circumstances as to amount to an unconscionable contract of adhesion. *Id.* at *30-31. The court noted that despite the language contained within the agreement asserting that it was voluntary, knowing and considered by the parties to be in everyones best interests, if the contract was in fact offered on a take it or leave it basis, that might be enough to render it unconscionable. *Id.* at *31.

Conclusion. Arbitration agreements contained within nursing home admissions contracts may be challenged successfully if there is no valid agreement to arbitrate, if the arbitration agreement is against public policy and is not preempted by the Federal Arbitration Act, or if the arbitration agreement is unconscionable as a contract of adhesion.

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Harkness on Gifting Authority Pursuant to Durable Power of Attorney

2008 Emerging Issues 2059

Harkness on Gifting Authority Pursuant to Durable Power of Attorney

By Donna S. Harkness

May 6, 2008

SUMMARY: Donna S. Harkness comments on issues of fiduciary responsibility, fraud and undue influence which may arise when the agent under a durable power of attorney exercises gift giving authority to benefit him or her self.

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Tennessee Farmers Life Reassurance Co. v. Rose, No. E2005-00006-SC-R11-CV (Tenn. Sept. 6, 2007) (Oct. 2, 2007) *available at* http://www.tsc.state.tn.us/OPINIONS/TSC/073/TNFarmers%20OPN.wpd; *In re Estate of Ferrara, 2006 NY Slip Op. 5156, 7 N.Y.3d 244, 852 N.E.2d 138, 819 N.Y.S.2d 215, 2006 N.Y. LEXIS 1759 (N.Y. 2006)* (June 29, 2006); and *In re Estate of Leach, 2006 Ohio 3755, 2006 Ohio App. LEXIS 3721* (Ohio Ct. App.) (July 21, 2006) all discuss issues of fiduciary responsibility, fraud and undue influence which may arise when the agent under a durable power of attorney exercises gift giving authority to benefit him or her self. Although state statutes creating durable powers of attorney generally allow for inclusion of gift giving authority to the agent in recognition of the fact that the principals financial or estate plan may necessitate gifting, these powers must be exercised in the principals best interests.

1. Fiduciary Responsibility to Exercise Gift Giving Authority in the Best Interests of the Principal. An agent acting under the authority of a power of attorney is in a fiduciary relationship and is generally responsible for exercising his or her authority so as to further the best interests of the principal. Nina A. Kohn, *Elder Empowerment as a Strategy for Curbing the Hidden Abuses of Durable Powers of Attorney, 59 Rutgers L. Rev. 1, 14-15* (Fall, 2006). Gifting is usually not seen as being in the best interests of the principal, because divesting the principal of his or her property for less than fair market value is not prudent from the standpoint of financial management. Gifting instead is viewed as something that the principal may wish to do for emotional, psychological or social reasons that are not connected with his or her financial well being.

However, with the advent of tax policy that rewards gift giving through the mechanism of tax reduction, a program of gifting may in fact be in the financial best interests of the principal. In addition, if a principal has adhered to a long term strategy of gifting, continued adherence to that plan by the agent is certainly consistent with the principals best

interests as conceived by the principal. Thus, state statutes creating durable powers of attorney usually include provisions that enable a principal to authorize the agent to engage in gifting or enable the agent to engage in gifting that is in accord with the principals estate plan. *See* NY CLS Gen Oblig. § 5-1501 *et seq*. Section 201(a)(2) of the Uniform Power of Attorney Act of 2006 (UPAA) prohibits the making of a gift under a durable power of attorney in the absence of an express grant of gifting authority. Pursuant to Section 217 of the UPAA, in the ordinary course of things, gifts made under a general gifting authority may only be made by the agent in amounts up to the annual dollar limits of the federal gift tax exclusion set by IRS Code Section 2503(b). The power of attorney may provide otherwise, of course, in which case the specific directions of the durable power of attorney are controlling.

In *Tennessee Farmers Life Reassurance Co. v. Rose*, the agent acting under a durable power of attorney that granted her general authority to transact all insurance business on behalf of the principal, undertook to change the beneficiary designation on the principals life insurance from the principals three children and grandchild to the agent, who was the principals sister, as sole beneficiary. (*Tennessee Farmers* at 1-2). Upon receiving the conflicting claims for the insurance proceeds, the insurance company brought suit for guidance concerning which claimant to pay. The Tennessee Supreme Court noted that had the durable power of attorney incorporated the language of Tennessees durable power of attorney statute relating to fiduciary powers, the lack of a specific authorizing clause would have prevented the agent from having authority to make such a change. However, the principal did not cite to the Tennessee statute, and thus, the Court, in giving a fair construction to the language used, concluded that the agent did have the legal authority to change the beneficiary designation. (*Id. at 6)* Nevertheless, possession of legal authority by the agent did not resolve the case in the mind of the Court, and the matter was remanded for consideration of whether the agent had breached her fiduciary duty to the principal by naming herself as beneficiary on the principals life insurance policy. Because the confidential relationship of principal and agent existed between these parties, any transaction benefiting the agent at the expense of the principal raises a presumption of undue influence, which could only be rebutted by presentation of clear and convincing evidence of the fairness/reasonableness of the transaction as a whole. (*Id. at 7).*

Similarly, in *Estate of Ferrara*, the principal executed a durable power of attorney that contained an express typewritten clause authorizing the agent to makegifts without limitation to himself. The agent argued that this grant of carte blanche authority from the principal ratified the agents wholesale conversion of all the principals assets to himself during the last few weeks of his life (*Estate of Ferrara* at 140.). The New York Court of Appeals disagreed, and despite the grant of apparently unfettered gifting power, found that where an agent under a durable power of attorney engages in self-dealing, that agent bears the burden to establish that the gifts made were free from fraud, deception or undue influence. (*Id. at 144*, ftn. 4). This holding is basically reiterated in the case of *Estate of Leach*, citing again to the presumption of undue influence that arises from transactions that benefit the agent acting in a fiduciary capacity pursuant to a durable power of attorney. (*Estate of Leach* at **12). Clear and convincing rebuttal evidence of the fairness and reasonableness of the transaction as a whole may require resort to extrinsic evidence or established that such gifts were in fact in the best interest of the principal. (*Id*.)

2. Determining What Constitutes The Best Interests Of The Principal. In the absence of specific knowledge of the principals wishes and values sufficient to support a subjective view of his or her best interests, the agent must rely on that which can be reasonably justified objectively as serving the principals best interests. From an objective standpoint, an action is in the principals best interests if it can be shown that the principal will benefit in some way from the action. For example, under the New York statute at issue in the *Ferrara* case, gift-giving authority under a durable power of attorney could only be exercised for purposes which the agent reasonably deems to be in the best interest of the principal. NY CLS Gen. Oblig § 5-1502M(1). The statute goes on to enumerate reduction of tax liability as being in the best interests of a principal, and the court in *Ferrara* noted that the best interest requirement is consistent with fiduciary duties[and] the intent that the attorney-in-fact will[act]for the benefit of the principal. *Id*. at 144.

Reduction of tax liability, however, is not the only consideration relevant to the best interest inquiry. Section 217(c) of the UPAA lists the following as relevant factors: (1) the value and nature of the principals property; (2) the principals foreseeable obligations and need for maintenance; (3) minimization of taxes, including income, estate, inheritance, generation skipping transfer, and gift taxes; (4) the eligibility for a benefit, a program, or assistance under a statute or

regulation; and (5) the principals personal history of making or joining in gifts. The Comments to Section 217 indicate that this listing is intended to be illustrative rather than exclusive. As Professor Kuhn writes, what constitutes best interests may be understood in a number of different ways, depending on which of the individuals values or desires are being given preference. *Kohn, Elder Empowerment, at 14*. Thus, if the principal is known to value education above all else, making a gift of the principals funds to create a college scholarship in his or her name may be in keeping with the principals best interests, as opposed to placing the funds in a prudent investment account, even though the latter option will lead to growth of the principals funds, while the former will reduce them, so long as the funds are not so diminished as to leave the principal financially uncomfortable. It is the heavy responsibility of the agent to consider all of the possible best interests scenarios, weigh the positive and negative consequences of each and settle upon the course of action that is in the principals best interests, considering the totality of circumstances. Attorneys representing fiduciaries in the management of durable powers of attorney must also advise them to consider whether or not their activities are affecting third parties that the principal might owe a duty to or might wish to protect. To avoid a possible future malpractice action arising out of such a circumstance, the best interest calculation should also encompass meeting the financial responsibilities of the principal and acting in conformance with his or her estate plan. *See Biakanja v. Irving, 49 Cal. 2d 647, 320 P.2d 16, 1958 Cal LEXIS 253, 65 A.L.R.2d 1358 (Cal. 1958)* (Jan. 17, 1958); and *Albright v. Burns, 206 N.J. Super. 625, 503 A.2d 386, 1986 N.J. Super. LEXIS 1105 (N.J. Super Ct. App. Div. 1986)* (Jan. 16, 1986).

Conclusion. An agent that exercises gift-giving authority pursuant to a durable power of attorney must still act in the best interests of the principal. If the principal has given explicit directions concerning the making of gifts, these directions constitute the principals best interests as determined by the principal, but in the absence of such directions, the best interests of the principal can be determined by reference to such factors as the principals wealth, his or her projected expenses, tax liability, eligibility for public benefits, and his or her past propensity for gifting.

For additional cases dealing with fiduciary responsibilities of agents engaged in gifting pursuant to a durable power of attorney, *see Estate of Dooley v. Hickman, 2006 Tenn. App. LEXIS 562,* No. E2005-02322-COA-R3-CV (Tenn. App. 2006) (Aug. 29, 2006); *Antrim v. Wolken, 228 S.W.3d 50, 2007 Mo. App. LEXIS 1001 (Mo. App. 2007)* (June 29, 2007); *Russ ex rel. Schwartz v. Russ, 2007 WI 83, 734 N.W.2d 874, 2007 Wisc. LEXIS 414 (Wis. 2007)* (July 3, 2007); *Bienash v. Moller, 2006 SD 78, 721 N.W.2d 431, 2006 S.D.LEXIS 135 (S.D. 2006)* (Aug. 16, 2006).

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Flannery on Finley v. Astrue

2008 Emerging Issues 2060

Flannery on Finley v. Astrue

By Michael Flannery

May 6, 2008

SUMMARY: Professor Michael T. Flannery comments on *Finley v. Astrue [2008 Ark. LEXIS 2* (Jan. 10, 2008)], a case that considered the intestacy rights of a child who was created as an embryo through in vitro fertilization during the parents marriage, but who was implanted in the mothers womb after the fathers death.

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Finley v. Astrue [2008 Ark. LEXIS 2 (Jan. 10, 2008)] considers the intestacy rights of a child who was created as an embryo through in vitro fertilization during the parents marriage, but who was implanted in the mothers womb after the fathers death. The United States District Court for the Eastern District of Arkansas certified the issue to the Supreme Court of Arkansas, which held that such a child may not inherit from the father as a surviving child under Arkansas intestacy laws. The issue depended upon whether the child was conceived before the fathers death under Arkansas posthumous heir statute. See Ark. Code Ann. § 28-9-210(a) (to inherit as a surviving child, a child born after the decedents death must have been conceived before the decedents death). Although the term conceived is not defined in the statute, the court held that because the statute was enacted well before the technology of in vitro fertilization was developed, the General Assembly could not have intended the statute to allow a child created under such a scenario to inherit by intestate succession.

Because many state intestacy statutes were enacted prior to the development of such technologies or do not specifically address the issue of posthumous conception, many state legislatures must reconsider their intestacy statutes in light of such modern technological advancements and amend current intestacy statutes to include posthumously conceived children who are created by such methods. For example, New York and other states provide for such children to inherit through their respective intestacy statutes by specifically accommodating the express intent of the parents who wish for their posthumously conceived children to inherit through intestacy. Finley v. Astrue is a call for the Arkansas General Assembly and other state legislatures to reconsider public policy affecting the intestacy rights of posthumously conceived children and to amend intestacy statutes to include such children under the protections of intestate succession.

(1) Technology Outpaces the Law

There is ample evidence supporting the fact that assisted reproductive technologies have developed faster than the statutory provisions that are affected by their uses and limitations. See *In the Matter of Martin B., 17 Misc. 3d 198, 841 N.Y.S.2d 207 (2007); Gillett-Netting v. Barnhart, 371 F.3d 593 (9th Cir. 2004)* (Developing reproductive technology has outpaced federal and state laws, which currently do not address directly the legal issues created by posthumous conception). It is estimated that there are hundreds of thousands of cryopreserved embryos in the United States alone. Charles P. Kindregan, Jr. and Maureen McBrien, Assisted Reproductive Technology: A Lawyers Guide to Emerging Law and Science, at 219 § 7.1, n.1 (ABA 2006). These embryos can remain viable for as long as fifty years. *Id.* As technology continues to develop, thereby providing more and more people with opportunities to preserve sperm and embryos during illnesses and even after death, the legal questions surrounding the rights and interests of the resulting children become more complicated and less clearly defined. With the possibility of posthumous children come questions of parentage, intestate rights, testamentary interests, the effect on class gifts, and the entitlement to related interests, such as social security benefits.

For example, with regard to intestacy rights, most states fix ascertainable heirs as of the death of the decedent, and states include as ascertainable heirseither through statutory law or common lawthose children who were either born or in utero at the time of the decedents death. Such restrictions ensure the prompt and definitive administration of estates. However, now that procreation is so readily separated from coitus, and conception and birth may be significantly subsequent to the death of a biological parent, the purposes of state intestacy statutes and the interests affected by posthumous conception may become widely conflicted.

Such was the case is *Finley v. Astrue*. In *Finley*, the Plaintiff, Amy Finley, and her husband, Wade W. Finley, Jr., were married in 1990 and participated in the In Vitro Fertilization and Embryo Transfer (IVF/ET) Program at the University of Arkansas for Medical Sciences (UAMS). In June of 2001, doctors produced ten embryos using Ms. Finleys eggs and Mr. Finleys sperm. Two of the embryos were implanted and four were frozen for preservation. Ms. Finley subsequently suffered a miscarriage of the implanted embryos.

Mr. Finley died intestate in July of 2001. Less than a year later, Ms. Finley had two of the preserved embryos implanted in her uterus, which resulted in a single pregnancy. She gave birth to a child in March of 2003. In April of 2003, Ms. Finley filed a claim for childs insurance benefits based on Mr. Finleys earning history. The claims were denied. However, in June of 2006, an Administrative Law Judge awarded the benefits. In December of 2006, an Appeals Council reversed the ruling, and Ms. Finley appealed that decision to the United States District Court for the Eastern District of Arkansas. The District Court certified the issue to the Supreme Court of Arkansas.

(2) A Balance of Interests

Because the Arkansas General Assembly may not have contemplated the possibility of posthumous conception beyond that afforded by natural pregnancy and child birth, it leaves unprotected under intestacy laws an entire class of children who claim an interest in the deceased parents estate. As a result of advancing technologies that allow for such posthumously conceived children, courts and law makers must balance the conflicting interests that result from intestacy laws that do not specifically address or even consider the possibility of such technologies. These interests include the welfare of the posthumously conceived children, the States interest in administrative certainty and finality, as well as the interests of collateral relations to posthumously conceived children whose inheritance may be diminished by any intestate interests of after-born children.

(A) The Welfare of the Child. As a societal matter, once a child exists, it is a fundamental policy of law to provide for the welfare of the child. Historically, this is a hallmark of any legislative action concerning children, particularly with regard to financial support from parents. Generally, in all state intestacy schemes, there is a basic legislative intent to enable children to take property from and through their parents and ancestors as a result of death. More specifically, such interests include the equal inheritance rights of illegitimate, pretermitted, after-born, and even equitably adopted

children, regardless of the accident of their birth. *Woodward v. Comm. of Soc. Sec., 760 N.E.2d 257, 265 (Mass. 2002).* In addition to their interests in their parents estates, all such children have an interest in any future inheritance of the parents estates, as well as testamentary interests in their parents estates and intestate interests in the estates of collateral ancestors. Thus, the interests of posthumously conceived children are significant regardless of when their conception occurs, and these interests must be considered an overriding concern of law makers. Furthermore, states have encouraged and supported through legislation the development and advancement of such reproductive technologies. It follows, then, that law makers must provide for the children who are created as a result of the technologies that they promote.

(B) The States Interest in the Orderly Administration of Estates. The only limitation on providing for the child through intestacy is if such protection interferes with the rights of others or the orderly administration of estates. Many states fix ascertainable heirs at death because such designation provides certainty and finality to the probate of the estate and the heirs who will benefit from it. Estates cannot be held open indefinitely simply to allow for the possibility that a child may be posthumously conceived using the reproductive technologies now available. Heirs are entitled to the probate of estates within a reasonable time. However, to include posthumously conceived children within the intestacy scheme necessarily diminishes the intestate interests of the class of ascertainable heirs who are vested in the decedents estate by being born or in utero at the time of the decedents death, and it delays the distribution of their interests. Thus, the orderly, prompt, and definitive distribution of the estate provides an important legislative purpose behind intestate statutes that consider posthumously conceived children.

(C) The Parents Personal Interests in Reproductive Autonomy. A third consideration that the courts must balance in determining the purpose and scope of intestate statutes is the interest of each parent in reproductive autonomy. First, to limit inheritance rights of posthumously conceived children to those who were in utero at the time of the decedents death, or even within a limited period thereafter, necessarily requires the surviving spouse to decide to undergo assisted reproductive procedures and to bear a childand to do so successfullywhile consumed by the grief of the loss of her spouse. This is not a burden that intestacy statutes should provide. Furthermore, individuals have an interest in controlling the use of their gametes. Thus, the decedent spouse has an interest in the enforcement of his clearly expressed wishes that his biological child be born after his death and that his child inherit from his estate.

(3) Defining Intestacy Rights of Posthumously Conceived Children

To resolve the balancing of interests that must be considered in determining whether and to what extent intestacy statutes should include posthumously conceived children, some state legislatures have specifically addressed the issue by statute. For example, at one time, both Louisiana and North Dakota specifically provided that posthumously conceived children may not take through intestacy from a deceased parent. See La. Civ. Code Ann. art 939 (effective July 1, 1999) (West 2000) (A successor must exist at the death of the decedent.); N.D. Cent. Code Ann. § 14-18-04 (Michie 1997) (A person who dies before a conception using that persons sperm or egg is not a parent of any resulting child born of the conception). However, both jurisdictions now provide for the interests of such posthumously conceived children. See La. Stat. Ann. § 9:391.1(A) (2007) (any child conceived after the death of a decedent . . . shall be deemed the child of such decedent [as if] the child had been in existence at the time of the death of the deceased parent . . . [specific requirements omitted]); N.D. Cent. Code Ann. § 14-20-65 (Michie 1997) (including posthumously conceived child under specific conditions).

But in other jurisdictions that do not consider modern technologies or specifically account for such posthumously conceived children, courts are confronted with the limitation of antiquated statutory language. For example, under Arkansas law, a posthumous child may inherit from its deceased parent only if it is *conceived before* [the parents] death. Ark. Code § 28-9-210(a) (2007) (emphasis added). Thus, in *Finley v. Astrue*, the court was forced to determine whether a child who was created through in vitro fertilization during the parents marriage but implanted after the fathers death was conceived before the fathers death. Ms. Finley argued that her child was conceived as a zygoteprior to his fathers death. The Commissioner of the Social Security Administration, Michael Astrue, argued that the logical point of conception would be at the onset of pregnancy, or the successful implantation of an embryo in the womb, since this is

the generally accepted definition of the term in the medical community. *Finley v. Astrue, 2008 Ark. LEXIS 2* (Jan. 10, 2008**)** (quoting District Court certification order). But the court did not define when conception takes place. Instead, it simply noted that the General Assembly did not intend for the statute to permit a child, created through in vitro fertilization and implanted after the fathers death, to inherit under intestate succession. The court reasoned that because the intestacy statute was enacted in 1969, and the first birth resulting from in vitro fertilization did not occur until 1978, the statute could not apply to this scenario.

Likewise, in *Khabbaz v. Commr., Soc. Sec. Administration, 930 A.2d 1180 (N.H. 2007),* although the New Hampshire statute providing for intestate inheritance by surviving issue included children created by alternative means, the statute required that such children be alive or in existence at the time of the parents death to qualify as a surviving issue. Therefore, as in *Finley*, the court held that, under the strict language of the statute, posthumously conceived children are not included under the applicable intestacy law.

Arkansas and New Hampshire are not uniquely postured with regard to the issue of posthumously conceived children. In other states that do not expressly provide for posthumously conceived children to inherit through intestacy, the inheritance rights of these children are subject to the strict language of antiquated statutes that were drafted long before assisted reproduction methods were readily available and considered as affecting inheritance rights.

While these states leave an entire class of posthumously conceived children unprotected, many other states expressly provide for such children by relying on the express consent of the parents that any posthumously conceived children should inherit through intestacy after the death of one of the parents. See, e.g., Colo. Rev. Stat. § 19-4-106 (8) (2007) (requiring deceased parent to consent in record to being a parent of a posthumously conceived child); Del. Code Ann. tit. 13, § 8-707 (2007) (requiring consent in record); N.D. Cent. Code § 14-20-65 (2007) (requiring consent in record); Okla. Stat. tit. 84, § 228 (2007) (Posthumous children are considered as living at the death of their parents); Utah Code Ann. § 78-45g-707 (2007) (requiring consent in record); Wash. Rev. Code § 26.26.730 (2007) (requiring consent in record); Wyo. Stat. Ann. §14-2-907 (2007) (requiring consent in record). Other states may accommodate the deceased parents consent but may place more restrictive limits on the scope of such consent. See, e.g., Tex. Fam. Code Ann. § 160.707 (2007) (requiring consent in record kept by licensed physician and limited only to consent of spouse); Va. Code Ann. § 20-158 (2007) (requiring consent in record, but applying only to a spouse). In general, these states adopt and apply the perspective of the Uniform Parentage Act, § 707, which provides:

If an individual who consented in a record to be a parent by assisted reproduction dies before placement of eggs, sperm, or embryos, the deceased individual is not a parent of the resulting child unless the deceased spouse consented in a record that if assisted reproduction were to occur after death, the deceased individual would be a parent of the child.

Still other states may provide for consent by the parent but may place a time limit after the parents death by which the child must be implanted in utero or born. See, e.g., Cal. Prob. Code Ann. § 249.5 (2007) (requiring, among other things, consent in writing and that the child be in utero within two years of decedents death); La. Stat. Ann. § 9:391.1(A) (2007) (requiring that child be born within three years of the death of the decedent); Va. Code Ann. § 20-158(B), 20-164 (2007) (requiring that child be born not more than ten months after the death of a parent). In Florida, a posthumously conceived child is not eligible for a claim against a deceased parents estate unless the deceased parent specifically provides for such child in his or her will. See Fla. Stat. § 742.17 (2007). See also *Stephen v. Commr. of Soc. Sec., 386 F. Supp. 2d 1257 (Fla. 2005).* The Restatement (Third) of Property also provides for posthumously conceived children to inherit with the consent of the parents for class gift purposes. See Restatement (Third) Prop. (Wills & Don. Trans.) § 14.8 (T.D. No. 4, 2004).

Despite variations in application, all of these states specifically provide for the protection of posthumously conceived children by taking into account the capabilities of modern assisted reproductive technologies and the express wishes of the parents who utilize these technologies. Even in cases in which the state statute in question did not specifically provide for the protection of such children, courts have balanced the welfare of the posthumously conceived child against the interests in administrative certainty and timeliness, and have held that the childs interests must prevail,

especially when expressed via the consent of the parents.

For example, in *In re Estate of Kolacy, 753 A.2d 1257 (N.J. Super. 2000),* the court held that twin girls conceived by in vitro fertilization and born 18 months after their fathers death qualified as legal heirs for purposes of state intestacy laws. The court recognized that the relevant statute was enacted in 1981, at a time when reproductive technology had advanced to the point that it is conceivable that the legislature might have been aware of the kind of problem posed by [the] case, but the court held that, in fact, the legislative history supported the conclusion that the legislature was not giving any thought whatsoever to the kind of problem that was present in the case. *Id. at 1261*. Nevertheless, the court held that there is a basic legislative intent to enable children to take property from their parents and through their parents from parental relatives . . . and that the general intent should prevail over a restrictive, literal reading of statutes which did not consciously purport to deal with [this] kind of problem . . . . In balancing these interests against the orderly administration of the estate, the court held that

once a child has come into existence, she is a full-fledged human being and is entitled to all the love, respect, dignity and legal protection which that status requires. . . . [A] fundamental policy of law should be to enhance and enlarge the rights of each human being to the maximum extent possible, consistent with the duty not to intrude unfairly upon the interests of other persons.

Id. at 1263. See also *Gillett-Netting v. Barnhart, 371 F.3d 593 (9th Cir. 2004)* (considering Arizona illegitimacy and dependency laws). Thus, in balancing the interests, the court favored the protection of posthumously conceived children, regardless of how long after the parents death the children are born.

Likewise, in *Woodward v. Commr. of Soc. Sec., 760 N.E.2d 257 (2002),* the court considered an intestacy statute in the absence of any express legislative directive and balanced the interests in favor of the posthumously conceived children. The court held that

[p]osthumously conceived children may not come into the world the way the majority of children do. But they are children nonetheless. We may assume that the legislature intended that such children be entitled, in so far as possible, to the same rights and protections of the law as children conceived before death.

Id. at 266. The court held that [i]n the absence of statutory directives, we have answered the certified question by identifying and harmonizing the important state interests implicated therein in a manner that advances the Legislatures over-all purposes. *Id. at 272*. The court found that a posthumously conceived child may be entitled to inheritance rights when there is a genetic relationship between the child and the decedent, and the decedent affirmatively consents to the posthumous conception of the child and to the support of the child. *Id*.

The issue of the intestacy rights of posthumously conceived children also arose within the context of trust agreements in *In the Matter of Martin B., 17 Misc. 3d 198, 841 N.Y.S.2d 207 (2007).* In Martin B., the grantor, Martin B., was a life income beneficiary of seven trusts. He died on July 9, 2001, survived by a wife (Abigail), a son (Lindsay), and two adult grandchildren (Lindsays children). Martin B. also had a predeceased son, James, who died of Hodgkins disease in January of 2001. After learning of his illness, James cryopreserved his semen and provided that, in the event of his death, his semen was to be held subject to the directions of his wife (Nancy). At his death, James and Nancy had no children. However, three years after James died, Nancy underwent in vitro fertilization with James cryopreserved sperm and gave birth to a son (James Mitchell) in October of 2004. Nancy underwent the same procedure again and, two years later, in August of 2006, Nancy gave birth to another son (Warren).

The trusts gave the trustees discretion to give principal to Martin B.s issue during Abigails life and, upon Abigails death, to distribute the principal, as directed by Abigail under a special power of appointment, to Martin B.s issue or descendants. The trustees brought the proceeding to determine if James Mitchell and Warren qualified under the beneficiary classes.

The court in *Martin B.* recognized that the legal complexities arising out of advancing reproductive technologies

have been predicted for more than three decades. *Martin B., 841 N.Y.S.2d at 208-09* (citing *Matter of Anonymous, 74 Misc. 2d 99, 345 N.Y.S.2d 430 (1973))* and that, during this time, there has been an evolution of the States public policy toward eliminating the distinction between marital and non-marital children in determining family rights. *Id. at 209*. Yet the court recognized that earlier statutes that were enacted when human reproduction was natural, consistent, and predicted, do not fit the needs of the more complex modern era. Thus, in another case in which the court was left with no legislative direction on the issue, the court in *Martin B.* balanced the interests involved and held that, even when the inclusion of posthumously conceived children may not have been contemplated, where a governing instrument is silent, children born of this new biotechnology with the consent of their parents are entitled to the same rights for all purposes as those of a natural child. *Id. at 211*.

(4) A Call for Reform

Many courts confronted with the burden of balancing all the interests associated with intestacy statutes that do not specifically provide for posthumously conceived children have placed the burden on law makers to amend intestacy statutes. The *Kolacy* court, for example, recognized that

it is now possible to preserve the viability of human genetic material for as long as ten years. It is likely that the time will be extended in the future. The evolving human productive technology opens up some wonderful possibilities, but it also creates difficult issues and potential problems in many areas. It would undoubtedly be useful for the Legislature to deal consciously and in a well informed way with at least some of the issues presented by reproductive technology.

Kolacy, 753 A.2d at 1262.

Likewise, the court in *Woodward* noted that

As these technologies advance, the number of children they produce will continue to multiply. So, too, will the complex moral, legal, social, and ethical questions that surround their births. The questions presented in this case cry out for lengthy, careful examination outside the adversary process, which can only address the specific circumstances of each controversy that presents itself. They demand a comprehensive response reflecting the considered will of the people.

Woodward, 760 N.E.2d at 272. See also *Khabbaz, 930 A.2d at 1186* (We reserve such matters of public policy for the legislature); *Martin B., 841 N.Y.S.2d at 212* ([T]here is a need for comprehensive legislation to resolve the issue raised by advances in biotechnology).

In *Finley v. Astrue*, the court strictly applied the antiquated language of Arkansas posthumous heir statute. The court held that, as a matter of public policy, the issue of posthumous conception resulting from assisted reproductive technology lies almost exclusively with the legislature. *Finley v. Astrue, 2008 Ark. LEXIS 2* (Jan. 10, 2008). Accordingly, the court urged that [w]ith this in mind, we strongly encourage the General Assembly to revisit the intestacy succession statutes to address the issues involved in the instant case and those that have not but will likely evolve. *Id*. at *17.

Finley v. Astrue, then, stands as a call to all law makers that have not yet expressly provided for the possibilities that modern technologies bring, to reform their perspectives on posthumous conception and expressly provide for the inheritance rights of all children.

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Flannery on State Bar of California on Professional Responsibility and Conduct

2008 Emerging Issues 2061

Flannery on State Bar of California on Professional Responsibility and Conduct

By Michael Flannery

May 6, 2008

SUMMARY: Professor Michael T. Flannery comments on the formal opinion of the State Bar of California Standing Committee on Professional Responsibility and Conduct, which provided that an attorney who retains a clients will or estate planning document, but who cannot locate the client, may not register the clients information with a commercial will registry without the clients consent, unless the attorney can determine, based upon knowledge of the client, the clients matter, and investigation of the will registry, that registration will not violate the attorneys fiduciary duties of confidentiality and competence.

PDF LINK: Click Here for Enhanced PDF of Commentary

ARTICLE: The State Bar of California Standing Committee on Professional Responsibility and Conduct issued a Formal Opinion providing that an attorney who retains a clients will or estate planning documents, but who cannot locate the client, may not register the clients information with a commercial will registry without the clients consent, unless the attorney can determine, based upon knowledge of the client, the clients matter, and investigation of the will registry, that registration will not violate the attorneys fiduciary duties of confidentiality and competence. It also precluded an attorney from depositing a clients will or other estate planning documents in a private will depository without the clients consent.

Attorneys in California and in other jurisdictions that employ a will registry system or will depository program are advised to act responsibly and to fully consider all applicable state laws, as well as ethical and professional conduct considerations, before utilizing such resources without a clients consent. In jurisdictions in which a will registry system is employed, attorneys might consider obtaining a clients consent to use a will registry when the will is executed, to avoid future dilemmas if the client is not able to be located to offer consent. Of course, even with consent, attorneys must evaluate whether use of a will registry is in the clients best interest. States that do not employ a registry system should consider statutorily providing for them and clearly defining the scope of their use.

(1) A Hypothetical Consideration

In 1990, Attorney A drafted a will for Client C. A and C agreed that A would retain the executed original of Cs will

for safekeeping. A and C have no further contact. In 2008, A opts to retire from the practice of law. A wishes to terminate the deposit of Cs Will. A makes all reasonable efforts to contact C, to no avail. A has maintained no notes recording her original meeting with C and has no independent recollection of any part of their conversation from 1990. In an effort to ensure that C has access to her will, or, in the event of Cs death, that Cs heirs are able to locate the will, A considers depositing Cs original will with a private will depository and registering specific information about Cs will with a private will registry.

It is likely that every attorney who drafts wills has retained on deposit an original copy of a former clients will or other estate planning documents. Upon discontinuing the practice of law, any such attorney has an ethical duty to make reasonable efforts to contact the former client and to dispose of the documents according to the lawful instructions of the client. However, when the attorney is unable to locate the former client, these duties become impractical. Under such circumstances, the availability of online attorney will registries and will depositories represent inviting solutions to the dilemma of fulfilling the best interests of unavailable former clients. However, the State Bar of California Standing Committee on Professional Responsibility and Conduct considered this precise fact scenario and determined that, under such conditions, it is unethical for an attorney to use a will registry or will depository without the express consent of the client, unless the attorney can demonstrate, based upon knowledge of the client, the clients matter, and investigation of the will registry or depository, that using such resources will serve the interests of the client and not violate the attorneys fiduciary duties.

(2) Will Registries and Will Depositories, Generally

With the advent of readily available online legal resources, will depositories and will registries have become popular commercial resources for private individuals and attorneys. Will depositories are private, online resources for storing, locating, and retrieving original wills or estate planning documents. Such documents are actually deposited with the depository, where they are maintained for safekeeping. A will registry is an online searchable database that retains pertinent information about a will, such as the testators name, social security number, address, date of birth, and place of birth, as well as information relating to the will, such as the date of execution, the identity of the lawyer who drafted the will, and the location of the original executed will at the time of registration. The information may be accessed by the general public, or a state may place restrictions on who may be authorized to access the information.

The advantages of will registries and will depositories are several. Legal documents have no legal effect if they cannot be located. Will registries allow persons with an interest in a decedents estate to determine if there may be a valid will in existence that was not otherwise made known, and they provide the opportunity to locate the relevant documents regarding the estate. In this respect, will registries may now add to the available resources by which parties must satisfy the burden of due diligence in determining the appropriate disposition of ones estate, as well as to notify beneficiaries of their potential interests and to validate legally effective documents against competing documents. In addition, in cases such as the one described in the above hypothetical, it affords an attorney an opportunity to possibly carry out a clients best interests when confronted with former clients who cannot be located or the need to discontinue the practice of law. Despite these and other advantages, however, there are ethical and legal limitations to an attorneys use of these resources.

(3) Attorneys, Act at Your Own Peril!

Despite the advantages of these resources, the State Bar of California has advised that, under the circumstances described above, it is unethical for an attorney to use such resources without a clients consent unless it can be shown that use of such resources is in the clients best interest and does not violate the attorneys fiduciary duties. The State Bar takes its position for two reasons: (1) depositing such documents with a commercial will depository without consent would violate California law, see Cal. Bus. & Prof. Code § 6068(a) (requiring lawyers to support the laws of the state and to perform legal services competently); see also State Bar of Cal. Rules of Prof. Conduct § 3-110; and (2) registering a clients information with a will registry without consent may violate the attorneys ethical duty of confidentiality, see *Evidence Code § 912(d)* (regarding duty of confidentiality).

(A) California Probate Code. Under California probate law, once an attorney retains on deposit a clients will or other estate planning documents, he or she may terminate the deposit in accordance with the clients lawful wishes. Absent evidence of the clients wishes, California law requires that attorneys use ordinary care for preservation of the document . . . and . . . hold the document in a safe, vault, safe deposit box, or other secure place where it will be reasonably protected against loss or destruction. Cal. Prob. Code Ann. § 710**.** Once an attorney accepts the deposit of a clients will, the attorney may terminate the deposit only in accordance with state law**.** Id. at § 730. With regard to the allowable methods by which an attorney may terminate a will deposit, California law provides:

An attorney may terminate the deposit by one of the following methods:

(a) Personal delivery of the document to the depositor.

(b) Mailing the document to the depositors last known address, by registered or certified mail with return receipt requested, and receiving a signed receipt.

(c) The method agreed on by the depositor and attorney.

Id. at § 731.

If the attorney mails notice to reclaim the will to the clients last known address and the client fails to reclaim the will within 90 days, the attorney may terminate the deposit by transferring the will to another attorney. Id. at § 732(a)-(b); see also § 733 (regarding notice of transfer). Likewise, if the attorney dies, lacks capacity, or no longer practices law, the will may be transferred to the clerk of the superior court of the county where the client was last domiciled. Id. at § 732(c); see also § 735 (allowing for termination by other representative if attorney has died or is incapacitated)**.** If the attorney knows that the client has died, the attorney may terminate the deposit by personal delivery of the will to the clients personal representative. Id. at §§ 731(f) & 734(a). Thus, California law makes no allowance for the deposit of any such documents with a will depository absent the express consent of the client. Additionally, Cal. Prob. Code § 732 provides that when a will is transferred to another attorney, the transfer does not waive or breach any privilege or confidentiality associated with the will, nor does it violate the rules of professional conduct. Because these protections are expressly retained in the statute with respect to transfer, they likewise would be retained if the documents were deposited or registered with a private depository or registry. Therefore, although an attorney is bound by the limitations of state laws regarding the termination of deposits of wills, even if state law specifically provided for will registries and will depositories to be used as resources, without a clients consent, such use would still be limited by the attorneys fiduciary duty of confidentiality.

(B) Duty of Confidentiality. Even if a state provides for the use of a will registry or will depository within its statutory probate scheme, attorneys must be mindful of the confidentiality ramifications of depositing a clients will with a public registry without the clients consent. In its formal opinion, the State Bar of California determined that because of the nature of the information that is disclosed when someone registers a will with a registry system, the disclosure of such identifying informationalthough probably not privileged in most contextsmay reveal the nature of the clients legal matters for which the attorney was retained and, therefore, may be considered privileged. Like the evidentiary attorney-client privilege and physician-patient privilege, the attorneys ethical duty of confidentiality is fundamental to the attorney-client relationship. See Cal. Bus. & Prof. Code § 6068(e)(1).

The State Bar of California recognizes an exception to the prohibition of disclosing a clients identifying information in a will registry without the clients consent when the attorney can assess that such disclosure may advance the clients interests. It may be the case that making the information available to potential beneficiaries and heirs is conducive to the clients wishes and estate planning goals. However, attorneys must also consider that disclosure of even general information may prompt contest from disappointed heirs and contention among family and friends. The attorney must be able to assess this from his or her knowledge of the client, review of the clients file, recollection of communications with the client, the nature of the clients legal matters, and investigation of the registry in which the

information may be disclosed. In light of the attorneys fiduciary obligation to maintain confidentiality and the circumstances that would bring an attorney to consider relying on such resources without the express consent of the client, which often includes a significant lapse in time, prudence dictates that attorneys err on the side of caution and act within the limits of the applicable probate provisions and ethical rules when considering the safekeeping of validly executed wills.

(4) Other Jurisdictions

Although the State Bar of Californias formal opinion on the issue of the use of will registries and will depositories is purely advisory and is not binding upon California courts or any members of the California State Bar, its warning that attorneys act at their own peril in these matters is sound advice, not just for California attorneys, but for all attorneysparticularly those in other states, like Idaho and New Jersey, for example, where the use of will registries is statutorily provided for, see Idaho Code Ann. § 15-2-101 (The secretary of state shall create and maintain a will registry . . . [which] shall include: the full name of the person making the will; the date the will was made; and sufficient identification of the location of the will at the time of registration); N.J. Stat. Ann. § 3B:3-2.1 (The Secretary of State shall create and maintain a will registry in which his testator or his attorney may register information regarding the testators will), and in New York, where the use of such resources is being considered, see N.Y. Sen. 659, 2007-08 (Jan. 5, 2007) (Each county shall establish and maintain a registry of wills and codicils . . . [which] shall be available for public inspection . . . .). One version of the proposed New York law provides that the statute would apply only to the attorneys of persons who create wills, not to the individual makers of wills. See N.Y. A. 1289 (Jan. 9, 2008). Louisiana also statutorily provides for use of a will registry system, but specifically requires a clients consent before an attorney may use it for his or her client. See La. Stat. Ann. § 9:2446 (2007) (The secretary of state shall establish a registry in which a testator, or his attorney, *if authorized by the testator to do so*, may register information regarding the execution of the testators will) (emphasis added).

In a separate but related context, there are fourteen jurisdictions that have adopted some version of the Uniform International Wills Act, see Unif. *Prob. Code § 2-1001* (1990), which specifically provides for requirements for the execution of international wills; these jurisdictions are: California, Colorado, Connecticut, Delaware, the District of Columbia, Illinois, Michigan, Minnesota, Montana, New Hampshire, New Mexico, North Dakota, Oregon, and Virginia. All fourteen of these jurisdictions provide for the attorney to ask the testator if he or she wishes to make a declaration concerning the safekeeping of the international will, and all provide for a certification of such a declaration, see Cal. Prob. Code Ann. §§ 6383 & 6384 (2007); Colo. Rev. Stat. §§ 15-11-1005 & -1006 (2007); Conn. Gen. Stat. §§ 50a-4 & 50a-5 (2007); Del. Code Ann. tit. 12, §§ 254 & 255 (2008); D.C. Code Ann. §§ 18-704 & -705 (2008); 10 Ill. Comp. Stat. Ann. §§ 4 & 5 (2007); Mich. Stat. Ann. §§ 700.2954 & 700.2955 (2008); Minn. Stat. §§ 524.2-1004, subd. 3 & 524.2-1005 (2007); Mont. Code Ann. §§ 72-2-904 & -905 (2007); N.H. Rev. Stat. Ann. §§ 551-A:4 & 551-A:5 (2007); N.M. Stat. Ann. §§ 45-2-1004 & -1005 (2008); N.D. Cent. Code §§ 30.1-08.2-04 & -05 (2007); Or. Rev. Stat. §§ 112.232(4)c) & 112.232(5) (2007); Va. Code Ann. §§ 64.1-96.5 & 64.1-96.6 (2007). However, eight of the fourteen jurisdictions expressly provide for the use of a registry system with regard to the disposition and safekeeping of international wills, see Cal. Prob. Code Ann. § 6389 (2007); D.C. Code Ann. § 18-710 (2008); 10 Ill. Comp. Stat. Ann. § 10 (2007); Minn. Stat. § 524.2-1010 (2007); Mont. Code Ann. § 72-2-909 (2007); N.M. Stat. Ann. § 45-2-1010 (2008); N.D. Cent. Code § 30.1-08.2-09 (2007); Va. Code Ann. § 64.1-96.11 (2007). Despite specific provisions authorizing the use of registry systems for international wills in these jurisdictions, attorneys and other individuals authorized to participate in the execution of international wills must be mindful of the same considerations addressed by the State Bar of California respecting the disposition of standard statutory wills.

(5) Conclusion

When considering the safekeeping of wills via will depository and will registry, especially for clients who have not expressly consented to a specific disposition for their documents, attorneys must be mindful of their legal obligation to act competently by following the applicable state law with respect to the termination of deposits of wills, and by fully considering and protecting the confidentiality of a clients personal information, which in specific contexts, may be

deemed privileged. Attorneys are encouraged to address these issues with their clients at the time that they are availablewhen executing their willsand perhaps obtain the clients consent to utilize registry and depository programs for the safekeeping of documents if the attorney determines at a later time that such resources will serve the clients best interests.

States legislatures should also consider the benefits of will registry and will depository programs. If such programs are permitted or implemented, they should require attorneys to obtain a clients consent before using such resources, and they should clearly set out the scope of protections afforded for the confidentiality of all information and documents that are disclosed.

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Harkness on Documentation of U.S. Citizenship under Deficit Reduction Act

2008 Emerging Issues 2048

Harkness on Documentation of U.S. Citizenship under Deficit Reduction Act

By Donna S. Harkness

May 5, 2008

SUMMARY: Donna S. Harkness, Associate Professor of Clinical Law at the University of Memphis Cecil C. Humphreys School of Law, comments on the The Deficit Reduction Act of 2005, which enacted burdensome citizenship documentation requirements for those seeking to either apply or recertify for eligibility for Medicaid benefits.

PDF LINK: Click Here for Enhanced PDF of Commentary

ARTICLE: Cite as: Harkness, Donna S. Documentation of United States Citizenship under the Deficit Reduction Act and Applicable Regulations. LexisNexis Expert Commentary, *(Insert date you accessed the document online).*

Initial regulations promulgated pursuant to the authority granted by the Deficit Reduction Act suggested stringent documentation requirements for those applying for Medicaid benefits, even those applicants asserting status as United States. Unexpected difficulties encountered by elderly Medicaid beneficiaries in attempting to provide documentation of citizenship led to amendment of the law to exempt those already receiving SSI and/or Social Security disability benefits from the requirements of documentation as a condition of Medicaid eligibility.

(1) Initial Regulations Found At *71 FR 39214* (Wednesday, July 12, 2006). Tight budgets and the perceived influx of noncitizens applying for and receiving public benefits led to passage in the mid-1990s of the *Personal Responsibility and Work Opportunity Reconciliation Act of 1996, 104 P.L. 193, 110 Stat. 2105* (Aug. 22, 1996), which restricted eligibility of SSI benefits to only those aliens that were lawfully residing within the United States and already receiving benefits as on August 22, 1996. *8 U.S.C.S. §1612(a)(2)(E).* Noncitizens applying for public benefits have always been required to produce documentation of the legality of their status since the passage of the *Immigration Reform and Control Act of 1986, P.L. 99-603, 100 Stat. 3359* (Nov. 6, 1986). Nevertheless, those claiming to be United States citizens did not previously have to produce any similar documentation to verify their status. With the enactment of the *Deficit Reduction Act of 2005, P.L. 109-171, 120 Stat. 4* (Feb. 8, 2006), such verification was mandated, beginning July 1, 2006. *See 42 U.S.C.S. §1396b(x)(1).* The *DRA* did exempt from the documentation requirements any alien who is eligible for medical assistanceand is entitled to or enrolled for benefits by reason of being eligible for SSI. *42 U.S.C.S. §1396b(x)(2)(A) & (B).* In attempting to make sense of this exemption for purposes of promulgating regulations, the Centers for Medicare and Medicaid Services, United States Department of Health and Human Services concluded that the Congressional reference to aliens in the statutory language made no sense within the statutory

context of verifying citizenship, as aliens have no citizenship status to verify. *71 FR 39215-16.* CMS therefore exempted all those persons who were either receiving Medicaid by virtue of their eligibility for SSI or Social Security disability from the necessity of proving their citizenship. *71 FR 39216.*

The types of documentation that would be considered satisfactory documentary evidence of citizenship or nationality are spelled out in the statute. Primary evidence of citizenship includes the following: a U.S. passport, *42 U.S.C.S. §1396b(x)(3)(B)(i)*; a Certificate of Naturalization, *42 U.S.C.S. §1396b(x)(3)(B)(ii)*; a Certificate of United States Citizenship, *42 U.S.C.S. §1396b(x)(3)(B)(iii)*; a valid State drivers license, if the state requires proof of U.S. citizenship and verification of Social Security number prior to issuance of the license, *42 U.S.C.S. §1396b(x)(3)(B)(iv).* Secondary level evidence would include things like an American birth certificate, *42 U.S.C.S. §1396b(x)(3)(C)(i)*; a Certification of Birth Abroad, *42 U.S.C.S. §1396b(x)(3)(C)(ii)*; a United States Citizen Identification Card, *42 U.S.C. §1396b(x)(3)(C)(iii)*; or a Report of Birth Abroad of a Citizen of the United States, *42 U.S.C. §1396b(x)(3)(C)(iv).* In addition to the statutorily enumerated documents, Congress also directed the Centers for Medicare and Medicaid Services, U.S. Department of Health and Human Services, to promulgate regulations establishing alternative means of documenting citizenship. The regulations add identification cards from the Northern Mariana Islands, *71 FR 39223, 42 CFR §435.407(b)(6)*; American Indian Cards, *71 FR 39223, 42 CFR §435.407(b)(7)*; a final decree of adoption stating both the name of the child and the place of birth within the United States, *71 FR 39223, 42 CFR §435.407(b)(8);* evidence of employment in the U.S. Civil Service prior to June 1, 1976, *71 FR 39223, 42 CFR §435.407(b)(9);* and production of a U.S. Military Record documenting a place of birth in the United States, *71 FR 39223, 42 CFR §435.407(b)(10).*

An individual producing secondary evidence of citizenship must also provide documentation to verify his or her identity. *42 U.S.C.S. §1396b(x)(3)(A)(ii).* Proper identification includes a state drivers license or state issued identification card with a photo or identifying description, school photo identification, U.S. military identification, and other documents of identity acceptable to the U.S. Department of Homeland Security (Immigration and Naturalization) as indicated at *8 CFR §274a.2(b)(1)(v)(B)(1). See 71 FR 39224, 42 CFR §435.407(e)(1) (10).*

In the absence of either primary or secondary evidence of citizenship, third level evidence of citizenship could be produced and relied upon in the event that primary evidence could not be acquired within a reasonable period of time and secondary evidence either did not exist or could not be acquired. *71 FR 39223, 42 CFR §435.407(c).* Third level evidence of citizenship could include such things as a hospital or insurance record, at least five years old, establishing a U.S. place of birth. *71 FR 39223-24, 42 CFR §435.407(c)(1) & (2).* Finally, a fourth level of citizenship, to be used only as a last resort, might include such things as the census records, statement of a midwife or physician in attendance at the persons birth, records from a nursing home or other institutional facility, medical records at least five years old indicating an American birthplace, and lastly, affidavits of two persons, one of whom is not related to the applicant, and both of whom can establish citizenship themselves and have personal knowledge of the events documenting the applicants citizenship. *71 FR 39224, 42 CFR §435.407(d)(1) (5).*

As can be imagined from the foregoing, establishment of proof of citizenship for those in greatest need of medical assistance benefits could be expected to be the most difficult. Those applicants for benefits that were elderly, poor, illiterate and from a minority group were among those likely not to have passports, certificates of citizenship, or birth certificates and drivers licenses. As a consequence, when the policy first went into effect, those who were undeniably American citizens were being deprived of benefits to which they were entitled because of the new citizenship documentation requirement. *See* Robert Pear, *Lacking Papers, Citizens Are Cut From Medicaid*, N.Y. Times, Section A, col. 6, National Desk, p.1 (March 12, 2007). Although the intent of the legislation was ostensibly to prevent payment of medical assistance benefits to those lacking citizenship status, the new law really operated to deprive American citizens of medical assistance. *Id.* Despite the legislative furor, there simply was no proof of widespread fraud being committed by illegal immigrants, for the simple reason that such persons would lack all indicia of citizenship and are distrustful of government intrusion that might result in discovery of their illegal status and consequent deportation. *See* Jacob Press, *Poor Law: The Deficit Reduction Act: Citizenship Documentation Requirement for Medicaid Eligibility*, *8 U. Pa. J. Const. L. 1033, 1043 (2006).* It is therefore arguable, at least, that the imposition of such an onerous

verification requirement on those who are clearly eligible for benefits would not even pass constitutional muster under the minimal rational basis test required to support legislative action under the Fifth and Fourteenth Amendment Due Process clauses and the Equal Protection Clause of the Fourteenth Amendment. *Id. at 1053*.

(2) Subsequent Enactment of Trhca. In any event, with the passage of the *Tax Relief and Health Care Act (TRHCA), 109 P.L. 432, 120 Stat. 2922* (December 20, 2006), Congress corrected several drafting errors in the DRA and amended the statute to exempt all those receiving SSI from the requirements of citizenship documentation (and not just those that obtained Medicaid benefits due to their SSI eligibility). Congress also amended the statute to exempt persons receiving Social Security disability benefits and those in foster care. These new amendments were incorporated into new regulations issued at *72 FR 38662* (Friday, July 13, 2007).

Conclusion. The *Deficit Reduction Act of 2005* enacted burdensome citizenship documentation requirements for those seeking to either apply or recertify for eligibility for Medicaid benefits. Regulations promulgated at *71 FR 39214* relieved those who were eligible for Medicaid by virtue of SSI eligibility or who received Social Security disability from the requirements of documenting citizenship. These exemptions were subsequently enacted into law with the passage of the *TRHCA.*

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Carey on Deduction for Non-U.S. Citizen Spouses -- Qualified Domestic Trust

2008 Emerging Issues 2049

Carey on Deduction for Non-U.S. Citizen Spouses -- Qualified Domestic Trust

By James L. Carey

May 5, 2008

SUMMARY: Professor James L. Carey, Assistant Professor at the Auburn Hills Campus of the Thomas M. Cooley Law School, comments on the benefits of a Qualified Domestic Trust (QDOT) to a non-citizen spouse, under the right circumstances and with proper planning. When dealing with foreign nationals or resident aliens, the QDOT may be an important consideration for effective estate planning.

PDF LINK: Click Here for Enhanced PDF of Commentary

ARTICLE: Cite as: Carey, James L. Securing the Material Deduction for Non-U.S. Citizen Spouses the Qualified Domestic Trust (QDOT). LexisNexis Expert Commentary, *(Insert date you accessed the document online)*.

When immediate citizenship is not a possibility, a well-crafted estate plan for a non-citizen may involve a trust that meets the requirements of a Qualified Domestic Trust (QDOT). While the requirements are legion, delaying estate tax for a non-citizen surviving spouse may be a valuable estate planning tool. Be sure to consider the QDOT if you are advising foreign nationals or resident aliens.

The Internal Revenue Code of 1986, as amended (IRC), generally provides for an unlimited marital deduction the gross estate of a decedent is reduced by the value of all property that passes to the spouse of the decedent *unless the spouse is not a United States citizen* (*IRC § 2056*(a and d)). The citizenship of the decedent is immaterial. The unlimited marital deduction is effectively eliminated if the spouse is not a U.S. citizen unless specific planning is done before or shortly following death. If the surviving spouse is a resident of the U.S. at the time of decedents death, then the martial deduction will be available if such spouse becomes a U.S. citizen before the decedents tax return is filed (*IRC § 2056(d)(4)*). Citizenship for the surviving spouse is clearly the best way to secure the material deduction, but citizenship may not be an easy task to accomplish in a timely manner. A more practical estate planning solution may be to use a qualified domestic trust (QDOT).

The QDOT does not have to be a separate or distinct trust, and there may be more than one trust that qualifies. A QDOT can be any trust that meets the QDOT requirements. Trusts that meet the QDOT requirement will enable the decedents estate to utilize, for a time, the unlimited material deduction for all assets that pass to the QDOT for the lifetime benefit of the decedents spouse. The QDOT does not eliminate the estate tax burden attached to these assets, nor does it transfer such burden to the surviving spouse when the surviving spouse dies. Rather, the QDOT is a method

whereby decedents estate taxes can be delayed while the surviving spouse enjoys lifetime income.

Principal distributions from the QDOT will be subject to tax at the rates applicable to the decedents estate unless the principal distribution is for hardship reasons. This is true whether the principal distribution occurs during the lifetime of the surviving spouse or at the surviving spouses death. Therefore, practitioners should view the QDOT as a means of delaying estate taxes otherwise due through the decedents estate while recognizing that principal may escape estate tax completely if hardship distributions may be made. Even if the federal estate tax is abolished, estate taxes will still be due on principal distributions (other than for hardships) from a QDOT through December 31, 2020.

Hardship distributions may be made from the QDOT in response to an immediate and substantial financial need relating to the spouses (or a person whom the spouse is legally obligated to support) health, maintenance, education or support. If other assets are reasonably available to the surviving spouse, then the distribution may lose its hardship character. Liquid assets that are directly owned by the surviving spouse will often be considered reasonably available. Illiquid assets generally will not need to be utilized. In addition to discussions regarding hardship distributions in *26 CFR 20.2056A-5*, hardship distributions are also provided in connection with retirement vehicles (IRAs, 401(k)s, etc.) which may be useful in formulating arguments regarding permitted hardship distributions.

Combining the statutory and regulatory requirements for QDOTs found in *IRC § 2056A* and *26 CFR 20.2056A-1 et seq*., practitioners should be certain to address the following major issues when seeking to utilize the martial deduction for non-citizen, surviving spouses.

Timing. The trust seeking to be qualified as a QDOT may be formed by the decedent prior to death, through the decedents will, or by the surviving spouse following the decedents demise. The trust must elect QDOT treatment and, once made, the election is irrevocable. The election must be made on the last federal estate tax return filed before the due date (including extensions of time to file actually granted) or, if a timely return is not filed, on the first federal estate tax return filed after the due date.

Trustee Requirements. The trust must require at least one trustee be a U.S. citizen or domestic corporation (the U.S. Trustee) and that no distribution of trust principal may be made unless the US Trustee has the right to withhold from the distribution the applicable estate tax. Due to the many QDOT requirements, practitioners should generally provide the trustees with broad rights of reformation specifically granted to ensure that the trust complies with the QDOT regulations. The US Trustee is ultimately responsible for the payment of any estate tax due and the filing of the annual report on IRS Form 706-QDT.

Transfer of Property from Decedent to Trust. If property passes from the decedent to the QDOT, the trust must qualify for the federal estate tax marital deduction under § 2056(b)(5) (life estate with power of appointment), § 2056(b)(7) (qualified terminable interest property, including joint and survivor annuities), or § 2056(b)(8) (surviving spouse is the only non-charitable beneficiary of a charitable remainder trust), or meet the requirements of an estate trust as defined in *26 CFR 20.2056(c)-2(b)(1)(i)* through (iii).

Transfer of Property from Decedent to Surviving Spouse to Trust. If property does not pass from the decedent directly to the QDOT, the surviving spouse must either actually transfer the property, or irrevocably assign the property, to the QDOT. This must be accomplished prior to the filing of the estate tax return for the decedents estate AND on or before the last date that the QDOT election may be made. If an irrevocable assignment is used, the property must

actually be transferred to the QDOT prior to completion of the decedents estate administration.

Nontransferable Property. The surviving spouse may have interests in retirement funds, or other plans or annuities, where assignment of the property or payments is prohibited. Such assets may still qualify as QDOT property for purposes of estate taxation if the surviving spouse either executes an irrevocable agreement to remit estate tax on the principal portion of each such payment, or pays into the QDOT the principal portion of each such payment as received.

Governing Law of the Trust. The trust must be governed by the laws of a U.S. state or the District of Columbia. Foreign trusts may be used provided that the foreign trust designates the law of a particular U.S. state (or the District of Columbia) and, in most cases, that the records of the trust (or copies thereof) are kept in the designated U.S. state (or the District of Columbia). The trust must also be an ordinary trust, generally considered as a trust where the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit. *See 26 CFR 20.2056A-2(a)* and *26 CFR 301.7701-4*.

Bond Requirement. If the QDOT assets are in excess of $2 million, the US Trustee must provide a bond or irrevocable letter of credit equal to 65% of the fair market value of the trust assets, determined without regard to indebtedness. This same bond or letter of credit is required if the QDOT has assets of $2 million or less, but more than 35% of such assets are real property located outside of the United States. The bond is not required if at least one US Trustee is a US bank or trust company as defined in *IRC § 581*.

While the requirements are legion, the benefits may be considerable to the non-citizen spouse under the right circumstances and with the proper planning. When dealing with foreign nationals or resident aliens, the QDOT may be an important consideration for effective estate planning.

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Hellwig on Bona Fide Sale Exception to 26 USCS § 2036(a) in Estate of Bigelow

2008 Emerging Issues 2051

Hellwig on Bona Fide Sale Exception to 26 USCS § 2036(a) in Estate of Bigelow

By Brant Hellwig

May 5, 2008

SUMMARY: Professor Brant Hellwig, Associate Professor of Law at the University of South Carolina School of Law, comments on the decision of the Ninth Circuit in Estate of Bigelow v. Commissioner, in which the court undertook a critical inquiry of the purported non-tax benefits of the partnership to determine if they constituted an actual motivation for the decedent to transfer assets to the entity.

PDF LINK: Click Here for Enhanced PDF of Commentary

ARTICLE: Cite as: Hellwig, Brant. The Ninth Circuits Interpretation of the Bona Fide Sale Exception to § 2036(a) in *Estate of Bigelow v. Commissioner*. LexisNexis Expert Commentary, *(Insert date you accessed the document online)*.

In *Estate of Bigelow v. Commissioner, 503 F.3d 955, 2007 U.S. App. LEXIS 22030, 2007-2 U.S. Tax Cas. (CCH) 60,548 (9th Cir. 2007),* the Ninth Circuit became the latest Circuit Court of Appeals to interpret the application of § 2036(a) in the family limited partnership context. Most of the recent cases in this area turn on whether the formation of the entity satisfies the parenthetical exception to § 2036(a). The critical inquiry thus has become whether the contributions of property by the decedent (and other partners) in exchange for beneficial interests in the partnership constitute a bona fide sale for an adequate and full consideration in money or moneys worth. As discussed below, the Ninth Circuit adopted a critical approach to this inquiry.

Factual Setting. Like many cases the Service selects to litigate in the family limited partnership context, *Estate of Bigelow* contained a number of traditional bad facts. After suffering a debilitating stroke and moving into an assistant living facility, the decedent (through her revocable trust of which her son was co-trustee) transferred residential rental real estate valued at $1.45 million to a limited partnership. In return, the decedents revocable trust took back a 1% interest as the sole general partner and a roughly 98% interest as limited partner. The decedents children each contributed $100 for the remaining limited partnership interests. Although the partnership had not assumed liability for the decedents loan that was secured by the partnership property, the partnership used its rental income to make the $2,000 monthly payment on her behalf. Furthermore, after the decedents long-term care policies expired, the partnership made distributions to finance the decedents living expenses. No distributions were made to the other partners (who had acquired significant partnership interests by way of gift), and the partnership formalities were not respected. The decedent died owning a 1% interest as general partner and a 45% interest as limited partner, which the estate valued through the application of a 37% valuation discount.

Retention of Beneficial Enjoyment. In simplified terms, § 2036(a) pulls back into the decedents gross estate property which the decedent transferred during lifetime but retained either (1) the possession or enjoyment, or the right to income from the transferred property, or (2) the right to designate who will possess or enjoy the property or the income it generates. Like most § 2036 cases in the family limited partnership context, the Service asserted that the decedent had retained the beneficial enjoyment of the property she transferred to the partnership under § 2036(a)(1). The Service pointed to the partnerships use of income to pay the decedents personal loan, the use of partnership funds to cover the shortfall in the decedents living expenses, and the existence of an implied agreement that the children would sell the partnership property if necessary to generate cash for their mother. Not surprisingly, the Tax Court agreed and the Ninth Circuit affirmed on this basis.

Practice Tip. Individuals using family limited partnerships should not transfer the vast majority of their wealth to the partnership. Practical impoverishment is a recurring theme of § 2036(a)(1) cases, as this scenario either begets distributions of cash to finance the individuals living expenses or supports the existence of an implied agreement that the partners (typically the individuals children) would make such distributions if necessary.

Bona Fide Sale Exception. Regardless of whether a decedent retained the beneficial enjoyment of the transferred property or the right to control it, § 2036(a) excludes any transfer that constituted a bona fide sale for an adequate and full consideration in money or moneys worth. The underlying theory behind this exception is that the transfer does not deplete the transferors future gross estate. *See Estate of Wheeler v. United States, 116 F.3d 749, 762 (5th Cir. 1997).* This theory is problematic in the context of transfers to family-owned entities, as the fair market value of a beneficial interest in the entity typically is significantly less than the value of the contributed property--generally, by design. Nonetheless, every court that has examined the application of § 2036 in the family limited partnership context has determined that the use of discounts to value the transferred partnership interests is not *per se* fatal to the bona fide sale exception, and the Ninth Circuit joined the chorus in *Estate of Bigelow*. Courts differ, however, on the standard that family limited partnerships must satisfy in order to be excused for the discrepancy in the objective, transfer-tax value of the property contributed to the entity and the partnership interests received in exchange.

Contrasting Standards. In order to put the Ninth Circuits analysis in *Estate of Bigelow* in context, it is helpful to first review the approaches of other courts that preceded the *Bigelow* decision. The Fifth Circuit in *Kimbell v. United States, 371 F.3d 257 (5th Cir. 2004),* for instance, appeared to significantly lower the bar for taxpayers. The *Kimbell* court first noted that the statutory exception to § 2036(a) was two-pronged, requiring both (1) the existence of a bona fide sale, and (2) the receipt of adequate and full consideration. With respect to the second prong, the Fifth Circuit declared that formation of a pro-rata partnership would provide the transferor with constitute adequate and full consideration. More specifically, the transferor need only receive a partnership interest proportionate to the value of the contributed property, have her partnership capital account credited with the fair market value of the contributed property, and be entitled to a distribution of her capital account balance upon termination of the partnership. *See Kimbell, 371 F.3d at 266.* [Note that these requirements will be satisfied with respect to any partnership or LLC that follows the capital account maintenance rules under § 704(b) and that opts for the alternate test for economic effect.] As for the bona-fide sale prong, the Fifth Circuit found that this ordinarily would be satisfied so long as the decedent/transferor actually parted with the assets transferred and the partnership/transferee actually parted with the partnership interests issued in exchange. *Id. at 265*. In other words, the partnership formation actually had to take place. Given the intra-family nature of the transaction, the court applied heightened scrutiny to ensure the transaction was not a sham. According to the Firth Circuit, this heightened scrutiny would be satisfied so long as the partnership was formed for a substantial business [or] non-tax purpose. *Estate of Strangi v. Commissioner, 417 F.3d 468, 479 (5th Cir. 2005)* (quoting *Kimbell, 371 F.3d at 267* with modification). In short, the Fifth Circuit appeared to require only a pro-rata partnership that was formed for at least one non-tax purpose to satisfy the bona-fide sale exception to § 2036(a).

In contrast to the Fifth Circuits liberal interpretation of the § 2036(a) exception, the Third Circuit in *Estate of Thompson, 382 F.3d 367 (3d Circ. 2004),* adopted a more stringent approach. Noting that the partnership at issue did not engage in any legitimate business operations, the Third Circuit determined that the partnership formation did not

constitute a transfer for any consideration whatsoever. *Thompson, 382 F.3d at 379-81.* Instead, the court viewed the partnership formation as a mere change in the form of ownership; that is, a mere recycling of value as first described by the Tax Court in *Estate of Harper, T.C. Memo. 2002-121, 83 T.C.M. (CCH) 1641.* The Third Circuit similarly found the partnership formation failed the bona-fide sale prong of the exception, due to the absence of any discernable benefit or purpose of the partnership apart from estate tax savings. *Thompson, 382 F.3d at 383.* Here again, the court noted the absence of any business conducted by the entity (even though one of the partnerships at issue did undertake a real estate venture).

Faced with the competing approaches of the Fifth Circuit in *Kimbell* and the Third Circuit in *Thompson*, the Tax Court adopted a standard more in line with the former. In *Estate of Bongard, 124 T.C. 95 (2005),* a court-reviewed opinion, the Tax Court interpreted the two-pronged bona fide sale exception to § 2036(a) as being satisfied so long as (1) the partnership was formed for a legitimate and significant non-tax reason, and (2) the decedent received a partnership interest proportionate to the value of the contributed property. *Bongard, 124 T.C. at 118.* While this is virtually identical to the Fifth Circuits test, the Tax Court noted that the purported non-tax reasons for the partnership had to be real as opposed to theoretical, indicating that such justifications would examined rather than accepted at face value. *Id.* In a later case following the *Estate of Bongard* test, the Tax Court determined that a partnership formed with marketable securities solely for purposes of permitting the transferor to perpetuate his buy-and-hold investment philosophy (in other words, to make sure the partnership did absolutely nothing with the partnership assets) was a sufficient non-tax reason that satisfied the bona-fide sale exception. *See Estate of Schutt v. Commissioner, T.C. Memo. 2005-126, 89 T.C.M. (CCH) 1353.*

The Ninth Circuit Approach. Faced with the Fifth Circuits focus on the existence of a pro-rata partnership for at least one significant non-tax reason on one hand, and the Third Circuits emphasis on the existence of legitimate business operations on the other, the approach taken by the Ninth Circuit in *Estate of Bigelow* appears to favor the more stringent approach of the Third Circuit. The Ninth Circuit began its analysis of the estates invocation of the § 2036(a) exception by noting the two-prongs of the exception were interrelated: The validity of the adequate and full consideration prong cannot be gauged independently of the non-tax purposes involved in making the bona fide transfer inquiry. *Estate of Bigelow v. Commissioner, 503 F.3d 955, 966 (9th Cir. 2007).* This passage is important in several respects. Foremost, this standard implicitly rejects any argument that the adequate and full consideration exception is satisfied by the simple formation of a pro-rata partnership. Furthermore, by stressing the relevance of the non-tax *business* purposes as opposed to mere non-tax purposes, the Ninth Circuit in *Estate of Bigelow* appears more sympathetic to the Third Circuits emphasis on the presence or absence of legitimate business operations of the entity. The Ninth Circuit, however, never comes forward with its own articulated standard of the test necessary to satisfy the § 2036(a) exception in the family limited partnership context. Instead, the court simply recounts the various standards articulated by prior courts (including both the Fifth Circuit and Third Circuit), with suggested but not explicit approval.

Despite the absence of a concrete standard for evaluating the bona-fide sale exception to § 2036(a), the Ninth Circuits critical analysis of the non-tax justifications for the partnership offered by the estate indicates that the court does not take the exception lightly. Whereas the estate argued that the partnership was formed to insulate the decedent from any claims relating to the rental real estate, the Ninth Circuit agreed with the Tax Court that any such contention was unavailing, as the decedents revocable trust remained subject to the debts of the entity as general partner. *Id. at 971.* As to the estates contention that the partnership served to insulate the partnership property from future creditors of the decedent or her children, the Ninth Circuit noted the absence of evidence that any of the partners reasonably faced any genuine exposure to liability that might have validated the partnership for a non-tax purpose. *Id.* In this regard, the Ninth Circuit cited the Eight Circuit for its rejection of a blanket assertion of creditor protection (that is, protecting the partnership property from the claims of the partners creditors) as providing the requisite non-tax justification for the partnership. *Id.* (citing *Estate of Korby v. Commissioner, 471 F.3d 848, 854 (8th Cir. 2006)).* The Ninth Circuit similarly rejected the estates contention that the use of the partnership allowed the parties to avoid the prospect of a partition sale if they instead owned the property as co-tenants, again noting the absence of any prospect of a partition action. *Id. at 972.*

Practice Tip. In articulating the non-tax justifications for forming the partnership so as to satisfy the bona-fide sale exception under § 2036(a), practitioners should not rely solely on a claim that transferring assets to the partnership serves to insulate those assets from the claims of the partners creditors. Courts have demonstrated a reluctance to accept this argument in the absence of evidence that a partner faces meaningful prospect of creditor claims. Although the logic of such courts appears flawed in this regard (these courts do not seem to understand the benefits of charging orders; also, requiring a partner to face the prospect of a liability would seem to implicate fraudulent conveyance laws), the unsubstantiated generic claim of creditor protection has not proven persuasive.

The taxpayer in *Estate of Bigelow* had a few more non-tax justifications that the Ninth Circuit dismissed. The estate argued that the decedents transfer of property to the partnership facilitated her practice of making gifts to her children; the court rejected this as a testamentary purpose as opposed to a legitimate, non-tax business purpose. *Id.* (citing *Thompson, 382 F.3d at 373-74).* Next, although the court conceded that the use of a partnership to facilitate the efficient management of partnership property can serve as a credible non-tax justification for the entity, the court noted that the rental real estate at issue in the case required no active management. *Id.* In this manner, the court systematically rejected the estates arguments that the partnership served a meaningful purpose apart from the generation of valuation discounts.

Conclusion. The Ninth Circuit in *Estate of Bigelow* was the latest circuit to weigh in on the application of § 2036(a) in the family limited partnership context. The court declined to adopt standards articulated by other courts for interpreting the bona fide sale exception to § 2036(a) in a manner favorable to taxpayers. Rather, the court undertook a critical inquiry of the purported non-tax benefits of the partnership to determine if they constituted an actual motivation for the decedent to transfer assets to the entity. The Ninth Circuits decision, like other recent cases in the § 2036(a) context, indicates that taxpayers must be able to convincingly articulate non-tax justifications for why the partnership was formed--justifications that are tailored to the parties circumstances as opposed to purported benefits that are theoretical or generic in nature.

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Hellwig on Acceptance of Full Discount for Lurking Capital Gain Liability

2008 Emerging Issues 2052

Hellwig on Acceptance of Full Discount for Lurking Capital Gain Liability

By Brant Hellwig

May 5, 2008

SUMMARY: Professsor Brant Hellwig, Associate Professor of Law at the University of South Carolina School of Law, comments on Estate of Jelke v. Commissioner, in which the Eleventh Circuit Court of Appeals accepted the estates argument that, in valuing a decedents interest in a closely-held corporation, the net asset value of the corporations assets should be discounted by the entire amount of capital gains tax liability lurking in the corporations appreciated assets.

PDF LINK: Click Here for Enhanced PDF of Commentary

ARTICLE: Cite as: Hellwig, Brant. The Eleventh Circuits Acceptance of a Full Discount for the Lurking Capital Gain Liability in *Estate of Jelke v. Commissioner*. LexisNexis Expert Commentary, *(Insert date you accessed the document online)*.

In *Estate of Jelke v. Commissioner, 507 F.3d 1317, 2007 U.S. App. LEXIS 26477, 2007-2 U.S. Tax Cas. (CCH) 60,552 (11th Cir. 2007)*, the Eleventh Circuit Court of Appeals accepted the estates argument that, in valuing a decedents interest in a closely-held corporation, the net asset value of the corporations assets should be discounted by the entire amount of capital gains tax liability lurking in the corporations appreciated assets. In doing so, the Eleventh Circuit adopted the Fifth Circuits approach in *Estate of Dunn v. Commissioner, 301 F.3d 339 (5th Cir. 2002)*, while parting with those circuits that had declared a 100% discount inappropriate. *See Estate of Eisenberg v. Commissioner, 155 F.3d 50 (2d Cir. 1998); Estate of Welch v. Commissioner, 208 F.3d 213 (6th Cir. 2000)* (unpublished opinion).

Factual Setting. The decedent in *Jelke* died possessing a 6.44% interest in a closely-held corporation. The corporation owned marketable securities and other assets valued at $188 million as of the decedents death. In valuing the decedents stock interest for estate tax purposes, the estate started with a net asset value of $137 million as opposed to $188 million. The $51 million discrepancy was attributable to the tax liability the corporation would have faced had it sold all of its low-basis securities on the date of the decedents death. The estate subtracted the $51 million lurking capital gains tax liability in its entirety.

The $51 million tax liability had not actually been incurred by the corporation. Rather, the corporation historically had a relatively low rate of turnover in its assets, selling roughly 6% of its assets per year. If that rate had continued, it would have taken the corporation approximately 16 years to realize the full extent of the capital gain that existed in its assets as of the decedents date of death. Although a liquidation of the corporation would have accelerated this capital

gains tax under § 336, the corporation did not contemplate any such liquidation as of the decedents death and, in fact, continued in existence.

Valuation Standard. The focal point of the *Jelke* decision is the problematic and oft-litigated definition of fair market value for estate tax purposes. Reg. § 20.2031-1(b) defines fair market value as the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts. As the Eleventh Circuit noted, the willing buyer and willing seller are hypothetical disinterested parties who are presumed to act rationally. *See Jelke, 507 F.3d at 1321 n.11* (citing *Estate of Newhouse v. Commissioner, 94 T.C. 193, 218 (1990)).* This valuation standard is problematic in that it assumes that a hypothetical buyer and seller acting rationally will eventually arrive at a price acceptable to each party. For certain assets, such as a minority interest in a closely-held corporation, what a third-party purchaser would be willing to pay for the asset may not approach what a third-party seller would demand in return. In that situation, the perspective of one party must yield. As demonstrated in the *Jelke* decision, courts tend to focus on the perspective of the willing buyer at the expense of the willing seller. *See also Estate of Curry v. United States, 706 F.2d 1424, 1428 (7th Cir. 1983)* (It is well established that the willing buyer-willing seller rule presumes that the potential transaction is to be analyzed from the viewpoint of a hypothetical buyer whose only goal is to maximize his advantage.).

Tax Court Approach. In determining the fair market value of the decedents stock interest, the Tax Court conceded that some discount for the capital gains tax liability lurking in the corporations assets was appropriate in determining the net asset value of the entity. The court, however, rejected the estates claim for a discount equal to 100% of the future liability. Instead, the Tax Court estimated the value of the liability by assuming the corporation would continue its long-standing investment approach of low turnover in its securities, which would lead to the gain being realized for tax purposes over roughly 16 years. The court then determined the present value of that future liability to be $21 million--less than half of the $51 million discount sought by the estate.

Eleventh Circuit Approach. The Eleventh Circuit, in turn, rejected the Tax Courts approach of estimating the corporations future tax liability, asserting its preference for certainty and administrative ease over fact-specific estimations. After embarking on a thorough review of how courts have handled claims for built-in gains discounts in the past, the court in *Jelke* ultimately adopted the following simplifying assumption first articulated by the Fifth Circuit in *Estate of Dunn v. Commissioner, 301 F.3d 339, 354 (5th Cir. 2002):* The net asset value of the corporation would be determined as if it were liquidated on the date of the decedents death. *See Jelke, 507 F.3d at 1331* (recognizing this to be an arbitrary assumption). [Note: A presumed liquidation would cause the corporation to recognize all of its built-in capital gains immediately under § 336.] In opting for this approach, the Eleventh Circuit stressed the perspective of the hypothetical willing buyer: In our case, why would a hypothetical willing buyer of [the corporations] shares *not* adjust his or her purchase price to reflect the entire $51 million amount of [the corporations] built-in capital gains tax liability? *Id.* (emphasis in original). In the Eleventh Circuits view, this straightforward approach of allowing a 100% discount for the lurking tax liability was preferable because it brought certainty to the valuation process, as compared to the hunt-and-peck forecasting by courts that undertake to estimate the present value of the future liabilities based on the particular circumstances of the corporation at issue. *Id. at 1332*.

Other Alternatives. The Fifth Circuits prior decision in *Estate of Dunn* certainly paved the way for the Eleventh Circuit to endorse valuing the corporations assets through the application of a 100% discount for the future capital gains tax liability. Yet other circuit courts had rejected this arbitrary approach. For instance, in *Estate of Eisenberg v. Commissioner, 155 F.3d 50 (2d Cir. 1998),* the Second Circuit Court of Appeals conceded that some discount for the corporations built-in gains tax liability was appropriate. Yet after discussing an example from the Bittker and Eustice corporate tax treatise, the Second Circuit stated: One might conclude from this example that the full amount of the potential capital gains tax should be subtracted from what would otherwise be the fair market value of the real estate. This would not be a correct conclusion. *Eisenberg, 155 F.3d at 58 n.15.* Similarly, in an unpublished opinion in *Estate of Welch v. Commissioner, 208 F.3d 213 (6th Cir. 2000)* reported at *2000 U.S. App. LEXIS 3315,* the Sixth Circuit cited this aspect of the *Eisenberg* decision in declaring that a full, dollar-for-dollar discount for the built-in gain in the corporations property was not appropriate. *Welch, 2000 U.S. App. LEXIS 3315,* at *17. Yet because both the *Eisenberg*

and *Welch* courts merely rejected the denial of any built-in gains discount whatsoever and then remanded back to the Tax Court, neither of these decisions articulated a particular method for properly calculating the built-in gains discount.

Withering Dissent. The *Jelke* decision from the Eleventh Circuit was not unanimous; rather, Judge Carnes penned a thorough and, at times, stinging dissent. The gist of the dissent was that the majority was being lazy in adopting its admittedly arbitrary assumption that the corporation would be immediately liquidated in order to calculate the net value of its assets. *See Jelke, 507 F.3d at 1334* (Carnes, J., dissenting). The dissent notes that the definition of fair market value under Reg. § 20.2031-1(b) requires that the value of the corporate stock be determined based on all of the surrounding facts and circumstances, rather than resorting to assumptions belied by the facts that make the valuation task more facile and predictable. The dissent conceded that a willing buyer may seek a full discount for the lurking capital gains tax liability, but noted that the buyer could not reasonably expect a willing seller to agree to a price that ignored completely the time value of money. *Id. at 1336*. Pointing out that the tax liability for the lurking capital gains would not likely be recognized for tax purposes until several years down the road, the dissent objected to the majoritys simplified approach of treating such liability as presently due.

Conclusion. The existence of the classic circuit split makes *Estate of Jelke* a reasonable candidate for review by the Supreme Court. Given the majoritys admitted use of arbitrary, simplifying assumptions to render the valuation task more efficient and predictable, the decision is subject to a considerable risk of reversal if the Supreme Court accepts certiorari. Yet until that unlikely event occurs, the Eleventh Circuits opinion in *Jelke* reinforces the Fifth Circuits prior decision in *Dunn*. These two decisions provide taxpayers with a sound basis for claiming an immediate, full discount for the corporations future tax liability on existing built-in gains in the corporations assets when valuing an ownership interest in the corporation for estate and gift tax purposes.

Potential Application to Partnerships and LLCs. Given that all courts now accept some discount for built-in capital gains in the C corporation context--with the courts disagreeing on how to measure the discount--practitioners should consider whether a built-in gains discount can be taken in the partnership / LLC context. Unless a § 754 election is in place, a hypothetical third-party purchaser of a beneficial interest in a partnership that owns appreciated assets would be inheriting some portion of the lurking capital gain. The portion of the purchasing partners gain would be determined pursuant to the partnership agreement. [If, on the other hand, the partnership had made a § 754 election, the purchaser would be entitled to special basis adjustments under § 743(b) that would eliminate his or her share of the built-in gain.] Thus, for the same reasons described by the Eleventh Circuit in *Jelke* in the corporate context, a hypothetical willing buyer would pay less for an interest in a partnership owning appreciated property if a § 754 election were not in place. Most closely-owned partnerships or LLCs owning appreciated assets will choose to make the § 754 election so that the estate can benefit from the § 743 special basis adjustments. However, in certain instances where the amount of the traditional valuation discounts for lack of control and lack of marketability exceed the decedents pro-rata portion of appreciation in the partnership property, a § 754 election would be ill-advised. Hence, the *Jelke* decision has some potential application to valuing partnership and LLC interests for estate tax purposes.

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DiRusso on Statutory Unitrust Elections

2008 Emerging Issues 2053

DiRusso on Statutory Unitrust Elections

By Alyssa A. DiRusso

May 5, 2008

SUMMARY: A growing number of states have enacted unitrust statutes that allow income-only trusts to convert to unitrusts, allowing trustees to invest with more freedom and beneficiaries to escape the rigid categories of trust accounting income and principal. This commentary, written by Alyssa A. DiRusso, a professor of Wills, Trusts & Estates and author of several law review articles on trust law, leads counsel for trustees through the new opportunities and pitfalls this law creates.

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A growing number of states have enacted unitrust statutes that allow income-only trusts to convert to unitrusts, allowing trustees to invest with more freedom and beneficiaries to escape the rigid categories of trust accounting income and principal. With the added flexibility under these statutes comes greater responsibility for trustees to analyze their distribution and investment decisions prudently. This commentary, written by Alyssa A. DiRusso, a professor of Wills, Trusts & Estates and author of several law review articles on trust law, leads counsel for trustees through the new opportunities and pitfalls this law creates.

I. Introducing the Unitrust. When a state legislature enacts a unitrust statute, the landscape for trusts distributing income can change dramatically. Traditionally, when a trust provided distribute all of the income to my wife and the remainder to my son, the wife was entitled to trust accounting income: dividends, rents, royalties, and the like. Because of the duty of impartiality, which requires trustees to treat income and remainder beneficiaries fairly, trustees were forced to invest with an eye toward the character of the income their trust assets produced. *See* Restatement (Second) of Trusts 183 (1959), explaining that When there are two or more beneficiaries of a trust, the trustee is under a duty to deal impartially with them.

Compliant trustees, therefore, invested trust assets with the purpose of creating an appropriate amount of trust accounting income, while also being attentive to the need to protect and preserve the value of the principal. This challenge was perhaps workable under the Prudent Man Rule, the standard of trustee investment that governed fiduciary behavior in the majority of states throughout most of the twentieth century. The rule was originally established in

Harvard College v. Armory, 26 Mass. 446, 461 (1830), and was ultimately adopted in the Restatement (Second) of Trusts, in which section 227 provided that the trustee's duty is to make such investments and only such investments as a prudent man would make of his own property having in view the preservation of the estate and the amount and regularity of the income to be derived. *See* Restatement (Second) of Trusts 227 (1959).

The duty of prudent investment, however, evolved with the times. Enlightened by modern portfolio theory, total return investing, and other concepts of efficient asset management, the drafters of the Restatement (Third) of Trusts incorporated a new rule on prudent investment. Section 227 explains that The trustee is under a duty to the beneficiaries to invest and manage the funds of the trust as a prudent investor would, in light of the purposes, terms, distribution requirements, and other circumstances of the trust This standard requires the exercise of reasonable care, skill, and caution, and is to be applied to investments not in isolation but in the context of the trust portfolio and as a part of an overall investment strategy, which should incorporate risk and return objectives reasonably suitable to the trust. *See* Restatement (Third) of Trusts 227 (1992). Likewise, the Uniform Prudent Investor Act set out a new standard for trustees consistent with the new Restatement and modern economic insights. Section 2(a) directs that "[a] trustee shall invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable, care, skill and caution." *See* Unif. Prudent Investor Act § 2 (1990). Trustees must abide by these new modern investment standards.

As it turns out, investing prudently according to the new standard is difficult if not impossible to do while focusing on churning out the proper amount of trust accounting income to satisfy the duty of impartiality. *See* Paul G. Haskell, *The Prudent Person Rule For Trustee Investment and Modern Portfolio Theory, 69 N.C. L. Rev. 87, 94 (1990).* Even the commentary to the Restatement provision on prudent investment recognized the inherent competition between investment incentives of the income beneficiary and those of the remainderman, concluding that the conflicting fiduciary obligations result in a necessarily flexible and somewhat indefinite duty of impartiality. The duty requires the trustee to balance the competing interests of differently situated beneficiaries in a fair and reasonable manner." *See* Restatement (Third) of Trusts, Section 227 cmt. c (1992). This conflict lead Professor Langbein to predict that, Traditional principal-and-income concepts will not survive in the world of MPT-driven investing. John H. Langbein, *The Uniform Prudent Investor Act and the Future of Trust Investing, 81 Iowa L. Rev. 641, 666 (1996).* He was right.

One response to the growing need of fiduciaries and beneficiaries to invest prudently without the constraints of trust accounting income is the power to adjust under the Uniform Principal and Income Act. *See* Unif. Principal and Income Act § 104(a) (1997). *See also Professor DiRusso on the Power to Adjust under the Principal and Income Act.* Many states, in addition to or as an alternative to the power to adjust, have enacted unitrust statutes to meet this same need.

As of early 2008, twenty states have enacted unitrust legislation, including Alaska, Colorado, Delaware, Florida, Illinois, Indiana, Iowa, Kansas, Maine, Maryland, Missouri, New Hampshire, New York, North Carolina, Ohio, Oregon, Pennsylvania, South Dakota, Virginia, and Washington. *See* Alaska Stat. § 13.38.200 (2004), Colo. Rev. Stat. 15-1-402 (2003), Del. Code Ann. tit. 12, § 3527 (2005), Fla. Stat. § 738.1041 (2007), 760 Ill. Comp. Stat. § 5/5.3 (2004), **Indiana Code §** 30-2-14-15 **(2006)**, Iowa Code § 637-601 (2003), Ky. Rev. Stat. Ann. § 386.454 (2006), Me. Rev. Stat. Ann. tit. 18-A, § 7-705 (2003), Md. Com. Law Code Ann., ch. 478 § 15-502.1 (2004), Mo. Rev. Stat. § 469.411 (2004), N.H. Rev. Stat. Ann. § 564-A:3-c (2004), N.Y. Est. Powers & Trusts Law §11-2.1 (2004), N.C. Gen. Stat. § 37A-1-104.1 (2007), **Ohio RC §** 5812.02 **(2007), O.R.S. § 129.225 (2006),** 20 Pa. Consol. Stat. Ann. § 8105 (2006), 15 S.D. Codified Laws § 55-15-2 (2004), Va. Code Ann. § 55-277.4:1 (2004),Wash. Rev. Code § 11.104A.040 (2006).

Several other states are considering unitrust legislation or may consider it soon, so careful practitioners will check their states laws. Unitrust statutes are often part of a states Principal and Income Act, but may be stand-alone statutes like New Hampshire or part of the Prudent Investor Act like New York. *See* N.H. Rev. Stat. Ann. §564-A:3-c (2004) and N.Y. Est. Powers & Trusts Law §11-2.1 (2004).

II. How the Unitrust Works. Although there is no uniform unitrust act, there is a fair degree of consistency among states on the critical provisions of unitrust legislation. The unitrust statute in Maine is fairly representative and is discussed as an example below. *See* Me. Rev. Stat. Ann. tit. 18-A § 7-705 (2003).

Under Maine law, a trustee may elect to convert a trust to a unitrust without court intervention, provided that the beneficiaries are given notice and an opportunity to object *Id. § 7-705*(a)(2). The trustee may make the conversion only if it determines that the conversion will improve the ability of the trustee to carry out the intent of the settlor and the purposes of the trust. *Id. § 7-705*(a)(1). The unitrust election is an alternative to the power to adjust under the Principal and Income Act; the options are mutually exclusive *Id. § 7-705*(a).

Maines unitrust statute, and many similar ones, sets forth several non-exclusive factors that a trustee should consider in deciding whether electing unitrust treatment is best for the trust. *See id. at § 7-705*(c). The factors include familiar concepts like settlor intent, trust purpose and duration, beneficiary circumstances, need for liquidity, character of trust assets, the scope of trustee discretionary powers, economic conditions, and of course the actual amount allocated to income or principal under the terms of the Act. *See id.* Many of these factors mirror the considerations of a trustee under the Uniform Prudent Investor Act. *See* Unif. Prudent Investor Act § 2(c) (1990).

Certain trusts, under Maines statute or others like it, are not eligible for unitrust treatment. *See* Me. Rev. Stat. Ann. tit. 18-A § 7-705(i) (2003). Many of these prohibitions protect against unwanted tax consequences, such as threatening transfer tax marital deductions. *See, e.g., id. at § 7-705*(i)(5) (2003). Others limit the power to elect unitrust treatment when a trustee has a personal stake, such as when the trustee is also a beneficiary. *See, e.g., id. at § 7-705*(i)(6) (2003). When a trustee is concerned that any of these factors may have adverse consequences, the trustee may release the ability to convert to a unitrust, temporarily or permanently. *See id. at § 7-705*(k) (2003). Of course, where the document itself prohibits unitrust election, that option is not available. *See id. at § 7-705*(a) (2003).

Court intervention is available to (1) select a payout percentage other than 4%; (2) provide for a distribution of net income, as would be determined if the trust were not a unitrust, in excess of the unitrust distribution if such distribution is necessary to preserve a tax benefit; (3) average the valuation of the trusts net assets over a period other than three years; or (4) reconvert from a unitrust. *Id. § 7-705*(g).The court may also intervene if the beneficiaries disagree as to whether the trustee should make the unitrust election. *Id. § 7-705*(b).

Some states have an approach to the unitrust alternative that is more flexible than the Maine Act, allowing a range of unitrust percentages rather than a set number. For example, Florida offers its trustees a range of reasonable choices: a trustee may select a percentage between 3% and 5%. *See* Fla. Stat. Ann. § 738.1041 (2004). Trustees who are not disinterested--who may be biased to select a higher or lower number within that range based upon their own stake in the matter--are guided to an objective number within that range by referring to the Applicable Federal Rate for that month, as defined in *section 7520 of the Internal Revenue Code*, and pinning the unitrust amount to half of that number. *Id. § 738.1041*(2)(b)(2)(a). Delaware, likewise, allows trustees to select a percentage within a 3% to 5% range. *See* Del. Code Ann. tit. 12, § 3527 (2002).

For a time, there was concern that electing unitrust treatment under a state statute might have negative income tax consequences for a trust: namely, that the income distributed as a result of electing unitrust treatment might not be defined as income for purposes of calculating fiduciary income tax. Fortunately, treasury regulations now clarify that amounts distributed to an income beneficiary under a statutory unitrust election (or power to adjust) are considered income for fiduciary tax purposes. *See Treas. Reg. § 1.643(b)-1* (2004). This comfort, however, does not extend to judicially-authorized unitrusts only statutory ones. *See id.*

III. Best Practices for Electing Unitrust Treatment. The enactment of unitrust statutes offers significant opportunities to realign investment standards with contemporary strategies while still assuring a fair level of return to

current beneficiaries. In light of these new statutes, attorneys should partner with trustees to analyze whether unitrust treatment will be as beneficial for all of its classes of beneficiaries as it is for facilitating prudent investment. Trustees may decide that unitrust treatment is the best course of action.

Best practices also dictate that practitioners consider other alternatives for aligning ideal investment strategies with fair distributions, such as making an adjustment under the state Principal and Income Act. *See Professor Alyssa A. DiRusso on the Power to Adjust under the Principal and Income Act*. Particularly for trusts where predicted after-tax returns do not seem sufficient to sustain real value while generating the statutory payout, counsel should consider advising trustees to exercise the power to adjust (if available) rather than unitrust treatment. Additional alternatives may also be available for charitable trusts.

Practitioners must also be cautioned that unitrusts are not a set it and forget it solution. Particularly to the extent state statutes authorize changing the unitrust percentage or returning to traditional distributions of trust accounting income, trustees must reassess the appropriateness of the unitrust election periodically.

The thoughtful practitioner will also want to thoroughly inform both trustees and beneficiaries as to the valuable impact of this new approach to trust management. Although there may be some resistance to change, beneficiaries are likely to embrace this new approach upon understanding the potential for financial benefit to both income and remainder beneficiaries when assets are invested without regard to the character of receipts they generate.

But how exactly is the unitrust election applied? The following is an example: Say a trustee administers a trust worth roughly $2,000,000, the terms of which provide that the donors child is to receive all of the income for life, with the remainder to be distributed to that childs descendants. The trustee invests the assets in a broadly diversified portfolio of stocks and bonds with a 1% ($20,000) return on income-producing investments and a 8% ($160,000) return on equity investments. The child is unlikely to be satisfied with a 1% rate of return in trust accounting income, and in past years might have alleged that the trustee violated its duty of impartiality if it did not alter its investment strategy to generate more income and less growth. However, under the a unitrust election, the trustee is not forced to switch to an underproductive investment allocation merely for the purpose of generating trust accounting income.

Instead, the trustee may retain its successful portfolio, but distribute a unitrust amount (a percentage of the trusts value) instead of the trust accounting income. Let us say that as of the trusts valuation date, December 31, the trust had a value of $1,820,000 two years ago, $2,000,000 one year ago, and $2,180,000 in the current year (having earned $180,000 in the past year as described above). The trustee would average the values over the past three years, arriving at a value of $2,000,000. (Note, however, that some statutes use multiple-year rolling averages and some value the trust annually without averaging.) The trustee would then apply the unitrust percentage (say 4%) to the average value ($2,000,000), leaving $80,000. This $80,000 would be distributed to the income beneficiary, instead of the $20,000 generated from trust accounting income alone.

Under a statutory unitrust, investment incentives of income and remainder beneficiaries are at last aligned, and trustees may invest prudently without restrictive overemphasis on character of receipts. Counsel should advise trustees to consider taking advantage of the unitrust approach available under new statutes and to insure that investment strategy is consistent with the new regime.

Additional Resources

. **For additional background on prudent investment**, *see C. Raymond Radigan on Delegation under the Prudent Investor Act.*

. **For a comparison of several statutory approaches available to trustees seeking to moderate the distribution desires of income and remainder beneficiaries**, *see* Alyssa A. DiRusso and Kathleen M. Sablone, *Statutory*

Techniques for Balancing the Financial Interests of Trust Beneficiaries, 39 U.S.F. L. Rev. 261 (2005).

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Alyssa A. DiRusso joined the faculty of Cumberland School of Law as an Assistant Professor in 2005, after practicing as a trusts and estates attorney in Boston since 1999. Professor DiRusso teaches Wills, Trusts & Estates, Estate and Trust Administration, and Estate and Gift Taxation. Professor DiRusso earned her law degree from the University of Texas School of Law, Order of the Coif. She also holds a Bachelor of Science degree (Psychology, with an additional major in Professional Writing) from Carnegie Mellon University, Phi Beta Kappa. Professor DiRusso is the author of Marketing Wills, 16 Elder L. J. ___ (forthcoming Spring 2008)(with Michael McCunney), He Says, She Asks: Gender, Language, and the Law of Precatory Words in Wills, 22 Wis. Womens L.J. 1 (2007), Supporting the Supporting Organization: The Potential and Exploitation of 509(a)(3) Charities, 39 Ind. L. Rev. 207 (2006), Statutory Techniques for Balancing the Financial Interests of Trust Beneficiaries, 39 U.S.F. L. Rev. 261 (2005) (with Kathleen Sablone), and articles appearing in The Law Teacher, The Young Lawyer, Student Lawyer, and Cognitive Development. Her research interests include wills, intestacy, trusts, and tax-exempt charitable organizations.

DiRusso on The Power to Adjust under the Principal and Income Act

2008 Emerging Issues 2054

DiRusso on The Power to Adjust under the Principal and Income Act

By Alyssa A. DiRusso

May 5, 2008

SUMMARY: The power to adjust under state principal and income acts can be a boon to trustees and beneficiaries alike if counsel for the trustee has a good handle on the new rules. Alyssa A. DiRusso, a professor of Wills, Trusts & Estates and author of several law review articles on trust law, leads counsel for trustees through the new opportunities and pitfalls this law creates.

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The power to adjust under state principal and income acts can be a boon to trustees and beneficiaries alike if counsel for the trustee has a good handle on the new rules. With the added flexibility under the new uniform act comes greater responsibility for trustees to analyze their distribution and investment decisions prudently. This commentary, written by Alyssa A. DiRusso, a professor of Wills, Trusts & Estates and author of several law review articles on trust law, leads counsel for trustees through the new opportunities and pitfalls this law creates.

I. Introducing the Power to Adjust. When the Uniform Principal and Income Act (P&I Act) was promulgated in 1997, the landscape for trusts distributing income changed dramatically. Traditionally, when a trust provided distribute all of the income to my wife and the remainder to my son, the wife was entitled to trust accounting income: dividends, rents, royalties, and the like. Because of the duty of impartiality, which requires trustees to treat income and remainder beneficiaries fairly, trustees were forced to invest with an eye toward the character of the income their trust assets produced. *See* Restatement (Second) of Trusts 183 (1959), explaining that When there are two or more beneficiaries of a trust, the trustee is under a duty to deal impartially with them.

Compliant trustees, therefore, invested trust assets with the purpose of creating an appropriate amount of trust accounting income, while also being attentive to the need to protect and preserve the value of the principal. This challenge was perhaps workable under the Prudent Man Rule, the standard of trustee investment that governed fiduciary behavior in the majority of states throughout most of the twentieth century. The rule was originally established in *Harvard College v. Armory, 26 Mass. 446, 461 (1830)*, and was ultimately adopted in the Restatement (Second) of Trusts, in which section 227 provided that the trustee's duty is to make such investments and only such investments as a

prudent man would make of his own property having in view the preservation of the estate and the amount and regularity of the income to be derived. *See* Restatement (Second) of Trusts 227 (1959).

The duty of prudent investment, however, evolved with the times. Enlightened by modern portfolio theory, total return investing, and other concepts of efficient asset management, the drafters of the Restatement (Third) of Trusts incorporated a new rule on prudent investment. Section 227 explains that The trustee is under a duty to the beneficiaries to invest and manage the funds of the trust as a prudent investor would, in light of the purposes, terms, distribution requirements, and other circumstances of the trust This standard requires the exercise of reasonable care, skill, and caution, and is to be applied to investments not in isolation but in the context of the trust portfolio and as a part of an overall investment strategy, which should incorporate risk and return objectives reasonably suitable to the trust. *See* Restatement (Third) of Trusts 227 (1992). Likewise, the Uniform Prudent Investor Act set out a new standard for trustees consistent with the new Restatement and modern economic insights. Section 2(a) directs that "[a] trustee shall invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable, care, skill and caution." *See* Unif. Prudent Investor Act § 2 (1990). Trustees must abide by these new modern investment standards.

As it turns out, investing prudently according to the new standard is difficult if not impossible to do while focusing on churning out the proper amount of trust accounting income to satisfy the duty of impartiality. *See* Paul G. Haskell, *The Prudent Person Rule For Trustee Investment and Modern Portfolio Theory, 69 N.C. L. Rev. 87, 94 (1990).* Even the commentary to the Restatement provision on prudent investment recognized the inherent competition between investment incentives of the income beneficiary and those of the remainderman, concluding that the conflicting fiduciary obligations result in a necessarily flexible and somewhat indefinite duty of impartiality. The duty requires the trustee to balance the competing interests of differently situated beneficiaries in a fair and reasonable manner." *See* Restatement (Third) of Trusts, Section 227 cmt. c (1992). This conflict lead Professor Langbein to predict that, Traditional principal-and-income concepts will not survive in the world of MPT-driven investing. John H. Langbein, *The Uniform Prudent Investor Act and the Future of Trust Investing, 81 Iowa L. Rev. 641, 666 (1996).* He was right.

II. How the Power to Adjust Works. When the new version of the Uniform Principal and Income Act was promulgated in 1997, it included a groundbreaking provision designed to alleviate the tension between the duty to invest prudently and the duty to treat current and future trust beneficiaries impartially: the power to adjust. This power grants trustees the ability to modify the content of distributions to current beneficiaries by reallocating receipts and expenses between income and principal, escaping the restrictive traditional definitions of these two categories. The Act provides that, A trustee may adjust between principal and income to the extent the trustee considers necessary if the trustee invests and manages trust assets as a prudent investor, the terms of the trust describe the amount that may or must be distributed to a beneficiary by referring to the trusts income, and the trustee determines, after applying the rules in Section 103(a), that the trustee is unable to comply with Section 103(b). *See* Unif. Principal and Income Act § 104(a) (1997). Section 103(a) requires a trustee to administer a trust according to its terms and according to the rules of the Principal and Income Act, deferring to the trust document in cases of conflict. Section 103(b) requires impartial administration, based upon what is fair and reasonable to all beneficiaries. *See* Unif. Principal and Income Act § 103 (1997). The power to adjust would be triggered, therefore, if the returns generated from prudent investment generated too much or too little trust accounting income to be fair and impartial to all beneficiaries. According to the Official Commentary, the purpose of the power to adjust is to facilitate prudent investment, and the selection of trust asses without having to realize a particular portion of the portfolios total return in the form of traditional trust accounting income such as interest, dividends, and rents. *See* Alyssa A. DiRusso and Kathleen M. Sablone, *Statutory Techniques for Balancing the Financial Interests of Trust Beneficiaries, 39 U.S.F. L. Rev. 261, 277 (2005),* explaining and citing much of the official commentary to the Principal and Income Act.

The Act sets forth several non-exclusive factors that a trustee should consider in deciding whether and to what

extent to exercise the power to adjust. *See* Unif. Principal and Income Act § 104(b) (1997). The factors include familiar concepts like settlor intent, trust purpose and duration, beneficiary circumstances, need for liquidity, character of trust assets, the scope of trustee discretionary powers, economic conditions, and of course the actual amount allocated to income or principal under the terms of the Act. *See id.* Many of these factors mirror the considerations of a trustee under the Uniform Prudent Investor Act. *See* Unif. Prudent Investor Act § 2(c) (1990).

The Uniform Principal and Income Act also sets forth a series of circumstances under which a trustee is forbidden from making an adjustment. *See* Unif. Principal and Income Act § 104(c) (1997). Many of these prohibitions protect against unwanted tax consequences, such as threatening gift tax exclusions or marital deductions. *See, e.g., id. at § 104*(c)(1) and (2). Others limit the power to adjust when a trustee has a personal stake, such as when the trustee is also a beneficiary or may otherwise benefit from a distribution. *See, e.g., id. at § 104*(c)(8) and (9). When a trustee is concerned that any of these factors may have adverse consequences, the trustee may release the power to adjust, temporarily or permanently. *See id. at § 104*(e).

The drafters of the Uniform Principal and Income Act intended the application of the power to adjust to be broad. Although language in a trust document may opt out of the power to adjust, most language will be construed to allow application of the act unless it is clear that the terms intend to deny the power of adjustment. *See id. § 104*(f). The Commentary to the Uniform Act suggests that instruments containing such provisions that are executed after the adoption of this Act should specifically refer to the power to adjust if the settlor intends to forbid its use. *See* Alyssa A. DiRusso and Kathleen M. Sablone, *Statutory Techniques for Balancing the Financial Interests of Trust Beneficiaries, 39 U.S.F. L. Rev. 261, 280 (2005),* explaining and citing the official commentary.

The practitioner must be cautioned, however, that the uniform act has been varied somewhat by many state legislatures. For example, New Jersey trustees not only have the power to adjust, they enjoy a 3 to 5% safe harbor (down from the original 4-to-6 percent range) that will be considered to be prudent. N.J. Stat. Ann. § 3B:19B-4 (2004). Ohio provides a 4% safe harbor, and Maryland includes a power to adjust, but only up to or down to 4%. *Compare* Ohio Rev. Code Ann. § 5812(G)(3) (2007) *with* Md. Code Ann., Est. & Trusts § 15-502.2(c) (2003). Colorado and Tennessee both added a section providing that a trustee has no duty to consider an adjustment, but attorneys in states without an explicit provision should not be so confident that no such duty exists. *See* Colo. Rev. Stat. § 15-1-404(7) (2003) and Tenn. Code Ann. § 35-6-104(g) (2004).

For a time, there was concern that exercising the power to adjust might have negative income tax consequences for a trust: namely, that the income distributed as a result of an adjustment might not be defined as income for purposes of calculating fiduciary income tax. Fortunately, treasury regulations now clarify that amounts distributed to an income beneficiary under a statutory power to adjust (or unitrust election) are considered income for fiduciary tax purposes. *See Treas. Reg. § 1.643(b)-1* (2004).

III. Best Practices for Exercising the Power to Adjust. The new power to adjust under the Principal and Income Act not only authorizes efficient investment strategies, it may effectively mandate them. If a trustee can earn a much higher return by investing without regard to the character of the receipts generated by the assets in the trust, how can she justify not doing so? In light of the new laws authorizing adjustments, savvy practitioners will advise trustees to insure their trust portfolios are invested to maximize total return, rather than income.

Once portfolios are aligned with modern investment strategies, trustees (and their counsel) should establish procedures for periodic review of both investments and distributions. In each year, the trustee should review the amount of income that has been allocated to the current beneficiary, and consider either withholding some income to add to corpus, or (more common in current markets) supplement income distributions with funds transferred from corpus, reflecting growth in value of the portfolio. The practitioner must be cautioned that exercising the power to adjust is not a one-time shot; trusts should be analyzed at least annually to determine whether an adjustment is appropriate. Failure to

reassess the facts relevant to the trust and its beneficiaries, and instead proceeding with the same distributive scheme year after year, may have dire consequences.

Best practices also dictate that practitioners consider other alternatives for aligning ideal investment strategies with fair distributions, such as unitrust elections. *See Professor Alyssa A. DiRusso on Statutory Unitrust Elections*. Additional alternatives may also be available for charitable trusts.

The thoughtful practitioner will also want to thoroughly inform both trustees and beneficiaries as to the valuable impact of this new approach to trust management. Although there may be some resistance to change, beneficiaries are likely to embrace this new approach upon understanding the potential for financial benefit to both income and remainder beneficiaries when assets are invested without regard to the character of receipts they generate.

But how exactly is the power to adjust applied? The following is an example: Say a trustee administers a $2,000,000 trust, the terms of which provide that the donors child is to receive all of the income for life, with the remainder to be distributed to that childs descendants. The trustee invests the assets in a broadly diversified portfolio of stocks and bonds with a 1% ($20,000) return on income-producing investments and a 8% ($160,000) return on equity investments. The child is unlikely to be satisfied with a 1% rate of return in trust accounting income, and in past years might have alleged that the trustee violated its duty of impartiality if it did not alter its investment strategy to generate more income and less growth. However, under the new Principal and Income Act power to adjust, the trustee is not forced to switch to an underproductive investment allocation merely for the purpose of generating trust accounting income. Instead, the trustee may retain its successful portfolio, but exercise the power to adjust to make distributions in excess of trust accounting income by transferring a reasonable amount (say $40,000) from principal to income. The trustee could then distribute to the income beneficiary the trust accounting income ($20,000) plus the amount adjusted from principal ($40,000), for a greater total distribution ($60,000). When exercising its discretion, the trustee will be guided by any limits in the applicable state statute.

Under the new Principal and Income Act power to adjust, investment incentives of income and remainder beneficiaries are at last aligned, and trustees may invest prudently without restrictive overemphasis on character of receipts. Counsel should advise trustees to take advantage of the flexibility available under the new statute and to insure that investment strategy is consistent with the new regime.

Additional Resources

. **For additional background on prudent investment**, *see C. Raymond Radigan on Delegation under the Prudent Investor Act.*

. **For a comparison of several statutory approaches available to trustees seeking to moderate the distribution desires of income and remainder beneficiaries**, s*ee* Alyssa A. DiRusso and Kathleen M. Sablone, *Statutory Techniques for Balancing the Financial Interests of Trust Beneficiaries, 39 U.S.F. L. Rev. 261 (2005).*

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Carey on Financial Assets with Beneficiary Designations

2008 Emerging Issues 2050

Carey on Financial Assets with Beneficiary Designations

By James L. Carey

May 5, 2008

SUMMARY: While beneficiary designations will not be the first or most important item on an estate planners list, it is important that practitioners explore, and testators understand, the importance of proper designations for these financial assets. Professor James L. Carey comments on the importance of beneficiary designation as a component of sound estate planning.

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ARTICLE: Beneficiary designations are often not carefully considered when initially made and are rarely reviewed. The decision about how to handle financial assets that pass through a beneficiary designation is not as basic as many would like to believe and needs to be an important concern when planning an estate.

When crafting an estate plan, there are many items that practitioners must consider, including, but certainly not limited to, the use of wills, the advantages of various trusts and structures, the tax consequences of the overall plan, the potential of disclaimer, and the titling of various assets. One area that clients often do not properly consider, and for which some estate plans may not properly account, is financial assets that transfer upon death through a beneficiary designation. Particularly in this age where the battle cry of "avoid probate" rings in the public's ears, many feel an unwarranted sense of security regarding assets that pass to a beneficiary. The decision about how to handle financial assets that pass through a beneficiary designation is not as basic as many would like to believe and needs to be an important concern when planning an estate.

Financial assets that pass through a beneficiary designation fall into several broad categories: life insurance, annuities (or other payment streams that may be redirected by death including pension payments), retirement funds (including various types of individual retirement accounts (IRAs) was well as other retirement account plans such as 401(k)s and 403(b)s), and payment-on-death (POD) accounts. Generally various levels of beneficiaries may be indicated: primary, secondary (receives financial asset if the primary beneficiary disclaims or predeceases the decedent) and, in some instances, tertiary (receives financial asset if the primary and secondary beneficiary either disclaim or predecease the decedent).

At the most basic level, problems develop because people will often make a beneficiary designation at one point in their life and then not update the designation as their circumstances change. A young person who starts a job and

obtains a life-insurance through work may list his parents as the primary, or even the primary and secondary, beneficiaries. The failure to update this designation for marriage, child birth, death of a parent, and/or divorce may mean that this life policy is not part of any comprehensive plan. In fact, such a policy may even work against other, well-laid plans. Other times a beneficiary designation may include minor children who may not directly receive the proceeds. Designating minor children as beneficiaries may lead to costly guardianship or conservatory proceedings before payments can be secured.

Another problem may be that the value of these financial accounts is likely to fluctuate over time. Take the situation where a widow would like to leave equal amounts to her two children. She has an IRA valued at $400,000 that she does not intend to draw down and a home valued at $400,000 with no encumbrances. The widow designates her eldest daughter as the beneficiary of the IRA and leaves the home to her youngest daughter in her will thinking that she has "fairly" allocated here gifts. When she passes away 10 years later, the home is worth $500,000 while the IRA is worth $1.1 million. Without better control and direction from the decedent, the daughters are now left with very different legacies -- legacies that may poison their relationship with each other and taint their impressions of their mother. Coordinating relative values among diverse assets can be quite complicated. Even attempting to regularly coordinate such items may result in mistakes or other problems.

Tax consequences may present complications when dealing with financial instruments that pass through a beneficiary designation. For instance, a widower may have a $500,000 life insurance policy that he would like to leave to his eldest son, and a $500,000 401(k) account that he would like to leave to his youngest son. Since the 401(k) account is invested in a guaranteed income contract and all of the income is being paid out, the father thinks that both sons will receive the same amount. Therefore, the father's will simply splits the rest of his estate with half for each son. However, the eldest boy will receive proceeds from the life insurance that are not subject to income tax, while the youngest son will have to pay income taxes on the full amount in the retirement account -- a difference that may amount to hundreds of thousands of dollars.

Further, record-keeping by the financial company may provide problems. For instance, if the beneficiary designation is improperly recorded or lost, then the proceeds could inadvertently become part of the decedent's probate estate. Practitioners should have their clients confirm in writing from time-to-time the beneficiary designations so that records exist in the hands of the decedent's estate to address problems of this type.

In addition to these general concerns, some specific issues that arise with beneficiary designations for various classes of financial assets follow. In many instances, the use of estate planning trusts may address these problems. However, there may be important considerations that lead a thoughtful estate plan to designate a particular beneficiary.

Life Insurance. Life insurance companies often have a very basic beneficiary designation scheme. For example, many life contracts include that secondary beneficiaries will only be paid if ALL of the primary beneficiaries disclaim or predecease the policy owner. This is not always what a client may wish. For instance, if Grandma would like to have the primary beneficiaries be her three grown daughters, with the secondary beneficiaries being her six grandchildren (two with each daughter), does she really mean to disinherit two-thirds of her family when two of her grown children predecease her? Depending on the policies of the specific company, the last living daughter may receive all of the life-insurance proceeds while the four children of her other two daughters receive nothing. However, different companies may have different approaches just as different states approach the question of per stirpes versus per capita differently in other settings. Finally, if all of the beneficiaries predecease the policy owner, then the life insurance proceeds will end up in the estate of the decedent.

Annuity / Pension Payments. These income streams may be for multiple lives or for a period certain, in which

case the death of one recipient will not necessarily end the payments. In some instances, a beneficiary designation may be irrevocable, as when the payments are for certain lifetimes so that the life expectancy of the beneficiary is part of the financial equation. However, in other instances beneficiary designations may be changeable or assignable. In any event, proper planning at the time of initial decision can be extremely valuable, for instance when the owner retires or annuitizes the annuity contract.

Retirement Accounts (IRAs, 401(k)s, 403(b)s, etc.). Because of the income tax-deferred nature of many of these types of accounts, using a trust beneficiary may not be the most effective planning strategy. It is imperative that practitioners understand the implications of not only the estate tax, but also the income tax obligations with these types of accounts. For instance, a spouse who is a beneficiary of an IRA account may simply roll-over the account into the spouse's own IRA and continue to enjoy tax deferral. However, non-spouse beneficiaries will need to take an immediate distribution, or establish an inherited IRA with distributions based on the beneficiary's life expectancy, or take distributions over a five year period -- in each case paying income tax on the distributed amount. Since a trust does not have a "life-expectancy", a trust not be able to stretch payments (and thereby delay/minimize income taxes) over a "lifetime" as a natural person may. Further, having a charity as a partial beneficiary along with others beneficiaries may result in forced distributions that accelerate income tax obligations.

Payment-On-Death Accounts. Many institutions permit account owners to designate that an account is payable upon death to a named beneficiary. While this designation is often touted as a convenient way to avoid probate, the question must be asked if avoiding probate is the most important objective. With a large estate where testamentary trusts have been established for specific reasons and contemplating specific tax consequences, large amounts of money passing through a POD account designation could disrupt the planning done through the will. Depending on the goals and plans of the testator, a will may be the best way to address certain financial assets rather than having a POD designation undo otherwise carefully laid plans.

While beneficiary designations will not be the first or most important item on an estate planner's list, it is important that practitioners explore, and testators understand, the importance of proper designations for these financial assets. As more and more wealth collects in these types of financial instruments, particularly in tax-advantaged accounts, the need to coordinate the beneficiary designations with one's overall estate plan grows. Time spent addressing these issues will mean dividends for your client and for your practice.

PDF LINK: Click here for enhanced PDF of this Emerging Issues Analysis at no additional charge

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Huffman and Shultz on Split Interest Trusts: Galloway v. United States

2008 Emerging Issues 2035

Huffman and Shultz on Split Interest Trusts: Galloway v. United States

By Douglas W. Huffman and Brooke A. Shultz

April 15, 2008

SUMMARY: Under *26 U.S.C § 2055*(e), charitable deductions for split interest trusts are generally prohibited unless they meet certain explicit exceptions, as demonstrated in *Galloway v. United States, 492 F.3d 219; 2007 U.S. App. LEXIS 14718 (3rd Cir. 2007)* (June 21, 2007). This Expert Commentary by Douglas W. Huffman and Brooke A. Shultz examines the split interest trust at issue in Galloway v. United States as well as some of the exceptions to this general rule.

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ARTICLE: Cite as: Huffman, Douglas W, and Shultz, Brooke A. Split Interest Trusts: *Galloway v. United States*. LexisNexis Expert Commentary, *(Insert date you accessed the document online)*.

Under *26 U.S.C. § 2055(e)*, charitable deductions for split interest trusts are generally prohibited unless they meet certain explicit exceptions, as demonstrated in *Galloway v. United States*. This commentary examines the split interest trust at issue in *Galloway* as well as some of the exceptions to this general rule.

In *Galloway v. United States, 492 F.3d 219; 2007 U.S. App. LEXIS 14718 (3rd Cir. 2007)* (June 21, 2007), the United States Court of Appeals for the Third Circuit affirms a judgment disallowing a nearly $400,000 charitable deduction claimed by a split interest trust.

At issue in this case is a revocable living trust created by James D. Galloway in 1991. Upon Mr. Galloways death in 1998, the trust provided that the residue passed to four beneficiaries two charitable and two non-charitable beneficiaries. The trust provided for one-half of the trust property to be evenly distributed among all of the trust beneficiaries in 2006 and for a similar distribution of the other one-half of the trust property in 2016. Thereafter, the trust would cease to exist. The trust contained no provisions for dividing the trust property into separate trusts upon Mr. Galloways death. Rather, each of the four beneficiaries held a one-quarter interest in the trust property of a single trust.

Following Mr. Galloways death, the Commonwealth of Pennsylvania Department of Revenue calculated the value of the residuary interest under the Trust to be $690,475.60, of which $399,079.33 would be distributed to charitable beneficiaries. Thereafter, Mr. Galloways estate claimed a charitable deduction of $399,079.33 on its federal estate tax return.

The Internal Revenue Service (IRS) denied the deduction. Because the trust divided interests in the same property between charitable and non-charitable beneficiaries, the IRS determined that the trust created a split interest. Based on *26 U.S.C. § 2055(e)*, which prohibits a charitable deduction where a trust creates a split interest, the IRS assessed the estate an additional $160,394.13 in estate tax. The successor trustee of the trust paid the disputed estate tax, but sought a refund thereafter. The refund was denied.

The successor trustee challenged the IRSs decision by filing a complaint in the United States District Court for the Western District of Pennsylvania. The successor trustee argued that § 2055(e) is ambiguous and asked the District Court to turn to its legislative history for further explanation. The successor trustees position was based on the legislative history, which suggests that the only kind of split interest trusts that Congress intended § 2055(e) to cover are those in which a non-charitable beneficiary has a life interest and the charitable beneficiary has a remainder interest. The trust at issue was not this type of trust; rather, under the trust instrument, charitable and non-charitable beneficiaries shared equally in the trust property. Thus, the successor trustee claimed that the trust did not fall under the purview of § 2055(e) as described in its legislative history.

Upon cross-motions for summary judgment, the District Court arrived at the same conclusion as the IRS and granted the United States motion. On appeal, the Third Circuit reviewed the District Courts grant of summary judgment *de novo*, and determined that the IRS rested its disallowance of the charitable deduction on a proper interpretation of § 2055(e) and that the split interest trust at issue falls directly within the language of § 2055(e).

Under the plain language of § 2055(e), when an interest in the same property passes to both charitable and non-charitable beneficiaries, no charitable deduction is allowed. The Third Circuit refused to use legislative history to create ambiguity or muddy the waters of an otherwise clear statute since [t]he authoritative statement is the statutory text, not the legislative history or any other extrinsic material. *Galloway, 492 F.3d at 224; 2007 U.S. App. LEXIS 14718* at *14 (quoting *Exxon Mobil Corp. v. Allapattah Servs., Inc., 545 U.S. 546, 568; 125 S.Ct. 2611; 162 L.Ed. 2d 502 (2005); Morgan v. Gay, 471 F.3d 469, 473 (3d Cir. 2006)).* Thus, the legislative history of § 2055(e) could not be used to influence the Third Circuits construction of the statute.

Moreover, courts strictly construe statutes allowing for deductions. Deductions will only be allowed when clearly authorized by statute. *Galloway, 492 F.3d at 223; 2007 U.S. App. LEXIS 14718* at *11 (citing *INDOPCO, Inc. v. C.I.R., 503 U.S. 79, 84; 112 S.Ct. 1039; 117 L.Ed 2d 226 (1992)* (quoting *New Colonial Ice Co. v. Helvering, 292 U.S. 435, 440; 54 S.Ct. 788; 78 L.Ed 1348 (1934); Deputy v. Du Pont, 308 U.S. 488, 493; 60 S.Ct. 363; 84 L.Ed. 416 (1940))).*

The Third Circuit acknowledged the unfortunate result in *Galloway*. Congress designed § 2055(e) to ensure that charitable deductions accurately reflect the value of property ultimately distributed to charitable beneficiaries. Prior to the enactment of § 2055(e), non-charitable beneficiaries frequently exploited their interest in trust property to the detriment of charitable remaindermen. Although the abuses which § 2055(e) was designed to correct were not present in *Galloway* since the charitable and non-charitable beneficiaries held an equal interest in the trust property, the Third Circuit could not circumvent the clear language of the statute.

Practitioners working with clients wanting to transfer an interest in property held in a single trust to both charitable and non-charitable beneficiaries are well-advised to plan such transfers carefully. Under § 2055(e), a charitable deduction for split interest trusts will not be allowed unless the transfer takes one of the forms described below:

1. Charitable Remainder Trust. There are two basic types of charitable remainder trusts: charitable remainder annuity trusts and charitable remainder unitrusts. A charitable remainder annuity trust is a trust under which a fixed sum is paid at least annually to one or more private beneficiaries. The fixed sum must be at least 5%, but not more than 50%, of the original fair market value of the trust corpus. The period during which the annuity amount is payable may extend for the life or lives of one or more named individuals or for a term not exceeding 20 years. Following the termination of these payments, the remainder interest in the trust must be transferred to or for the use of a charity. The value of such remainder interest must be at least 10% of the original value of the trust corpus. *See 26 U.S.C. §§ 664(d)(1)*, (2), and

(3). *See also 26 C.F.R. §§ 1.664-2, 1.664-3*.

The structure of a charitable remainder unitrust is similar to a charitable remainder annuity trust. Under a charitable remainder annuity trust, instead of paying a fixed sum, one or more private beneficiaries must receive a fixed percentage of the trust assets, valued annually. The fixed percentage must be at least 5%, but not more than 50%, of the annual fair market value of the trust assets. *See 26 U.S.C. § 664(d)(2)* and (3). *See also 26 C.F.R § 1.664-3*.

2. Charitable Lead Trust. A charitable lead trust is essentially the reverse of a charitable remainder trust. Under a charitable lead trust, a guaranteed annuity or unitrust amount is paid at least annually to a charity for a specified term of years or for the life or lives of certain named individuals. Upon the expiration of the annuity or unitrust period, the remainder interest in the trust assets is transferred to one or more private beneficiaries. *See 26 U.S.C. § 2055*(e)(2)(B). *See also 26 C.F.R. § 20.2055-2(e)(2)(vi)*.

3. Pooled Income Fund. A pooled income fund is trust established and maintained by a charity to which individual donors transfer property. Each donor retains an income interest in the property for the life or lives of one or more private beneficiaries, but leaves the remainder interest in the trust assets to or for the use of the charity. The property is commingled for investment purposes to form a single fund. The amount distributed annually to each private beneficiary is determined by the rate of return earned by the entire pooled income fund. *See 26 U.S.C. § 642*(c)(5). *See also 26 C.F.R. § 1.642(c)-5*.

In *Galloway*, although it appears that Mr. Galloways charitable intentions were honorable, the split interest trust he created was not cast in a qualifying form under § 2055(e). As a result, his estate was precluded from taking a charitable deduction for the interest in the split interest trust that would be distributed to charitable entities, and his estates tax liability was increased by more than $160,000.

For the deductibility of certain charitable contributions of partial interests in property not in trust, *see 26 U.S.C. § 170(f)(3)* and *26 C.F.R. § 1.170A-7*.

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Huffman & Shultz on Powers of Attorney & Undue Influence: Goodrich v. Thompson

2008 Emerging Issues 2036

Huffman and Shultz on Powers of Attorney and Undue Influence: Goodrich v. Thompson

By Douglas W. Huffman and Brooke A. Shultz

April 15, 2008

SUMMARY: *Goodrich v. Thompson, 2007 Iowa App. LEXIS 806* (Iowa Ct. App. June 12, 2007), serves as a cautionary tale about donative transfers between parties standing in a fiduciary relationship created by a power of attorney. This Expert Commentary, written by Douglas W. Huffman and Brooke A. Shultz, reviews the standard used in Goodrich to determine whether certain donative transfers were the product of undue influence.

PDF LINK: Click Here for Enhanced PDF of Commentary

ARTICLE: Cite as: Huffman, Douglas W, and Shultz, Brooke A. Powers of Attorney and Undue Influence: *Goodrich v. Thompson*. LexisNexis Expert Commentary, *(Insert date you accessed the document online)*.

Goodrich v. Thompson serves as a cautionary tale about donative transfers between parties standing in a fiduciary relationship created by a power of attorney. This commentary, written by Douglas W. Huffman and Brooke A. Shultz, reviews the standard used in *Goodrich* to determine whether certain donative transfers were the product of undue influence.

Goodrich v. Thompson, 2007 Iowa App. LEXIS 806 (Iowa Ct. App. June 12, 2007) addresses complications arising from donative transfers between parties standing in a fiduciary relationship created by a power of attorney. As a general rule, a donative transfer will be set aside to the extent it is procured by undue influence. A presumption of undue influence may arise when a fiduciary relationship and a donative transfer co-exist. Under such circumstances, the burden of rebutting the presumption of undue influence falls on the recipient of the donative transfer. Such was the case for an attorney-in-fact who was the recipient of a donative transfer in *Goodrich*.

Lucille Goodrich passed away at age 86 on December 3, 2003. She spent her life living with her brother on the farm where they were born. Ms. Goodrichs brother passed away in 1991, after which Ms. Goodrichs nieces and nephews believe her mental health began to decline. They also believe that Ms. Goodrichs executed a will in 1992 which divided her assets equally among them.

Ms. Goodrichs nieces and nephews believe her mental decline improperly influenced certain transactions involving Phyllis Thompson. Ms. Goodrich gave Ms. Thompson her power of attorney in December 1996. For some time thereafter, Ms. Goodrich continued to pay her own bills and write her own checks, with Ms. Thompsons supervision.

In January 1997, Ms. Goodrich established two certificates of deposit with Ms. Thompson listed as joint-tenant. The transfers were witnessed by bank personnel, and there was no showing at trial that Ms. Thompson advised or influenced Ms. Goodrich to make the transfers.

Ms. Goodrich eventually went into a nursing home, and, consequently, Ms. Thompson took a more active role in assisting Ms. Goodrich with the management of her finances. Ms. Goodrichs nursing home expenses were considerable and were increasing on an annual basis. To help pay for Ms. Goodrichs care, Ms. Thompson transferred a number of Ms. Goodrichs certificates of deposit as they came due into a joint checking account held by Ms. Goodrich and Ms. Thompson. During Ms. Goodrichs life, the funds in the joint checking account were used solely for her care.

The checking account had a balance of $21,915.07 on the day Ms. Thompson was added as a joint owner on the account. Several times after she was added as joint owner, Ms. Thompson let the account balance fall below this mark. An account balance remained at the time of Ms. Goodrichs death, which Ms. Thompson ultimately received as joint owner of the account.

Following Ms. Goodrichs death, her nieces and nephews filed a petition before the Iowa District Court for Dallas County based on certain transactions made after Ms. Goodrich gave Ms. Thompson power of attorney. The nieces and nephews alleged that these transactions were the product of an unsound mind and/or improper maneuvering by Ms. Thompson and her husband, Bernard Thompson. The nieces and nephews further alleged that Ms. Thompson was in a confidential and fiduciary relationship with their aunt at the time the transfers were made. As a result, they claim that the transfers made to Ms. Thompson were presumptively fraudulent and the result of undue influence.

Ordinarily, a claim of undue influence in Iowa requires the claimant to prove that: (1) the grantor was susceptible to undue influence, (2) the grantee had an opportunity to exercise undue influence and effect the wrongful purpose, (3) the grantee had a disposition to influence unduly for the purpose of procuring an improper favor, and (4) the result was clearly the effect of undue influence. *Mendenhall v. Judy, 671 N.W.2d 452, 454; 2003 Iowa Sup. LEXIS 207 (Iowa 2003)* (citing *Estate of Herm v. Henderson, 284 N.W.2d 191, 200-01; 1979 Iowa Sup. LEXIS 1021 (Iowa 1979)).*

However, when a transfer is made in favor a grantee who stands in a fiduciary relationship with the grantor, under Iowa law, the transfer is presumptively fraudulent and presumptively the product of undue influence. *Goodrich* at *4 (quoting *Mendenhall, 671 N.W.2d at 454).* Unlike the position take by the Restatement (Third) of Property and many other jurisdictions, Iowas presumption of undue influence is triggered merely by proof of the existence of a fiduciary relationship between the grantor and grantee. S*ee* Restatement (Third) § 8.3, cmt f. Iowa does not require proof of anything more. *But see* Restatement (Third) § 8.3, cmt h (discussing additional suspicious circumstances that must be found surrounding the preparation, execution, or formulation of a donative transfer before a presumption of undue influence will be triggered by the existence of a confidential relationship between the alleged wrongdoer and the donor).

When a presumption of undue influence is triggered, the burden shifts to the grantee to rebut the presumption. To overcome a presumption involving an inter vivos transfer, Iowa requires the grantee to establish by clear, convincing, and satisfactory evidence that the grantee acted in good faith and that the grantor acted freely, intelligently, and voluntarily throughout the transaction. *Goodrich* at *4-*5, *Jackson v. Schrader, 676 N.W.2d 599, 605; 2003 Iowa Sup. LEXIS 210,* *17 (Iowa 2003). The burden of proof for undue influence actions involving testamentary transfers in Iowa is the lower preponderance of the evidence standard. *Jackson, 676 N.W.2d at 604* (citing *In re Estate of Todd, 585 N.W.2d 273, 277; 1998 Iowa Sup. LEXIS 240 (Iowa 1998)).*

The parties in *Goodrich* did not dispute the existence of a fiduciary relationship between Ms. Goodrich and Ms. Thompson resulting from the power of attorney. Thus, under Iowa law, the burden fell on Ms. Thompson to rebut the presumption of undue influence arising from the disputed transfers. However, the District Court misapplied the burden, ultimately concluding that the plaintiffs failed to support their claims by clear, convincing, and satisfactory evidence and denying the plaintiffs petition.

Four of the original eleven plaintiffs appealed this denial to the Court of Appeals of Iowa, claiming, among other things, that the District Court failed to apply the appropriate standard when reviewing the transfers made after Ms. Goodrich executed a power of attorney in favor of Ms. Thompson. The Court of Appeals determined that Iowa case law required Ms. Thompson to make an affirmative showing that she did not advise or influence Ms. Goodrich to make the donative transfers. Upon *de novo* review under the correct standard, the Court of Appeals determined that Ms. Thompson had satisfied her burden of proof and affirmed the judgment of the District Court.

Goodrich serves as a cautionary tale of potential complications that can arise from donative transfers between parties standing in a fiduciary relationship created by a power of attorney. The rule applied in *Goodrich* is designed to protect donors from making decisions induced by fiduciary relationships with donees. Fiduciary relationships, whether resulting from a power of attorney or otherwise, are often entered with close family members or trusted friends. It is to individuals fitting the same description that one may be naturally inclined to make donative transfers during life or upon death. It is not uncommon for this natural inclination to result in litigation down the road when fiduciary relationships and donative transfers co-exist. With this in mind, practitioners are well-advised to review the applicable laws of their jurisdiction regarding donative transfers between parties standing in a fiduciary relationship and to counsel their clients accordingly.

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Flannery on Olver v. Fowler

2008 Emerging Issues 2037

Flannery on Olver v. Fowler

By Michael Flannery

April 15, 2008

SUMMARY: In this Expert Commentary, Professor Michael T. Flannery analyzes the Supreme Court of Washingtons decision in *Olver v. Fowler, 161 Wn. 2d 655, 168 P.3d 348, 2007 Wash. LEXIS 704 (2007)*, a case that involved the distribution of property of the estates of two non-married persons who were in a committed intimate relationship but who were both deceased, having died simultaneously in an automobile accident. In Olver, the court held that the death of both non-married parties was not a bar to the equitable distribution of jointly acquired property.

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ARTICLE: Cite as: Flannery, Michael T. The Division of Assets Owned by Decedents Who Were Engaged in a Committed Intimate Relationship: *Olver v. Fowler*. LexisNexis Expert Commentary, *(Insert date you accessed the document online)*.

Olver v. Fowler [161 Wn. 2d 655, 168 P.3d 348, 2007 Wash. LEXIS 704 (2007)] involves the distribution of property of the estates of two non-married persons who were in a committed intimate relationship but who are now both deceased, having died simultaneously in an automobile accident. The court holds that the separately titled but jointly acquired property of the deceased parties may be equitably distributed upon the death of the parties, just as if the parties had been married and had acquired marital community property. Relying on ninety years of precedent involving the distribution of property upon dissolution of the non-marital relationship, the court holds that the death of both non-married parties is not a bar to the equitable distribution of jointly acquired property. Also noteworthy is the courts use of the term committed intimate relationship to replace the term meretricious relationship in describing the nature of the couples relationship.

(1) Equitable Distribution of Property. The equitable distribution of jointly acquired property in common law jurisdictions (or the equal distribution in community property jurisdictions) is traditionally reserved for parties who are married but whose relationship terminates upon dissolution. Upon dissolution, each party in the marriage retains an interest in his or her separate property, plus an equitable interest in the jointly acquired property obtained during the marriage, generally regardless of how title is held between the parties. Thus, for example, when a husband and wife obtain real or personal property during the marriage, the wife maintains an equitable interest in the jointly acquired

marital property, even though the husband may be named as the sole title-holder. Upon dissolution of the marriage, when a court equitably distributes the couples property, it must account for the wifes equitable marital interest in the property. Historically, for persons who are *not* married, when courts distribute property upon the dissolution of a relationship or upon death, distribution is premised solely on title. Thus, the benefit of the equitable distribution of jointly acquired property, among other exclusive interests, is a concept that traditionally is reserved for those who are married.

However, many jurisdictions have statutorily provided to non-married parties, without affording marital status, the rights and benefits traditionally held exclusive to marriage. Arguably, California began the movement toward the erosion of the unique status of marriage with the introduction of no-fault divorce in 1969 (the basis for the dissolution of marriage previously had been limited to fault groundsadultery, cruelty, or abandonment). In 1976, in *Marvin v. Marvin, 557 P.2d 106, 134 Cal. Rptr. 815 (Cal. 1976),* the Supreme Court of California recognized the validity of a non-marital contract between cohabiting parties who promised to support each other. Until then, such a contract would be held unenforceable as against public policy due to the meretricious nature of the relationship. After the *Marvin* decision, equitable remedies traditionally reserved for the dissolution of marriage were available to non-married parties through private contraction.

Within the constitutional realm, *Griswold v. Connecticut, 381 U.S. 479, 85 S. Ct. 1678 (1965)* (affording privacy protection within the scope of the marital bedroom), began the evolution of affording to otherwise excluded parties the protected privacy rights found within the penumbra of the First, Third, Fourth, Fifth, and Ninth Amendments of the Bill of Rights. The evolution continued in cases like *Eisenstadt v. Baird, 405 U.S. 438, 92 S. Ct. 1029 (1972)* (extending privacy protection to the individual, using an equal protection rationale), *Romer v. Evans, 517 U.S. 620, 116 S. Ct. 1620 (1996)* (prohibiting status-based discrimination against homosexuals), and *Lawrence v. Texas, 539 U.S. 558, 123 S. Ct. 2472 (2003)* (respecting the private lives of two consenting adults regardless of marital status or sexual orientation), which overruled the aberrant *Bowers v. Hardwick, 478 U.S. 186, 106 S. Ct. 2841 (1986)* (denying a constitutional right to privacy to homosexuals). Thus, the Equal Protection and Due Process rights once held exclusive to the marital relationship and the privacies inherent in it have laid the groundwork for expanding to non-married partners economic interests normally associated with marriage, such as the equitable distribution of property and support.

Indeed, the evolution of the extension of traditional marital rights and benefits to non-married parties might be viewed as a photomosaic of common law and statutory perspectives. For example, Hawaii offers a view of reciprocal beneficiaries, see Haw. Rev. Stat. Ann. § 572C-1 (Lexis 2007); Vermont, Connecticut, New Jersey, and New Hampshire offer views on common benefits through civil unions, see Vt. Stat. Ann. tit. 15, § 1201 et seq. (2007); Conn. Gen. Stat. § 46b-38aa et seq. (2007); N.J. Stat. Ann. § 37:1-28 et seq. (West 2007); N.H. Rev. Stat. Ann. § 457-A:1 et seq. (Lexis 2007) (effective Jan. 1, 2008); California and other states present a view on domestic partnerships, see, e.g., Cal. Fam. Code Ann. § 297 et seq. (Lexis 2007); and Massachusetts offers the unique perspective of the view of same-sex marriages, see *Goodridge v. Department of Public Health, 798 N.E.2d 941 (Mass. 2003).*

The Supreme Court of Washingtons decision in *Olver* is merely a snapshot in the evolution of the promotion of private contractual rights with respect to the equitable interest in jointly acquired property. The perspective of the *Olver* court is unique in the sense that its focus is on the equitable distribution of jointly acquired property *after the death of the non-marital partners*. Although this perspective is unique, the big picture remains the same; the *Olver* decision simply lends clarity to the view of equitable rights afforded to non-married partners *upon death*.

To clarify this perspective, the *Olver* court looks through the lens of ninety years of precedent concerning the distribution of jointly acquired property between non-married parties. Since 1917, in *In re Brenchleys Estate, 96 Wash. 223, 164 P. 1913 (1917)* (wife entitled to half interest in property when marriage voided), Washington courts have recognized the equitable interest in jointly acquired property of parties involved in meretricious relationships. See also *In re Marriage of Lindsey, 101 Wash. 2d 299, 678 P.2d 328 (1984)* (overruling *Creasman v. Boyle, 31 Wash. 2d 345, 196 P.2d 835 (1948),* which applied a presumption favoring the party holding title).

In 1989, the court in *Peffley-Warner v. Bowen, 113 Wash. 2d 243, 778 P.2d 1022 (1989),* held that a committed intimate partner could take an equitable share of jointly acquired property, but was not entitled to an *intestate* share. This distinction is significant in two respects: (1) it distinguishes the rights of a committed, intimate partner from the rights of a spouse, and (2) it distinguishes the equitable interests of non-married partners resulting from the dissolution of the relationship during life and those resulting from the dissolution of the relationship upon death. In 1995, the court in *Connell v. Francisco, 127 Wash. 2d 339, 898 P.2d 831 (1995),* recognized the first distinction by equitably distributing to non-married parties the property that would be considered community property had the parties been married, but excluding from the equitable distribution the separate property of the parties, which also would be considered if the parties were married. Thus, the court did not extend to the unmarried partners all of the equitable interests of married spouses. Finally, in 2001, in *Vasquez v. Hawthorne, 145 Wash. 2d 103, 33 P.2d 735 (2001),* the court addressed the second distinction by considering the distribution of property of a same-sex couple when one of the partners died. The trial court awarded the surviving partner an interest in the jointly acquired property. The appellate court reversed, holding that equitable distribution may not apply to partners who were otherwise prohibited from marrying. However, the Supreme Court of Washington reversed, holding that the inability to marry did not preclude equitable distribution, per se. More importantly, the court specifically held that death was not a barrier to the equitable distribution of property.

However, in every jurisdiction, there are statutory provisions for the distribution of property upon death; for those who die with a last will and testament, there are testate provisions, and for those who die without a last will and testament, there are intestacy provisions, which, traditionally, extend interests in property only to those related by blood or marriage. For those who are not married, one possible means of acquiring equitable interests in property upon death is through constructive trust, but such relief must still confront the testacy and intestacy rights that are statutorily provided for.

Thus, by extending to non-married parties the equitable interests in jointly acquired property that otherwise would not be distributable upon death, except between married parties, the Olver court clarifies the historical perspective on the equitable interests of committed intimate partners upon death, but it also continues the evolution of the deterioration of the unique status of marriage with respect to the equitable distribution of property upon dissolution or death.

The dissent in *Olver* argues that the precedent on the doctrine of meretricious relationships is only applicable when both parties are alive and seek to dissolve the relationship; to hold otherwise circumvents a decedents last will and testament when one of the parties dies before the other, which is the more typical scenario. Thus, the dissent argues that the majority opinion inappropriately equates the equitable interests of non-marital partners with the interests of spouses by creating a putative marriage that affects the testate and intestacy rights of a non-married person.

Although there are criteria by which a court may determine if a committed intimate relationship exists, see *In re Marriage of Pennington, 142 Wash. 2d 592, 14 P.3d 764 (2000),* the Olver decision is significant for parties in such relationships because, absent intent demonstrating otherwise, it essentially presumes a private contract for the equitable distribution of jointly acquired property upon death. Thus, committed intimate partners may not solely rely on title to distinguish separately held property. Practitioners are encouraged, then, to recommend to clients in committed intimate relationships who wish to retain respective separate interests in otherwise jointly acquired property to memorialize their intent by a method other than mere title. Without such evidence, when one party in a committed intimate relationship dies, he or she may be unwillingly subject to the ever-expanding scope of equitable interests in the distribution of property, including those interests traditionally reserved for marriage.

(2) Meretricious Relationships. Notably, the court in *Olver* replaces the term meretricious relationship with the term committed intimate relationship, which it determines to more accurately describe[] the status of the parties and which it finds to be less derogatory. Thus, the court attempts to elevate the social status of such non-marital relationships by dignifying the title by which they are referred. Although this may be a dignity long overdue, the dissent relies on the very historical context relied on by the majority court and defines the term meretricious as a necessary and historically legal constructnot simply a social one. The dissent accepts the term meretricious and its historical

connotation as the means by which the court traditionally distinguished the interests associated with the status of marriage from those of non-married but committed partners. It is logical, then, that in obviating the distinction between the equitable interests of married and non-married partners after death, the majority court also disavows the term that identified and sustained this distinction. Thus, even the terminology adopted in *Olver* has a dual effect: it clarifies the social perspective of non-marital but committed, intimate relationships, yet it blurs the historical and legal distinction between the equitable interests afforded to such relationships and those interests traditionally afforded to the status of marriage. Therefore, practitioners must be mindful of the connotative effect of the terms used to describe interested parties and the legal interests represented by such terms.

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Flannery on Langston v. Langston

2008 Emerging Issues 2038

Flannery on Langston v. Langston

By Michael Flannery

April 15, 2008

SUMMARY: In this Expert Commentary, Professor Michael T. Flannery analyzes *Langston v. Langston, 2007 Ark. LEXIS 578 (AR 2007),* which involves the revocation by operation of law of a valid last will and testament, even when such revocation frustrates the clearly established intent of the testator. According to Flannery, practitioners must determine for their clients if, in any given jurisdiction, a previously executed last will and testament may be revoked upon the occurrence of divorce, and, if so, practitioners must assure the intended disposition of the testators property at death by having newly-divorced clients effectively re-execute their wills.

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ARTICLE: Cite as: Flannery, Michael T. Revoking a Valid Will, Even When the Revocation Frustrates the Clearly-Established Intent of the Testator: *Langston v. Langston* (Ark.). LexisNexis Expert Commentary, *(Insert date you accessed the document online).*

Langston v. Langston [2007 Ark. LEXIS 578 (AR 2007)] involves the revocation by operation of law of a valid last will and testament, even when such revocation frustrates the clearly established intent of the testator. In many states, as in Arkansas, divorce is an event that automatically invalidates or revokes a previously validly executed will. Thus, practitioners must determine for their clients if, in any given jurisdiction, a previously executed last will and testament may be revoked upon the occurrence of divorce, and, if so, practitioners must assure the intended disposition of the testators property at death by having newly-divorced clients effectively re-execute their wills.

(1) A Common Trap. Consider the following scenario:

Husband and wife are married for more than twenty years, when they agree to divorce. They have no children and, despite their decision to divorce, they remain very closethey communicate daily, attend family functions together, continue to pay bills together, and even continue to reside together while they seek respective new residences. Wife files for divorce, and approximately a year later, the court accepts the parties settlement agreement prior to granting the divorce. Because the divorce is amicable and husband and wife remain very close after so many years, husband nevertheless wishes to include his soon-to-be former wife in his will, so he validly executes a last will and testament, designating his wife as the sole beneficiary of his estate. As anticipated, the divorce is decreed approximately one month later. The parties continue their very close relationship until husband dies five years later.

It may be unusual for a person to devise his or her entire estate to a former spouse, but this is precisely what occurred in Arkansas in the case of Langston v. Langston. Given the fact that the husband, Donald Langston, was a judge in Arkansas, was knowledgeable about the law, and seemingly very clearly evidenced his intent that his wife of 21 years should inherit his estate upon his death, one might expect that his wishes would be fulfilled. But the Supreme Court of Arkansas held differently. The court found that Judge Langston had fallen prey to a trap that many practitioners overlook; the court held that Judge Langstons validly executed will was revoked by the entry of his divorce decree.

(2) Implied Revocation. Ark. Code Ann. § 28-25-109(b) (Lexis 2007) provides in relevant part:

(a) A will or any part thereof is revoked:

. . .

(b) If, after making a will, the testator is divorced or the marriage of the testator is annulled, all provisions in the will in favor of the testators spouse so divorced are revoked.

Langstons holographic will, which was executed before his divorce became final, simply provided:

I, Don Langston, hereby will all my property, real, personal, and money to Caroline Louise Langston.

Langston did not name his wife as the personal representative of the estate, but when Langston died, his wife filed a petition to probate the will and to be named as the sole beneficiary. The circuit court entered an order probating the will, with Langstons wife as sole beneficiary, and appointed Langstons wife as the personal representative. Langstons siblings and their heirs objected, claiming that the implied revocation statute effectively revoked the will, without regard to Langstons subjective intent. The circuit court held that because the holographic will was executed before the divorce was finalized, Ark. Code Ann. § 28-25-109(b) effectively voided the will. The court recognized that Langstons intent was to pass his estate to his former wife, but held that he did not legally do so. Accordingly, Langstons wife appealed.

The Supreme Court of Arkansas affirmed the circuit courts ruling that the statute effectively voids Langstons will. As a matter of statutory construction, the court construes the clear meaning of the statute to be that any bequest to the former spouse is void, but the remainder of the will remains in effect. The court strictly construes the statute to void only those provisions benefiting the former spouse; since Langstons will contained only the one, single provision, the entire will is void.

The court referenced *Davis v. Aringe, 292 Ark. 549, 731 S.W.2d 210 (1987),* which holds that even when a will is executed prior to marriage, when a decedent and a spouse have married and subsequently divorced, the divorce revokes the will provisions made in the surviving spouses favor. Further, the court holds that [t]he fact that Donald Langston did not indicate . . . Caroline Langston as his spouse, but merely stated, to Caroline Louise Langston is of no legal consequence. They were legally married at the time.

(3) Subjective Intent. The Arkansas Supreme Court agrees with the circuit courts ruling that Judge Langston failed to legally manifest his intent that his estate should pass to his former wife. The court recognizes this as a very harsh ruling in that it stands contrary to Judge Langstons desire. Langstons wife argues that Langstons testamentary intent must prevail over the language of the statute. However, the court provides that Judge Langston was educated in the law and he failed to ensure that the Arkansas probate laws were followed. Justifying its conclusion, the court relied on *McGuire v. McGuire, 275 Ark. 432, 631 S.W.2d 12 (1982),* in reasoning that it is not necessary for [the court] to try to reach the intent of the testator because the statute solves that problem for [the court]. In view of the obvious effect of the statute [there is] no reason to embark upon a long discussion [about the testators intent]. Thus, under McGuire, Langstons testamentary intent is irrelevant in light of the plain language of the implied revocation statute.

(4) The Final Decree of Divorce. Langstons wife further argues that the parties divorce occurred on March 20, 2000the day of the hearing at which the court announced the parties settlement agreement from the bench. However, based on the applicable Appellate Rules and Rules of Civil Procedure, the court holds that a judgment or order is considered entered when it is filed in accordance with [administrative rules] . . . and that a judgment or decree is effective only when so set forth and entered as provided in [the relevant administrative rules]. Thus, despite the courts recognition of the parties divorce by approval of the parties settlement agreement on March 20, 2000, the court holds that the divorce decree was not entered with the court until May 23, 2000, after Langston executed his holographic will. Thus, the courts recognition of the parties divorce is of no consequence to the application of the implied revocation statute. Langston executed his will before his divorce was finalized via administrative filing by the court; accordingly, his will falls squarely within the scope of the implied revocation statute and is void.

Conclusion. The effect of the Langston decision is not to alter a line of precedent or to circumvent a statutory restriction, but rather to strictly construe the plain meaning of the implied revocation statute, and to warn practitioners of reliance on clearly established testamentary intent in the face of an intervening divorce. Almost every state has addressed the issue of the effect of divorce on the validity of wills. See Unif. *Prob. Code § 2*-508 (1997) (Revocation by Change of Circumstances); Daniel E. Feld, *Divorce or Annulment as Affecting Will Previously Executed By Husband or Wife, 71 A.L.R.3d 1297 (2007).* But states vary as to the effect; some states imply revocation by operation of law, while others prohibit such implied revocation.

Under the applicable statute in Langston, and any other similar statutory provisions in other jurisdictions, a divorce effectuates an automatic revocation of any testamentary devises to former spouses. Thus, to manifest the continued intent of a divorced testator who has previously executed a will in which he or she names a spouse as a beneficiary, practitioners must be sure that clients execute a new will or an appropriately executed codicil that revives the prior will, so that the testators intent is clearly evidenced subsequent to the final decree of divorce. This places a practical burden on practitioners to advise clients of the effect of divorce on validly executed wills, and to remain informed of the marital status of clients who execute wills naming spouses as beneficiaries.

For a discussion of the effect of marriage on the validity of previously executed wills, *see* Jay M. Zitter, *Sufficiency of Provision for, or Reference to, Prospective Spouse to Avoid Lapse or Revocation of Will By Subsequent Marriage, 38 A.L.R.4th 117 (2007); Validity of Statutes or Rules providing That Marriage or Remarriage of Woman Operates as Revocation of Will Previously Executed By Her, 99 A.L.R.3d 1020 (2007).*

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Bress on Gurfinkel v. Josi

2008 Emerging Issues 2039

Bress on Gurfinkel v. Josi

By Kevin F. Bress

April 15, 2008

SUMMARY: If an estate planning attorneys goal is to confer the maximum degree of flexibility to the fiduciary who will be dealing with the principals elder law issues that typically arise, *Gurfinkel v. Josi*, *972 So. 2d 927, 2007 Fla. App. LEXIS 19719* (Ct App. 3rd Dist. Dec. 12, 2007), underscores the importance of coordinating the provisions of a clients revocable living trust with the authority granted under the principals power of attorney document. In this Expert Commentary, Kevin F. Bress analyzes the Gurfinkel decision.

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If an estate planning attorneys goal is to confer the maximum degree of flexibility to the fiduciary who will be dealing with the principals elder law issues that typically arise, this case underscores the importance of coordinating the provisions of a clients revocable living trust with the authority granted under the principals power of attorney document.

(1) Background. Floridas Third District Court of Appeal held that despite language in the wifes power of attorney that expressly authorized the husband, attorney-in-fact, to gift assets away from his wifes revocable living trust, such actions taken by the attorney-in-fact were impermissible under Florida law. The court held that the grantor of the trust must expressly convey such authority in the trust instrument. Without such authority, the grantors husband argued that since he was serving as the grantors attorney-in-fact, he could use that fiduciary capacity to act for the trusts grantor. The grant of authority relied upon in the power of attorney stated:

Transfer and convey to the trustee or trustees then acting under any revocable trust agreement executed by me any and all assets, real or personal, . . . This shall include the power to transfer the same into the names of any nominee or nominees as such trustee or trustees shall direct

(2) Common dilemma with drafting Revocable Trusts. The challenge posed to estate planning attorneys is how much power to confer to the fiduciary in both the revocable trust and the power of attorney. In a perfect world, when the family is a tight-knit group and there exists little chance of family conflict, the powers granted to the fiduciaries would

be limitless. But another concern looms. One eye must be kept on the estate tax ramifications of such a broad-sweeping grant of power. It had been a long-standing rule of practice for scriveners of these documents to limit the powers of the fiduciary so that the assets under the fiduciarys control would not be deemed as belonging to the fiduciary should that person predecease the principal. Care was to taken to avoid conferring what is known as a general power of appointment under the *Internal Revenue Code, Section 2041*.

The concern has lessened somewhat over granting the fiduciary a broad sweeping power as the exemption equivalent (the amount below which no federal estate tax is imposed) has risen substantially from the $600,000 level of 1997. The increase in 1997 marked the rise in the exemption amount in some 10 years and it has since risen steadily to the current $2 million threshold.

Most trust agreements are drafted with the grantor reserving the sole right to amend the trust. As a result, if the Grantor becomes mentally incapacitated, the trust essentially becomes irrevocable upon the occurrence of that event. In such case, the trustee, who may be acting for an incapacitated principal, is precluded from making a transfer of assets from the trust to another person in order to preserve and protect assets. Assuming the fiduciary is acting with all good intentions, and such a transfer would in no way jeopardize the ability to care for the principal, this limitation works against the principal if the goal is to protect assets from diminution.

(3) Drafting around the problem. Clearly, under Floridas statute governing trust amendments, the authority to amend the trust can be delegated if expressly authorized. The trust instrument needed to expressly authorize either the trustee or an attorney-in-fact to amend the trust if there was to be a gift of trust assets to a third party.

Another approach would be to state in the trust agreement that such powers may be exercised by the grantors attorney-in-fact. While these rights are ordinarily deemed to be personal to the grantor, so long as the laws of that state permit the grantor to authorize another person to exercise these rights on the grantors behalf, the principal can coordinate the documents in this fashion.

Either way, the estate tax ramifications would loom over a fiduciary who is given the broad power of appointment. A careful review of the net worth for both the principal and fiduciarys would be advised to determine how large a tax risk such a clause poses.

(4) Medicaid planning issues. Prior to the passage of the Deficit Reduction Act of 2006 (the DRA), grantors were advised not to make gifts from their revocable trusts to other family members. This advice stemmed from a provision contained in the Omnibus Budget Reconciliation Act of 1993 that stated the general three-year look back period for determining whether a person made gifts subject to a penalty for Medicaid eligibility purposes would be extended to five years if any gifts were made from a revocable trust. Now, under the DRA, the look back period is extended to five years, regardless of whether such transfers are made from a revocable trust. Perhaps attorneys were not drafting the enabling language to make gifts from revocable trusts due to the fear of luring a grantor into the five-year look back trap that was set for such gifts.

(5) Conclusion. While it is not clear in the Gurfinkel decision whether the trust amendment and subsequent transfer of the trust assets by the principals husband was made for elder law planning purposes, this is often the motivation. As the case shows, unless all family members are on board with the fiduciary making such transfers, then conferring these powers in the instrument may be an invitation to inter-family litigation. The grantor-wife could have averted her family resorting to litigation by addressing the fiduciary powers more comprehensively prior to her mental incapacity.

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Bress on Finnerty v. Robinson

2008 Emerging Issues 2040

Bress on Finnerty v. Robinson

By Kevin F. Bress

April 15, 2008

SUMMARY: In this Expert Commentary, Kevin F. Bress analyzes *Finnerty v. Robinson, 2007 Va. App. LEXIS 425* (Va. Ct. App. Dec. 4, 2007), a decision in which the Court of Appeals of Virginia rejected the Medicaid applicants real property appraisal as establishing the fair market value. The Finnerty decision has essentially established a standard for Virginia Medicaid applicants to bear the burden of proving the inaccuracy of the countys tax assessment when seeking to use an alternate valuation.

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ARTICLE: Cite as: Bress, Kevin F. Virginia Medicaid Applicants Bear Burden of Proving the Inaccuracy of a Countys Tax Assessment When Seeking to Use an Alternate Valuation: *Finnerty v. Robinson*. LexisNexis Expert Commentary, *(Insert date you accessed the document online)*.

By the Court of Appeals of Virginia rejecting the Medicaid applicants real property appraisal as establishing the fair market value, it has essentially established a standard for Virginia Medicaid applicants to bear the burden of proving the inaccuracy of the countys tax assessment when seeking to use an alternate valuation.

(1) Background. Medicaid applicants often own real property and dispose of it in the course of entering long term care. In administering the Medicaid program, governmental officials charged with enforcing the Medicaid eligibility standards must determine whether real property was sold at the fair market value or if sold below market value. Sales below market value are penalized under the Medicaid rules. Many jurisdictions deem the tax assessed value to be determinative of the fair market value of real property. This then leads to a presumption that if a person sells real property below the tax assessed value, that person must be doing so in a transaction that is not arms-length and should be penalized under the Medicaid regime.

(2) The General Rule. The valuation of real property is important because to qualify for Medicaid the assets of the applicant are reviewed for the three years preceding the application to determine whether the applicant disposed of assets for less than fair market value. Such disposals are subject to a transfer penalty. This means that the difference between the fair market value and the disposal price is presumed to be a gift. Gifts, or uncompensated transfers of property, by Medicaid applicants during the applicable look back period (currently three years, but to be phased into five years starting in March, 2009) are penalized. The effect of the penalty is to deny Medicaid applicants any benefits

until a waiting period has elapsed. The waiting period is calculated by dividing the amount of the uncompensated transfer by a state-set factor with the quotient equaling the number of months the penalty will be imposed.

Using the local county tax assessment for determining the fair market value of real property is generally beneficial to the Medicaid applicant for two reasons. First, by doing so, Medicaid applicants are afforded the convenience of not having to retain the services of a private appraiser to establish the fair market value. Second, many county appraisals are known to be slightly lower than the actual fair market value. A lower real property valuation is generally beneficial to the Medicaid applicant, especially when the property is transferred to a family member in a transaction that is not purely arms length.

The facts of the instant case do not reveal whether the sale of the property by Ms. Robinson was to a related party or otherwise alleged to be one that was not arms length.

(3) How might have Ms. Robinson prevailed? Clearly, the Court of Appeals of Virginia suggested that, for it to hold the other way, it needed something in the record to establish that the county tax assessment was in error. Apparently, the countys tax assessor did not know the poor conditions that existed within Ms. Robinsons property, but no evidence was introduced at trial to give the appellate judges a record to consider. The independent appraisal admitted into evidence was not enough by itself to enable to court to hold for the appellant. The court did not cite any reason for not giving the appraisal as much weight as the countys appraisal. Instead, the court seemed to shift even a greater burden on Ms. Robinson by suggesting she should have produced evidence which would refute the countys appraisal. In all likelihood, the county tax assessor did not enter Ms. Robinsons property at the time the assessment was performed. If true, this may have been more persuasive on the judges.

Under common usage, the definition of fair market value has been said to be the price at which real property would change hands between a willing buyer and a willing seller, neither being compelled to buy or sell and both having reasonable knowledge of relevant facts. What was apparently not argued by Ms. Robinson was that the selling price should be considered as establishing fair market value. If the sale is truly an arms length sale to an unrelated party, what better basis could there be for establishing fair market value? The facts indicate that no realtors commission was paid so perhaps the seller knew the buyer, but this is conjecture.

(4) Conclusion. This case is instructive in that merely relying on the selling price to establish fair market value for Medicaid eligibility purposes is not enough. Using a realtor to broker the sale would certainly lend credence to the proposition that the transaction was purely arms length. Obtaining an affidavit from the purchaser which details the events surrounding the sale may also be beneficial. While the holding in this case leaves us puzzled as to why Ms. Robinson did not have in evidence any indication to the court that the true nature of the real property transaction was arms length, it nonetheless serves to assist the practitioner in making a record so his client might prevail upon judicial review.

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Bress on Pfautz v. Ohio Dept of Job & Family Services

2008 Emerging Issues 2041

Bress on Pfautz v. Ohio Dept of Job & Family Services

By Kevin F. Bress

April 15, 2008

SUMMARY: In this Expert Commentary, Kevin F. Bress analyzes the decision in *Pfautz v. Ohio Dept of Job & Family Services, 2007 Ohio 6424, 2007 Ohio App. LEXIS 5624* (Ct App., 3rd Dist., Dec. 3, 2007), in which Ohios Medicaid laws were interpreted to answer the question of whether holding title to a Medicaid applicants personal residence in a revocable living trust would cause the property to lose its exemption and be treated as a countable resource. Bress writes that while the holding in this case is state-specific in its interpretation of Ohio law, it should serve as warning to those Medicaid planners who incorporate revocable living trusts in their overall plan.

PDF LINK: Click Here for Enhanced PDF of Commentary

ARTICLE: Cite as: Bress, Kevin F. **Does Holding Title to a Medicaid Applicants Personal Residence in a Revocable Living Trust Cause the Property to Lose its Exemption and be Treated as a Countable Resource?: *Pfautz v. Ohio Dept of Job & Family Services***. LexisNexis Expert Commentary, *(Insert date you accessed the document online)*.

(1) Background. In Pfautz, Ohios Medicaid laws were interpreted to answer the question of whether holding title to a Medicaid applicants personal residence in a revocable living trust would cause the property to lose its exemption and be treated as a countable resource. While the holding in this case is state-specific in its interpretation of Ohio law, it should serve as warning to those Medicaid planners who incorporate revocable living trusts in their overall plan.

(2) Use of revocable living trusts in Medicaid planning. In positioning a persons assets to achieve Medicaid eligibility for long term care benefits there are no unique benefits in using a revocable living trust to hold title to the homestead. The Pfautz case shows how it can actually be detrimental. Planners must be sure, before making such a transfer, that the result of such a transfer does not cause the Medicaid applicant to lose the homestead exemption. For a married couple, this exemption is essential for enabling the healthy spouse to remain in the home property while the institutionalized spouse receives Medicaid benefits.

While revocable trusts are touted for their utility in managing assets during a disability and for probate avoidance, they may be more of a hindrance than a help when holding assets for Medicaid eligibility purposes.

(3) Use of revocable living trusts prior to the passage of the Deficit Reduction Act of 2005 (DRA 2005). Prior to February 8, 2006, the enactment date for DRA 2005, transfers to, or from, a trust would cause the Medicaid applicant to be subjected to a five-year audit (the look back period), rather than the standard three-year audit. While it seemed unfair to impose the longer look back period for transfers to, or from, a revocable trust, when the revocable trust was deemed to be an available resource, the trust became caught up in a rule that was clearly aimed at transactions involving irrevocable trusts. Apparently, this longer look back period was originally enacted under the Omnibus Budget Reconciliation Act of 1993 (OBRA 93) to discourage persons who were otherwise disinclined to make large outright gift transfers for asset protection purposes but would be more willing to do so if the transfer was made to an irrevocable trust.

A second Medicaid rule which disfavors using a revocable trust for Medicaid planning purposes centers on the conversion of a revocable trust to an irrevocable trust for a surviving spouse who might require long term care. Under OBRA 93, if one spouse establishes an irrevocable trust and funds it for the benefit other spouse, then to the extent the trustee of the trust has the discretion to use trust assets for the benefit of that spouse, then the trust is deemed an available resource to the full extent of the assets in the trust. The term given to this type of trust is a Medicaid Qualifying trust (when in actuality, it is a Medicaid disqualifying trust). One exception to this treatment and which would not destroy eligibility would be a trust for a spouse that is established through the will of a predeceased spouse. A revocable living trust would not escape Medicaid qualifying trust treatment since it was not funded pursuant to a will. Upon conversion of a revocable trust to a purely discretionary irrevocable trust, at the death of the first spouse, the trust is deemed to be an available resource and counts toward the Medicaid asset limit.

(4) Use of Revocable Trusts under the DRA 2005. Medicaid planning after the DRA 2005 requires analyzing all financial transactions by the Medicaid applicant and a spouse for the five years preceding the Medicaid application. This uniform five-year look back has leveled the playing field for those employing revocable trusts or irrevocable trusts as an asset protection vehicle. Transfers to, or from, a revocable trust that would have previously extended an applicants look back period to five years, are now considered a difference without a distinction. But one must still proceed with caution; first checking their states local statutes to confirm whether titling the personal residence in the revocable trust will cause the homestead exemption to be lost, as in Pfautz.

One might ask, why even take a chance using a revocable trust to hold title to the personal residence given the risk that the homestead exemption could be lost? It is the probate avoidance feature of the trust that can be particularly useful in the Medicaid plan. For a married couple, if the spouse living at home dies while the other spouse is a Medicaid beneficiary, then probate assets become problematic. In states where the surviving spouse has a right to elect a statutory share of the deceased spouses probate estate, it would be detrimental to continued Medicaid eligibility for the deceased spouse to have any assets that would be subject to probate. This is due to the Medicaid rules governing what a surviving spouse under Medicaid must do, or not do, with respect to the deceased spouses estate.

One of three scenarios are possible when the deceased spouses probate assets exceed the states resource limit for Medicaid eligibility. If the Medicaid recipient inherits assets from the deceased spouse then Medicaid benefits would be terminated if the total exceeds the states resource limit (generally $2,500).

A second possibility is that the deceased spouse disinherited the institutionalized spouse by bequeathing all assets to others in the family. In those states that grant the surviving spouse a right of election against the will so as to receive a statutory share of the estate, the Medicaid rules are likely to require that the institutionalized spouse make that election. Doing so would still likely bring the asset level above the limit for Medicaid eligibility.

Finally, if the right of election is not exercised, then it could be deemed that the Medicaid recipient spouse has effected a transfer of assets subject to a Medicaid penalty because the spouse failed to affirmatively recover assets to which the spouse was entitled.

(5) Achieving the Goal without using a Revocable Trust. Rather than using a revocable trust to avoid probate and the right of election issue, consider titling real property under a life estate arrangement. The spouse living at the property could retain a life interest and name others in the deed as remaindermen to take title immediately upon the death of the life tenant. Assuming the state does not have rules extending the right of election to an augmented estate that would include such life estate properties, then the property passes without affecting the continued eligibility of the institutionalized spouse.

The added protection of a life estate *without powers of sale* should also be considered by the planner. If permissible in the particular state, such titling could insulate the house from being considered an available resource to the second spouse should he or she face a long term care situation.

(6) Conclusion. The holding in Pfautz made it clear that due to a change in Ohio Medicaid laws which took effect October 1, 2006 (Ohio Adm. Code 5101:1-39-31(C)(1)(a)-(b), the case would have a different result. Now, for the value of the home to be exempt in Ohio, the deed to the home must be in the name of the individual or the individuals spouses name and not titled to a trust. One will have to look more closely at Ohios new law to determine whether a life estate deed would qualify for a homestead exemption.

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Grant on Irrevocable Life Insurance Trusts

2008 Emerging Issues 2042

Grant on Irrevocable Life Insurance Trusts

By Joseph Karl Grant

April 15, 2008

SUMMARY: In this Expert Commentary, Joseph Karl Grant discusses irrevocable life insurance trusts, noting that it is clear that life insurance proceeds are treated divergently different from a personal federal income taxation and federal estate taxation perspective. On one hand life insurance policies and proceeds are exempt from personal income taxation, on the other hand life insurance policies and proceeds may inadvertently trigger imposition of the federal estate tax.

PDF LINK: Click Here for Enhanced PDF of Commentary

ARTICLE: Cite as: Grant, Joseph Karl. Irrevocable Life Insurance Trusts. LexisNexis Expert Commentary, *(Insert date you accessed the document online)*.

I. Introduction. Generally, most people operate under the impression that life insurance proceeds payable upon death are non-taxable. This perception is true to a certain extent. Indeed, *§ 101 of the Internal Revenue Code* (I.R.C.) excludes from gross income life insurance proceeds received as a result of the death of an insured. Thus, if you are the recipient of a life insurance death benefit payment, payment of such proceeds does not constitute personal income.

However, to the contrary, ownership of life insurance policies can have an adverse impact when you consider computation of the federal estate tax. Oftentimes, ownership of life insurance policies with substantial face values can inadvertently trigger imposition of the federal estate tax. For individuals who pass away in 2008, the applicable exclusion amount for federal estate tax purposes is $2,000,000. For those who die in 2009, the applicable exclusion amount is $3,500,000. Therefore, if you own life insurance policies that in aggregate exceed these amounts your estate could be subject to the federal estate tax.

For federal estate tax purposes, under *I.R.C. § 2042*, the gross estate consists of the value of life insurance proceeds dispersed by reason of the decedents death if (1) the proceeds are payable to the decedents estate or personal representative, or (2) the decedent owned any rights or incidents of ownership in the insurance policy at the time of the decedents death. For illustration, incidents of ownership can include the right or the ability to surrender or cancel the policy, change the beneficiary, assign the policy, to use the policy as collateral or pledge for a loan, to borrow against the policys cash value (as is usually the option and case with most whole life policies), or to change or control the method of payment of the insurance proceeds. As if this were not enough: *I.R.C. § 2035* forces inclusion and recognition of certain transfers within three (3) years of the decedents death in calculating the gross estate. Here, under

§ 2035, gifts of life insurance policies that occur three (3) years of less prior to death are included in the decedents gross estate.

Interestingly, it is clear that life insurance proceeds are treated divergently different from a personal federal income taxation and federal estate taxation perspective. On one hand life insurance policies and proceeds are exempt from personal income taxation, on the other hand life insurance policies and proceeds may inadvertently trigger imposition of the federal estate tax.

II. Avoiding Inclusion of Insurance Proceeds in Calculating the Gross Estate. In terms of calculation of the gross estate at death, the most effective way to avoid inclusion of life insurance policies in this calculus is to establish an irrevocable life insurance trust. In order to fund the trust, the insured/settlor transfers ownership of life insurance policies to the trust. These life insurance policies, and more specifically the contractual right to receive proceeds or the contract itself, constitute adequate property to create a trust corpus. In essence, to avoid application of *I.R.C. § 2042*, by creating a irrevocable life insurance trust the insured/settlor relinquishes their incidents of ownership in the life insurance policies which now represent trust corpus. Speaking to the issue of timing, the irrevocable life insurance trust needs to be established within three (3) years of the death of the insured/settlor in order not to initiate application and inclusion in the gross estate under *I.R.C. § 2035*.

III. The Advantages and Disadvantages of Establishing an Irrevocable Life Insurance Trust. Tax avoidance, particularly with respect to the federal estate tax, is clearly one reason why one would consider or seek to establish an irrevocable life insurance trust. Aside from obvious tax avoidance strategy, irrevocable life insurance trusts are laudatory and advantageous for the following reasons:

. They may provide liquidity and cash resources during estate administration.

. They serve as a vehicle to manage insurance proceeds for beneficiaries who lack legal capacity or who are impaired. For example, minors and individuals with special needs may be provided for without the associated costs, inconvenience, and expenses of guardianship proceedings.

. A trust assists in managing the assets of those who are unable or unwilling to manage their own property effectively. In essence, restrictions and limitations may be placed in the trust regarding use of funds to protect spendthrifts.

. A trust allows the insured/settlor to exert a level of control after death regarding the use of proceeds that they would not otherwise have if the proceeds were paid directly to their intended beneficiaries.

. A trust arrangement allows for selection of a knowledgeable, competent, and professional trustee.

Considering the downside, irrevocable life insurance trusts may not be appropriate in every situation for the following reasons:

. They may involve substantial and costly legal fees to establish.

. Trustee fees and expenses may be costly in order administer the trust.

. They are irrevocable! An individuals personal and financial situation may change at some point making this a restrictive and inflexible vehicle for estate planning.

. If the insured/settlor is making premium payments he or she may be subject to imposition of the federal gift tax.

. Finally, where insurance premium payments are financed very specialized and restrictive I.R.S. rules and

regulations may apply and be difficult to meet in order to maximize tax avoidance.

IV. Ten Crucial Irrevocable Life Insurance Trust Drafting Considerations. In no particular order of importance, the drafter of an irrevocable life insurance trust should take into account the following ten (10) suggestions:

. Generally, the insured must *never* be named as a trustee of an irrevocable insurance trust. Where the insured is named as a trustee, the IRS may deem exercise of rights as a trustee, even in a fiduciary capacity, to be incidents of ownership. Likewise, it is extremely important that the insured assign all rights in the insurance policies that fund the irrevocable insurance trust.

. The drafter should spell out the trustees power, authority, and obligation to make premium payments. These powers should address the trustees ability to invade trust principal, the right to borrow against and pledge insurance policies in the trust, the use of income from property used to fund the trust, and the obligation to send notice to the settler and trust beneficiaries where premium payments lapse or are deficient.

. The drafter should include a provision that speaks to and provides for the purchase and acquisition of additional/supplemental insurance policies, if this is what the insured/settlor desires. As an associated objective, the drafter should consider inclusion of pourover language that allows for inclusion of insurance policies from a testamentary instrument such as a will or by *inter vivos* transfer into trust.

. A great deal of flexibility is lost through the use of an irrevocable life insurance. As a result, the drafter may want to consider inclusion of provisions that give the trustee the discretionary power to sprinkle trust income among beneficiaries.

. Future martial status and divorce may create a problem in an inadequately drafted irrevocable life insurance trust. Thus, the drafter would be wise not to refer to the insureds/settlors spouse by name in the trust instrument, but rather use flexible language and make reference to the insureds/settlors spouse at the time of death.

. If the intention of the insured/settlor is use life insurance proceeds from the life insurance trust to pay their debts, taxes, and other associated probate administration costs and expenses, the drafter should include specific language that authorizes the trust to purchase estate assets or to make loans to the estate. Without this explicit language, any direct payments of this nature would force inclusion of the life insurance proceeds in the insured/settlors estate for federal estate tax purposes.

. The drafter should strongly consider inclusion of *Crummey* withdrawal rights limited to no more than $5,000 or 5% of the trust principal.

. The Trustee should take care to notify each trust beneficiary of their withdrawal rights to avoid loss of the annual gift tax exclusion.

. It is advisable to include a provision in trust that explicitly authorizes the trustee to implement lawsuits and proceedings to collect disputed insurance proceeds. Additionally, it is wise to include indemnification language that covers reimbursement for costs and expenses that the trustee might incur.

. Finally, it is also extremely important to describe all insurance policies that fund the trust with a great degree of accuracy and specificity. It is wise to include the policy number(s), the name of the insurance company issuing the policy, the face value and amount of the policy, and the name of the insured(s), etc.

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Grant on Family Limited Partnerships

2008 Emerging Issues 2043

Grant on Family Limited Partnerships

By Joseph Karl Grant

April 15, 2008

SUMMARY: In this Expert Commentary, Joseph Karl Grant discusses family limited partnerships (FLP), noting that as a result of being creatures of state law, FLPs must be operated like a true business in order to shield limited partners from liability. It is imperative, writes Grant, that the FLP maintain proper and accurate business records, properly handle the titling of FLP assets and property, and comply with applicable state laws and their own FLP partnership agreements.

PDF LINK: Click Here for Enhanced PDF of Commentary

ARTICLE: 1. Family Limited Partnerships. Family limited partnerships (FLP or FLPs) are a type of business entity that offers both tax and non-tax benefits to their owners. Often, ownership and control of assets through a FLP may be more advantageous than ownership in a C or S corporation, general partnership, or irrevocable or revocable trust. Typically, FLPs are used by high net worth individuals and families to accumulate and transmit wealth to younger generations in the family. In an FLP there are two primary actors: general partners (of which there must be at least one general partner) and limited partners. General partners are responsible for managing the day-to-day operations of the FLP, and are only limited in their management activity by the FLP partnership agreement. Limited partners do not participate in the daily management of the FLP. However, limited partners benefit from distributions of the profits of the FLP. Basically, limited partners are like silent partners.

FLPs are created under individual state law. Most states have enacted limited partnership laws. As a result of being creatures of state law, FLPs must be operated like a true business in order to shield limited partners from liability. It is imperative that the FLP maintain proper and accurate business records, properly handle the titling of FLP assets and property, and comply with applicable state laws and their own FLP partnership agreements.

2. Valuation Discounts. One of the chief attractions of FLPs is that they offer considerable valuation discounts to individuals who transfer property into the FLP. Often, FLPs place numerous restrictions by operation of state law and FLP partnership agreement on the voting rights and transferability of partnership interests. As a result, the owner of an FLP interest has far less control over assets held by the FLP than they have in assets that they own outright. In general, FLP owners have rights in their FLP interests but not the right to sell an interest in the underlying assets that make-up

the FLP. Thus, due to these factors the value of a FLP interest is considered to be less than the fair market value of the underlying assets that constitute the FLP. The discounted valuations of assets that form an FLP often minimize or eliminate imposition of the gift and estate taxes. The discount valuation may depend on the nature of the FLP, its assets, and restrictions on those assets.

The IRS has allowed for discounted valuation of FLP assets over the years. However, in recent years, the IRS has been much more aggressive in questioning and challenging unjustified valuation discounts. Therefore, it is critically important to retain an appraiser with an excellent background in appraising FLPs to appraise the FLP assets to determine the proper discount valuations for maximum gift and estate tax purposes. An inexperienced appraiser could inadequately appraise the assets and destroy the estate planning benefits stemming from use of the FLP.

3. Types of Assets Suitable for a Family Limited Partnership. FLPs may hold a diverse array of assets. The following types of property are best suited for inclusion in a FLP:

. Stock in privately owned businesses or closely-held corporations.

. Stock in public companies.

. Residential rental and investment and commercial real estate.

4. Benefits and Advantages of Family Limited Partnerships. There are numerous advantages that flow from formation of an FLP. Chief among these benefits and advantages are the following:

. FLPs offer asset valuation discounts that minimize or eliminate the federal gift and estate tax.

. FLPs offer privacy.

. FLPs offer the opportunity to train individuals across generations to manage a business and ease succession upon death.

. FLPs offer centralized control and management of business assets.

. FLPs offer enhanced protection from creditor claims.

. FLPs offer flexibility that irrevocable trusts dont offer. For example, the FLP agreement may be amended more easily.

. FLPs offer management for assets that would be difficult or impractical for minors or other with special needs to manage.

. FLPs offer opportunities for asset growth and accumulation over time because of centralization and marshalling of assets.

. FLPs offer the possibility to minimize and facilitate the resolution of family disputes. For example, the FLP agreement may contain alternative dispute resolution provisions (i.e. arbitration and mediation provisions) or provisions that shift the burden and cost of litigation on the losing party to cut down on the impact of litigation and the decision to

litigate in the first instance.

5. Disadvantages of Family Limited Partnerships. The primary disadvantages to forming an FLP consist of the following:

. FLPs can be costly and expensive to form initially and administer over time.

. FLPs require annual business filings in most states and preparation of separate tax returns.

. Generally, minimum franchise taxes are levied on FLPs in most states regardless of whether the FLP earns income or not.

. General partners are *personally liable* with respect to the obligations and actions of the FLP.

. FLPs are formed for business purposes. Thus, they are not appropriate vehicles for holding and managing personal real estate and vacation properties.

. Where valuations discounts are not properly supported or justified by a competent appraisal the IRS may be prone to audit the FLP or take other costly and time-consuming enforcement action.

However, in general, where appropriate for an individual family the benefits and advantages of FLPs far outweigh and override these disadvantages.

6. Creditor Claims. Generally, limited partners are immune from personal liability for partnership debts and creditor claims. However, in stark contrast, the general partner is personally liable for partnership debts and obligations. The most obvious immunity from liability flows to limited partners. Creditors are only entitled to a charging order with regard to their legal claims against the FLP. A creditor may only levy a judgment against a limited partners partnership interest. As such, the creditor may not force the general partner to make a distribution from the partnership assets to honor a judgment. Interestingly, when a charging order is executed fully the IRS treats the creditor as a limited partner and even taxes the creditors pro-rata share of partnership profits. This complicated situation often forces creditors to settle and negotiate their claims against limited partners to avoid such a difficult quagmire.

7. Conclusion. FLPs may offer an important tool and additional facet in the hands of an experienced estate planner. Substantial discount valuations may be derived through use of an FLP that serve to eliminate or minimize the federal gift and estate taxes. Remember, the FLP must have a legitimate business purpose that motivates formation. Assets that require management and control are best suited to adhere to this business purpose and motivation. Lastly, FLPs are enhanced vehicles to thwart creditors claims and collection efforts.

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Professor Joseph Karl Grant joined ASL after serving as Lecturer in Law at the West Virginia University College of Law, where he also served as faculty advisor to the West Virginia Law Review, the West Virginia Moot Court Board, and the Black Law Students Association. He is a graduate of Brown University and of the Duke University School of Law, where he was a Duke Merit Scholar and President of the Duke Bar Association. He practiced with the law firms of Squire, Sanders & Dempsey and Thompson Hine & Flory in Cleveland, Ohio, before opening his own law firm in that city. His areas of practice included corporate and commercial law, real estate, trusts, estate planning,

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Beyer on A.G. Edwards & Sons v. Beyer

2008 Emerging Issues 2031

Beyer on A.G. Edwards & Sons v. Beyer

By Gerry W. Beyer

April 14, 2008

SUMMARY: For decades, the courthouse doors were seemingly closed to survivors claiming that bank accounts were intended to have the survivorship feature when the account contracts did not expressly so provide. Although still prohibited from seeking the funds from the accounts themselves, the unhappy survivors now have the opportunity to prove that the financial institution breached its contract with the parties or acted negligently and thus recover directly from the institution. In this Expert Commentary, Gerry W. Beyer analyzes the impact of the Texas Supreme Courts decision in A.G. Edwards & Sons, Inc. v. Beyer.

PDF LINK: Click Here for Enhanced PDF of Commentary

ARTICLE: Cite as: Beyer, Gerry W. The Impact of the Texas Supreme Court Pronouncement on Defective Survivorship bank account contracts: *A.G. Edwards & Sons, Inc. v. Beyer*. LexisNexis Expert Commentary, *(Insert date you accessed the document online).*

For decades, the courthouse doors were seemingly closed to survivors claiming that bank accounts were intended to have the survivorship feature when the account contracts did not expressly so provide. Although still prohibited from seeking the funds from the accounts themselves, the unhappy survivors now have the opportunity to prove that the financial institution breached its contract with the parties or acted negligently and thus recover directly from the institution.

A.G. Edwards & Sons, Inc. v. Beyer, 235 S.W.3d 704, 2007 Tex. LEXIS 929 (Tex. 2007) involves an investment account in which the survivorship feature desired by the parties was not created due to the financial institutions negligence and breach of contract. The Texas Supreme Court, consistent with both the trial and lower appellate courts, agreed that the aggrieved survivor could recover against the financial institution.

Before we look at this case in detail, lets start by reviewing the basic rules regarding survivorship rights in Texas so that we may place the significance of this case into perspective.

(1) Survivorship Rights Not Presumed. The presumption in Texas, unlike in many states, is that a joint account does *not* have the survivorship feature. The net contributions of the deceased party pass into the deceased partys estate and then pass by intestacy to the deceased partys heirs or to the deceased partys beneficiaries named in a valid will. Tex.

Prob. Code § 439(a).

(2) Creating Survivorship Rights. The net contributions of the deceased party will pass to the surviving parties only if the account contains an express survivorship agreement. Tex. Prob. Code § 439(a). The survivorship agreement must (a) be in writing, (b) be signed by the deceased party (if community property is involved, both spouses must sign under Tex. Prob. Code § 451), and (c) contain language expressly making the deceased partys interest survive to the surviving party. Survivorship is not inferred from the mere fact that the account is in joint form.

Disputes between the surviving joint party and the deceased joint partys heirs or beneficiaries are apt to arise after the death of a party to ascertain whether a survivorship agreement exists. The courts carefully examine the precise language of the account contract to determine whether the account has the survivorship feature.

(3) Safe Harbor Language. It is prudent practice for a financial institution to use the safe harbor language found in the Probate Code:

. On the death of one party to a joint account, all sums in the account on the date of the death vest in and belong to the surviving party as his or her separate property and estate. Tex. Prob. Code § 439(a).

. On the death of a party, the partys ownership of the account passes to the surviving parties. Tex. Prob. Code § 439A(b) (Uniform Single-Party or Multiple-Party Account Form).

When a financial institution fails to use safe harbor language, disputes often arise as to whether the language is adequate to create the survivorship feature. The Texas courts have adopted a strict approach to resolving these disputes.

(4) Texas Courts Take Strict Approach. Texas courts make it clear that a mere authorization of payment of funds to the survivor does not create the survivorship feature. For example, in *Stauffer v. Henderson, 801 S.W.2d 858, 1990 Tex. LEXIS 160 (Tex. 1990),* the Texas Supreme Court held that a provision which read, Upon the death of either of us, any balance in said account or any part thereof may be withdrawn by, or upon the order of the survivor, did not create the survivorship feature. The language regarding the survivors rights addressed payment (the right to withdraw), not ownership.

If there is any ambiguity in an account designation, the survivorship feature does not exist. For example, in *Kitchen v. Sawyer, 814 S.W.2d 798, 1991 Tex. App. LEXIS 2339* (Tex. App.--Dallas 1991, writ denied), the account signature card had checkboxes next to paragraphs describing individual joint accounts and joint tenancy with right of survivorship accounts. Because neither box was checked, the account did not create survivorship rights. See also *Ephran v. Frazier, 840 S.W.2d 81, 1992 Tex. App. LEXIS 2501* (Tex. App. Corpus Christi 1992, no writ).

Nonetheless, deviations from the safe harbor language may still create survivorship rights if the language is clear. See, for example, *Banks v. Browning, 873 S.W.2d 763, 1994 Tex. App. LEXIS 766* (Tex. App.--Fort Worth 1994, writ denied) (Joint account with rights of survivorship.); *Ivey v. Steele, 857 S.W.2d 749, 1993 Tex. App. LEXIS 1723* (Tex. App.--Houston [14th Dist.] 1993, no writ) (Account holders own this account as joint tenants with right of survivorship. Upon the death of one of us, the survivor(s) shall own the entire balance.); *In re Estate of Gibson, 893 S.W.2d 749, 1995 Tex. App. LEXIS 340* (Tex. App.--Texarkana 1995, no writ) (As joint tenants with right of survivorship and not as tenants in common and not as tenants by the entirety.)

(5) Cannot Use Extrinsic Evidence to Determine Ownership of Account Funds. Extrinsic evidence is *not* admissible to establish whether or not the account has the survivorship feature. See *Stauffer v. Henderson, 801 S.W.2d 858, 1990 Tex. LEXIS 160 (Tex. 1990)* (holding that parol evidence is inadmissible * * * to vary, add to or contradict its terms).

Extrinsic evidence, however, that impacts the deceased partys ability to enter into the survivorship agreement may prevent the agreement from being enforced. For example, the deceased party may have lacked capacity to enter into the

account contract or have been subjected to undue influence, duress, or fraud.

Likewise, extrinsic evidence may be used to show that the depositor did not actually enter into the account contract. For example, in *Pressler v. Lytle State Bank, 982 S.W.2d 561, 1998 Tex. App. LEXIS 6853* (Tex. App.--San Antonio 1998, no writ), the court found that the Xs in the check box on the signature card by survivorship language were not placed there by the deceased depositor or with the depositors consent.

(6) May Use Extrinsic Evidence to Recover From Financial Institution. Although the survivorship feature of a joint account may not be established by extrinsic evidence to claim the funds in the account itself, the *A.G. Edwards* case holds that such evidence may be used to show the depositors intent in an action against the financial institution for breach of contract and negligence. Here is what happened in this landmark case.

Father and Daughter established a joint account with rights of survivorship. For tax reasons, the account was converted into a single party account in Fathers name. Later, Father told Broker over the telephone that he wanted Daughters name added back to the account. Broker prepared documents reflecting the change and delivered them to Daughter who then gave them to Father who signed them. Daughter left the documents with Brokers receptionist. Later, Broker could not locate the new joint account agreement despite a diligent search. Before Father could sign a replacement agreement, he lapsed into a coma and died. A dispute arose over whether the balance of the funds in the account, over $1 million, belonged to Daughter or passed to Fathers six children by intestacy. Daughter settled the dispute with her siblings by agreeing to share the account equally with them.

Daughter then sued Brokerage Firm for the difference between the balance in the account and the one-sixth share she received. The jury determined that Brokerage Firm was liable under six theories. Daughter elected to recover under contract. Brokerage Firm appealed and both the intermediate appellate and supreme court affirmed. (Note that there is a side dispute regarding attorney fees which is beyond the scope of our discussion.)

Brokerage Firm argued that the trial court improperly admitted extrinsic evidence of Fathers intent for the account to have the survivorship feature. The court recognized that Texas courts consistently hold that in the absence of a written agreement extrinsic evidence is inadmissible to prove rights of survivorship against the depositors estate. However, Daughter was not seeking a recovery from Fathers estate or against a party to the joint account. Instead, she was attempting to recover from Brokerage Firm for losing the survivorship agreement thereby breaching its contract with Daughter and Father to create a joint account with rights of survivorship.

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Gerry W. Beyer received his J.D., summa cum laude, from the Ohio State University and his LL.M. and J.S.D. degrees from the University of Illinois. Both his masters thesis and doctoral dissertation topics involved estate planning issues. Professor Beyer joined the faculty of the Texas Tech University School of Law in June 2005 as the Governor Preston E. Smith Regents Professor of Law. Previously, Prof. Beyer taught at the St. Marys University School of Law and has served as a visiting professor at Boston College, Southern Methodist University, the University of New Mexico, and Santa Clara University. A member of the Order of the Coif and the recipient of numerous outstanding and distinguished faculty awards, Professor Beyer specializes in estate planning and teaches courses such as Wills and Estates, Trusts, and Estate Planning.

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Bress on Tennessee Farmers Life Reassurance Company v. Linda Rose, et al.

2008 Emerging Issues 2032

Bress on Tennessee Farmers Life Reassurance Company v. Linda Rose, et al.

By Kevin F. Bress

April 14, 2008

SUMMARY: In this Expert Commentary, Kevin F. Bress analyzes Tennessee *Farmers Life Reassurance Company v. Linda Rose, et al., 239 S.W.3d 743, 2007 Tenn. LEXIS 1075 (2007),* a case that provides an excellent study on one of the most important principles associated with the proper drafting and execution of a durable power of attorney: the essential need to delineate in the document with specificity the powers to be granted.

PDF LINK: Click Here for Enhanced PDF of Commentary

ARTICLE: Cite as: Bress, Kevin F. The Proper Drafting and Execution of a Durable Power of Attorney: *Tennessee Farmers Life Reassurance Company v. Linda Rose et. al*. LexisNexis Expert Commentary, *(Insert date you accessed the document online)*.

This case provides an excellent study on one of the most important principles associated with the proper drafting and execution of a durable power of attorney: the essential need to delineate in the document with specificity the powers to be granted.

(1) Background. The laws governing the drafting, execution and interpretation of a power of attorney derive from local law and so it is not possible to analyze this case in a manner that will yield conclusions applicable to all other jurisdictions. However, there are many lessons to be gleaned from the Tennessee Farmers Life holding that would be of particular interest to elder law attorneys who are constantly confronted with the very issue presented here. How specific does a document need to be in granting the attorney-in-fact various powers?

Often the legal advice given to an attorney-in-fact is for the attorney-in-fact to change the principals beneficiary designation on life insurance policies in order to protect the proceeds from being consumed by a beneficiarys cost of long term care. Typically, an older couple faces this situation. Retirement plan beneficiary designations would be another example where such advice may be applicable.

(2) Authority to change beneficiary not granted under statute. The Tennessee statutory scheme governing powers of attorney includes the ability to incorporate by reference a long list of powers set out in the statute by the

Tennessee legislature. These powers will be deemed as having been granted under the document without the necessity of delineating them within the four corners of the document. It is noteworthy that these statutory powers are followed by an express exclusion of attorney-in-facts authority to change the beneficiary of the principals life insurance. While the holding did not address this issue, a question that many elder law attorneys have not had answered in their particular states is whether the grant of a power to change a principals testamentary disposition through a change in beneficiary designation is a power that may be exercised by an agent. Under Tennessee law, this question appears to have been addressed by implication. The legislature expressly denied an attorney-in-fact this power under its statutory grants of authority, but opened the door for a principal to override this default provision with express language in the document authorizing such changes.

The specific language in the document found by Tennessees highest court to be sufficient to rebut the statutory denial of authority to change a beneficiary seemingly wasnt all that specific: to transact all insurance business and to take any other action necessary or proper.

Contrary to the rationale presented in the holding, one could make a good argument that the broad grant of authority to transact all insurance business should be narrowly construed to determine whether such a general grant would be sufficient to override the statutory presumption that such a power is not conferred. The other powers set out in the subject power of attorney precedent to the broader phrase granting general authority to deal with the life insurance policies do not seem to support a conclusion that the intent of the principal appears to extend the powers to include changing a life insurance beneficiary. Rather, they seem to only address certain business aspects of handling an insurance policy. Clearly, there were no words that one could point to in the power of attorney which directly referred to any powers which might alter the policy owners original testamentary intent when the designation was first made.

(3) Specificity is an essential ingredient when drafting powers of attorney. In its opinion, the court indirectly referred to the Restatement (Second) of Agency §§ 33 cmt. B & 37(2) when setting forth the proposition that: The more specific a power of attorney is concerning the performance of particular acts, the more the agent is restricted from performing acts beyond the specific authority granted. Yet, the court did not seem to apply this standard. The court concluded that the general grant of authority to transact all insurance business was sufficient under Tennessee law to waive out of the statutory default provision disallowing such a change by the attorney-in-fact.

(4) Conclusion. It is unlikely from reviewing the facts recited in the Tennessee Farmers Life case that the change of beneficiary on the decedents life policy by her sister was motivated by a goal to achieve asset protection in the elder law context. It may have simply been an act of self dealing. In the elder law context, a change in beneficiary to oneself acting as attorney-in-fact is not uncommon. The alternative might be for the policy to be payable to a Medicaid recipient residing in a nursing facility; that is, the spouse of the deceased. What is not known from this case, as the issue was remanded to the trial court is whether such an act by the attorney-in-fact would be deemed a breach of fiduciary duty.

For the scriveners benefit, one who regularly drafts powers of attorney would be well advised to go much further to meet the specificity requirements when drafting power of attorney clauses which convey the authority to make, change or cancel beneficiary designations.

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Bress on LaFond v. Dep't of Pub. Welfare

2008 Emerging Issues 2033

Bress on LaFond v. Dep't of Pub. Welfare

By Kevin F. Bress

April 14, 2008

SUMMARY: While *LaFond v. Dept of Pub. Welfare, 933 A.2d 159, 2007 Pa. Commw. LEXIS 544*, involves a lower court decision, it presents a factual pattern that is all too common in Medicaid eligibility cases; how to properly structure transactions dealing with a personal residence prior to the time one may require nursing care and ultimately seek Medicaid benefits for the cost of such care. In this Expert Commentary, Kevin S. Bress analyzes the LaFond decision as an example of how not to plan.

PDF LINK: Click Here for Enhanced PDF of Commentary

ARTICLE: Cite as: Bress, Kevin F. **How to Properly Structure Transactions Dealing with Personal Residences Before the Owner Requires Nursing Care and Medicaid Benefits: *LaFond v. Dept of Pub. Welfare***. LexisNexis Expert Commentary, *(Insert date you accessed the document online).*

(1) Background. While this case involves a lower court decision it presents a factual pattern that is all too common in Medicaid eligibility cases; how to properly structure transactions dealing with a personal residence prior to the time one may require nursing care and ultimately seek Medicaid benefits for the cost of such care. Elder law practitioners are often approached by family members, typically the children, asking how best structure a new home purchase when a parent is contributing to the childs purchase price. Prior to the Deficit Reduction Act of 2005 (the DRA), the advice that could be given without much thought was to have the parent gift funds to the child and let the penalty clock start running on the gift. This means once the gift was made, the time period it would take for the parent to not subsequently be penalized for having made the asset transfer to the child would begin to run the month the gift was completed.

Under the DRA, this penalty clock does not begin to run now until the parent has presented a Medicaid application, having otherwise qualified for the Medicaid benefits. This new method for calculating the penalty has significantly impacted how Medicaid planning can be accomplished for such transactions.

While the case is silent on this point, a question that one might have after reading the opinion is: How did the father (recipient) initially qualify for Medicaid benefits while possessing an equity interest in the real property that was surely in excess of Pennsylvanias resource allowance? As alluded to in the opinion, the home could have been deemed temporarily exempt from Medicaids asset limit test because the real property was deemed to be the recipients primary residence. The Commonwealth of Pennsylvania would have a right, after six months, to place a lien against the fathers

interest in the property. Apparently this was not done in the LaFond case. Had it been, the recipients share of the settlement proceeds from the sale of the house would have been paid over directly to the Department of Public Welfare.

Another possibility is that the recipient was able to show that while he might have had equity in the house in excess of the stated $2,000 resource allowance, his equity was an unavailable resource because it was inextricably bound up with the sons interest in the property. Often, jointly-owned property can be deemed unavailable on this basis and not counted when applying for Medicaid.

(2) LaFond case an example of how not to plan. No matter how sympathetic one may be for the family in the LaFond case, it is plain to see that the Department of Public Welfare and every jurist involved in the subsequent appeals had no choice but to find against the recipient, even though the sons actions were not taken for the purpose of trying to shelter assets. By the son placing his fathers name on the deed, the son effected a gift to the father. Each subsequent payment the son made toward the mortgage, maintenance and upkeep of the house, were effectively additional gifts inuring to the fathers benefit to the extent of the proportionate share that arguably could, and should, have been paid by the father.

The asset limit test for Medicaid eligibility is a bright line test, from which there is no regulatory exception allowing a recipient to rationalize under the Medicaid rules that counting such excess resources would cause hardship and an inequitable result.

(4) Alternative strategies to consider. The following discussion setting out possible strategies that the son might have employed to avoid the unfavorable result in the LaFond case are presented for discussion purposes only. The laws and regulations of each state will dictate whether these strategies might have merit and should not be considered without a careful review of those laws.

(a) Fractional tenant-in-common interest Presumably, the only reason the father was given an equity interest at all, was because the lending bank made it a requirement if the father was signing onto the mortgage. The son might have considered setting the fathers equity interest on the deed no higher than say 1%, as a tenant-in-common. Then, upon a subsequent sale, the father could receive his fractional share of equity, a much smaller amount. Such a recipient might be able to continue Medicaid eligibility either because the receipt of the fractional share would not cause the recipient to exceed the Medicaid resource limit or because the funds could willingly be turned over to the state as a form of reimbursement. Typically, when such funds are received by a Medicaid recipient, the surrender of the asset to the department administering the Medicaid benefits will enable the recipient to retain benefits uninterrupted.

(b) Treat all advances on fathers behalf as a loan The son and father could have entered into a written arms length agreement at the time the home was purchased by the son that any payments made by the son would be deemed a loan to the father to the extent of the fathers proportionate share of such payment. In this way, the son would be entitled to recoup from the fathers share of the proceeds upon sale all the advances the son made for the father. In the instant case, it is possible the appreciation that the home realized during the course of the ownership between father and son may have outpaced these expenses. Nonetheless, it would have given the son the opportunity to recoup some portion of the outlay. Proceeding with this form of transaction would require a promissory note executed contemporaneously with the transfer of funds and ongoing documentation reflecting the advances made to the father.

(c) Care Management Agreement While the father resided with the son, the two may have entered into a written care management agreement whereby the son would receive compensation from his father in consideration of the services the son provides or promises to provide should the fathers care needs change. The amount of compensation to be paid to the son could be set to simply equal the future appreciation in the fathers equity share of the home. As this arrangement is far from typical, the level of scrutiny that this structure may draw from Medicaid officials could be high. The transaction has economic reality from each persons perspective and comes with risk to the son that the care he provides could easily outpace the equity growth in the home. Also to be considered in this strategy is the income tax effect to the son.

(5) Conclusion. A basic precept that has long been followed under the Medicaid regulations is that gifts made to a current or future Medicaid recipient cannot later be recalled, negated or disregarded. The legal presumption will be that such a gratuitous act cannot later be re-characterized during the Medicaid application process. Children who add a parents name to their bank account, deed or other valuable property do so at their peril.

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Bress on Maryland Department of Health and Mental Hygiene v. Ida Brown

2008 Emerging Issues 2034

Bress on Maryland Department of Health and Mental Hygiene v. Ida Brown

By Kevin F. Bress

April 14, 2008

SUMMARY: Medicaid eligibility for long term care benefits often hinges on an applicant meeting two important criteria: financial eligibility and meeting the test for being medically needy. Maryland is one of many states that has elected to implement a Medicaid program that extends beyond the traditional program by enabling individuals to apply for and obtain Medicaid benefits in a care setting other than in a nursing home environment. In this Expert Commentary, Kevin F. Bress analyzes the standard of eligibility for Medicaid reimbursement of assisted living facility costs as set forth in *Maryland Dept of Health & Mental Hygiene v. Brown, 177 Md. App. 440 (2007).*

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ARTICLE: Cite as: Bress, Kevin F. The Standard of Eligibility for Medicaid Reimbursement of Assisted Living Facility Costs: *Maryland Department of Health and Mental Hygiene v. Ida Brown*. LexisNexis Expert Commentary, *(Insert date you accessed the document online).*

(1) Background. Medicaid eligibility for long term care benefits often hinges on an applicant meeting two important criteria: financial eligibility and meeting the test for being medically needy. Maryland is one of many states that has elected to implement a Medicaid program that extends beyond the traditional program by enabling individuals to apply for and obtain Medicaid benefits in a care setting other than in a nursing home environment. In these instances, a state must apply for, and be granted, a waiver by the Centers for Medicare and Medicaid Services to offer Medicaid benefits in an alternative care setting. In the Ida Brown case, Ms. Brown applied for benefits associated with in-home care through the states Older Adults Waiver Program for financial assistance.

(2) States must not set criteria for eligibility more restrictive than federal law prescribes. Because it is purely elective for states to apply for a waiver from the general Medicaid scheme and the states construct their own plan, these waiver programs can vary widely by state. These plans are not as uniformly structured as the traditional Medicaid statutory scheme found throughout the nation for nursing home care. The plans, referred to as Medicaid Waiver programs are designed to offer applicants an alternative care setting that is deemed to be community-based. State officials will construct their own Medicaid Waiver plan to conform to its particular budgetary limitations by controlling the number of eligible participants. In Maryland, for example the number of Medicaid Waiver slots is capped and a long

waiting list has developed which can take over two years for a person to reach the top of the list.

Elder law practitioners in Maryland believed for some time that the Maryland Department of Health and Mental Hygiene, the states agency that sets Medicaid policy, had adopted a standard for determining the medically needy component for Medicaid Waiver eligibility by employing a test that was more restrictive than federal law mandated. When the Ida Brown case found its way to Marylands highest court, practitioners watched closely to see how much more restrictive Marylands regulations could be when it came to defining when a person meets the medical criteria for a waiver program. The case turned on the terminology used under the Medicaid Waiver program for determining medical eligibility. The focus was on the definition of a nursing facility and nursing facility services.

(3) Need to compare federal law with state law. The starting point for making the necessary comparison of federal law to state law is to review applicable federal law under *42 U.S.C. §§ 1396 et seq.* (2000). In Maryland, the comparison can then be made to its regulations where most of the Medicaid Waiver rules are contained in the Code of Maryland Regulations (COMAR). Many states will publish a Medicaid manual which is designed to assist personnel in the states regulatory agencies charged with determining Medicaid eligibility to interpret the regulations and apply their rules uniformly from county to county. Practitioners must remind themselves that these policy manuals are not rule of law and discrepancies can be found when comparing the manual to published federal and state regulations. If a Medicaid applicant finds that the state has set a standard that imposes greater restrictions than federal law, then the aggrieved applicant can seek redress through a fair hearing. To prevail in these types of cases, the applicant would be asking the administrative law judge to apply the correct standard for determining Medicaid eligibility as mandated by federal law.

(4) Appealing decisions that are based on failing to satisfy the level of care requirements. What can be gleaned from the Brown decision is that even if state law passes scrutiny when compared with federal law, an aggrieved Medicaid applicant denied eligibility on the basis of failing to meet the medical criteria, is well advised to present clear and convincing medical evidence at the fair hearing to support a claim that the medical eligibility test has been met. In the Brown case, the evidence presented to support the assertion that Ms. Brown met the medical criteria was based on a doctors letter. Ideally, the doctor should have testified for the appellant at the fair hearing. The difficulty these Medicaid appeals pose is that the applicant generally will not have the resources needed to retain counsel and to employ a medical expert to appear at an administrative hearing. Some jurisdictions may permit the doctor to be available by telephone to testify at the hearing thereby increasing the chances applicants can make their cases.

(5) Conclusion. With all states having to amend and re-draft substantial portions of their Medicaid regulations to comport with the new federal standards contained in the Deficit Reduction Act of 2005 (DRA), practitioners are well-advised to study their states new regulations side-by-side with federal rules. While the DRA did not make changes affecting medical eligibility per se, substantial changes have been made to the financial eligibility rules. It is predictable that states will invariably cross that invisible line when interpreting the federal rules and impose restrictions on Medicaid applicants greater than federal law permits. Before embarking on some form of appellate practice, elder law practitioners are advised to check with the specific committee that may be established through their states bar association to inquire whether such restrictions promulgated by their state agency are already under review by that committee.

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Martin on Take Advantage of Horizontal Virtual Representation by Drafting for It

2008 Emerging Issues 1821

Martin on Take Advantage of Horizontal Virtual Representation by Drafting for It

By Andrew L. Martin and Kelliann Kavanagh

January 25, 2008

SUMMARY: By statute, New York permits application of lateral or horizontal virtual representation when the governing instrument expressly provides for it. In this expert commentary, Andrew L. Martin discusses some of the benefits of such virtual representations, the need for express authorization for such representation, as well as the consequences of failing to do so.

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ARTICLE: Insight

SCPA § 315(5) permits application of lateral or horizontal virtual representation when the governing instrument expressly provides for it. Without express authorization in the governing instrument, horizontal virtual representation is not available, leading to unnecessary expense and delay. The simple expedient to ensure that the benefits which flow from application of the statute are available is to make it a practice to have all wills drafted contain a provision expressly authorizing the use of virtual representation in any and all proceedings effecting the decedent's estate.

Analysis

Horizontal virtual representation saves time, money. Horizontal virtual representation refers to a situation where the interests in a proceeding of a person under disability are "virtually represented" by another party to the proceeding with the same interest who is not under a disability. Consider an accounting proceeding where the trust remainder is left to the decedent's grandchildren. Since the grandchildren have an interest in the proceeding, process would have to issue to all of them. If at the time of the accounting there are one or more grandchildren who are infants or are otherwise under a disability, a guardian ad litem will have to be appointed to represent those interests (SCPA § 402(2)), causing delay and additional expense. However, if the instrument permits horizontal virtual representation and there is at least one grandchild who is adult and competent, there is no need to serve process on the parties under disability, as their interests are represented by the adult, competent grandchild (SCPA § 315(5)), unless the grandchildren's interest are different.

Without express authority in governing instrument, application of horizontal virtual representation not permitted. Application of the virtual representation statute deprives a party with an interest in a proceeding from being made a party to that proceeding. Thus, the courts will strictly apply its provisions. If the governing instrument does not expressly authorize the application of horizontal virtual representation, the courts will not permit it. *In re Campbell*, N.Y.L.J., Jan. 10, 2001, at 31, col. 3 (Sur. Ct. Queens County).

In *In re Estate of Sanders, 123 Misc. 2d 424 (N.Y. Misc. 1984)*, the court refused to allow decedent's great-grandchildren to be virtually represented by their parents, decedent's grandchildren, where the present interests of the grandchildren and great-grandchildren in a testamentary sprinkling trust were identical. Virtual representation is unavailable unless the will specifically authorizes it. Here, decedents will was silent as to virtual representation.

Expense and delay attendant on appointment of guardian ad litem easily avoidable. To avoid the expense and delay attendant upon the appointment of a guardian ad litem to represent the interests of parties under a disability where another party not so disabled has the same interest, simply include a provision in all wills and trusts authorizing the application of horizontal virtual representation in all actions or proceedings involving the estate or trust. Of course, if the estate or trust you are representing does not contain such a provision, this information is of limited immediate use. Nevertheless, practitioners should make it routine practice to include such a provision in all wills and trusts they draft.

For further discussion of the issue, *see* -5 NY Practice Guide: Probate & Estate Admin § 5.02: Necessary Parties to the Probate Proceeding; 2-28 NY Practice Guide: Probate & Estate Admin § 28.08: Contingent or Unliquidated Claims; 2-30 NY Practice Guide: Probate & Estate Admin § 30.08: Petition for Authority to Dispose of Real Property; 2-40 NY Practice Guide: Probate & Estate Admin § 40.03: Compulsory Judicial Accountings; 2-40 NY Practice Guide: Probate & Estate Admin § 40.04: Voluntary Judicial Accountings; 2-40 NY Practice Guide: Probate & Estate Admin § 40.05: Informal Accountings; 2-40 NY Practice Guide: Probate & Estate Admin § 40.08: Voluntary Judicial Accountings; 2-40 NY Practice Guide: Probate & Estate Admin § 40.11: FORM 40-2: Status Report as to Not Fully Distributed Estate Under 22 NYCRR § 207.42; 2-41 NY Practice Guide: Probate & Estate Admin § 41.02: Account Schedules; 2-41 NY Practice Guide: Probate & Estate Admin § 41.03: Account Schedules; 1-2 LexisNexis AnswerGuide New York Surrogate's Court § 2.17: Considering Virtual Representation; 1-2 LexisNexis AnswerGuide New York Surrogate's Court § 2.19: Determining If Virtual Representation Applies; 1-2 LexisNexis AnswerGuide New York Surrogate's Court § 2.20: Requesting Virtual Representation; 1-2 LexisNexis AnswerGuide New York Surrogate's Court § 2.21: Understanding Court's Discretion to Deny Virtual Representation; 1-2 LexisNexis AnswerGuide New York Surrogate's Court § 2.22: Using Virtual Representation in Non-Judicial Settlement of Accountings; 1-7 *Warren's Heaton on Surrogate's Court Practice § 7.05*: Virtual Representation; 3-41 *Warren's Heaton on Surrogate's Court Practice § 41.04*: Obtaining Jurisdiction Over Parties; 11-187 *Warren's Heaton on Surrogate's Court Practice § 187.05*: Procedure for Construction of Wills.

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This article was updated and expanded by Kelliann Kavanagh, Esq.

35 of 52 DOCUMENTS

Michael E. OConnor on Meeting Requirements for Effective Renunciation

2008 Emerging Issues 1822

Michael E. OConnor on Meeting Requirements for Effective Renunciation

By Michael E. OConnor and Kelliann Kavanaugh

January 25, 2008

SUMMARY: Renunciation may protect assets from creditors, avoid tax, or pass property to an alternate beneficiary. Transfers that may be renounced include intestate shares, testamentary legacies, beneficiary designations, joint interests, or tenancy by the entirety. This Expert Commentary, authored by Michael O Connor, a Fellow of the American College of Trust and Estate Counsel and a contributing author to Warrens Heaton on New York Estate Practice, urges legal counsel to insure that all outcomes of a renunciation are consistent with the client's objectives and then carry out all formalities so that renunciation is timely and effective. The commentary also discusses three relevant cases: *In re Adler, 869 F. Supp. 1021 (E.D.N.Y. 1994); In re Molloy v. Bane, 214 A.D.2d 171, 631 N.Y.S.2d 910* (2d Dep't 1995); and *Keuning v. Perales, 190 A.D.2d 1033, 593 N.Y.S.2d 653* (4th Dep't 1993).

PDF LINK: Click Here for Enhanced PDF of Commentary

ARTICLE: Insight

Renunciation may protect assets from creditors, avoid tax, or pass property to an alternate beneficiary. Transfers that may be renounced include intestate shares, testamentary legacies, beneficiary designations, joint interests, or tenancy by the entirety. Counsel must be sure that all outcomes of a renunciation are consistent with the client's objectives and then carry out all formalities so that renunciation is timely and effective.

Analysis

Consult federal and state law to ensure careful tax planning. New York determines liability for estate and gift tax pursuant to statutes, rules, EPTL 2-1.11, and regulations of the federal estate and gift tax. *IRC § 2518* deals with the tax effect of a renunciation. EPTL 2-1.11 is, to a great extent, coordinated with the federal statute. There are, however, differences that must be considered to achieved a tax objective.

Satisfaction of federal law requirements allows the alternate beneficiary to be substituted for the primary beneficiary without treating the transfer from the primary beneficiary to the second beneficiary as a taxable gift. Federal law does not require that renunciation notice be filed with the court but does require that state law be satisfied for the federal renunciation to be effective. The filing requirement of the statute is critical to an effective tax renunciation.

State law allows the period to renounce to be extended under certain circumstances. Federal law offers no similar opportunity. Therefore, for renunciation to be effective for tax purposes, it must be made strictly within the nine-month period provided under federal law.

Renunciation does not defeat all creditors and may threaten Medicaid benefits. The valid renunciation of an interest causes the beneficiary to be treated as having pre-deceased the transferor. Renunciation is an established means to defeat creditors of the beneficiary, since nothing comes into the beneficiary's hands which the creditor can claim. However, the District Court of the Eastern District of New York found that a renunciation is ineffective to avoid enforcement of a federal tax lien against the beneficiary.

In the case of *In re Adler, 869 F. Supp. 1021 (E.D.N.Y. 1994),* a widow brought a wrongful death action against the owner of the speeding car that struck and killed her husband. The action was settled in the widows favor for $350,000. Various creditors of the husbands estate and the widow asserted claims, including a federal tax lien, against the settlement proceeds. The widow sought to renounce her interest in the proceeds in favor of her five children. Under federal law, if a person fails to pay taxes, a lien in favor of the United States shall attach to all property and rights to property belonging to that person. Therefore, the widows renunciation was invalid as against the federal tax lien and any settlement proceeds to which she was entitled absent the renunciation were subject to the lien.

Creditor avoidance is ineffective also when the beneficiary is receiving or applying for Medicaid. Two appellate divisions have found that a renunciation by a beneficiary could be treated as a disqualifying transfer, making the beneficiary ineligible for Medicaid under Social Services Law § 366.

In *In re Molloy v. Bane, 214 A.D.2d 171, 631 N.Y.S.2d 910* (2d Dep't 1995), three years after petitioner began receiving Medicaid benefits, her 18-year-old daughter was killed in a car accident. The Department of Social Services, believing that the accident might result in a recovery for wrongful death, requested that the petitioner assign her interest in her daughters estate to it. Instead, the petitioner renounced her interest. Underlying all eligibility determinations, including eligibility for medical assistance, is a basic premise that aid is to be furnished only to the truly needy and not to those who have purposely created their own need. Petitioners Medicaid benefits were terminated on the grounds that she perpetuated her own neediness by failing to pursue a potentially available resource, i.e., a wrongful death award.

In *Keuning v. Perales, 190 A.D.2d 1033, 593 N.Y.S.2d 653* (4th Dep't 1993), petitioner, while a recipient of medical assistance, received a share of settlement proceeds in a wrongful death action. She renounced any interest in those proceeds. Petitioner contended that she never agreed to the wrongful death action and never intended to be a part of it, and therefore, it was an error to determine that she made a transfer of property for the purpose of qualifying for public assistance. The court determined that the petitioner did not overcome the statutory presumption that any transfer of property within one year of the date of application for benefits was made for the purpose of qualifying for such benefits. Therefore, petitioners medical assistance benefits were terminated.

Renunciating beneficiary does not control how benefit passes; will must be clear. When a beneficiary renounces an interest, the beneficiary has no right to direct how or to whom the benefit will pass. If the beneficiary has both a present and future interest, renunciation of the present interest is deemed to renounce the future interest as well. *See* EPTL 2-1.11(d). A spouse will often renounce part or all of an outright residuary gift, causing that renounced property to pass into a trust for the spouse's benefit. However, EPTL 2-1.11 provides an exception allowing a spouse to renounce one interest while retaining another interest in the same property. *See* EPTL 2-1.11(e). This is one of the most common purposes of renunciation. The will must be drafted to provide all the terms of the trust that will receive the renounced property, since the spouse-beneficiary cannot direct where it will go after renunciation.

For further discussion of the issue, *see* New York Practice Guide: Probate and Estate Administration § 31.01: Intestate Succession; New York Practice Guide: Probate and Estate Administration § 31.13: Right of Election; New York Practice Guide: Probate and Estate Administration § 41.03: Account Schedules; *Warren's Heaton on Surrogates*

Court § 195.01: Acceptance, Renunciation of Disposition; *Warren's Heaton on Surrogates Court § 200.07*: Renunciation and Release of Powers of Appointment; *Warren's Heaton on Surrogates Court § 209.09*: Modification and Termination of Trusts.

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Mr. O'Connor graduated from State University of New York at Buffalo (B.A. 1970) and Syracuse University College of Law (J.D. 1974). He is a Fellow of the American College of Trust and Estate Counsel (ACTEC) and its immediate past state chairman. He is a member of the New York State Bar Association and is its immediate past Chair of its 5,000+ member Trust & Estates Section. He has also acted as Chairman of Elder Law Section 1999-2000; Member House of Delegates; Committee on Specialization 1979-1984; Chairman, Committee on Continuing Legal Education, Trusts and Estates Section, 1988-1997; Chair of Publications Sub-Committee of the Continuing Legal Education Committee of New York State Bar Association.

He has been an adjunct professor of taxation in the Syracuse University School of Law Masters Program. He has acted as Chairman of State-wide New York State Bar Association continuing education programs for attorneys on Contested Estates and Fiduciary Income Taxation. He has been Moderator and Lecturer on New York State Bar Association programs on Will Drafting; Use of Trusts in Nursing Home Planning; Estate Settlement; Valuation of Business Interests; Estate Problems in Real Property Titles; Business Interests; Fiduciary Income Tax; Generation Skipping Tax; Use of Trusts and Gifts in Estate Planning. He has spoken, moderated and written for programs sponsored by the New York Society of CPAs, Central New York CPA Club, National Business Institute, Estate Planning Council of CNY, Estate Planning Council of the Capital District and Association of Real Estate Appraisers. He has authored articles, "US Savings Bonds in the Estate" and "Generation Skipping Tax-Questions and Answers for the Estate Planner" (New York State Bar Journal). He is a contributing author to Warrens Heaton on New York Estate Practice, and has authored numerous statutory commentaries for LexisNexis Publishing. He is Editor-in-Chief of a book "Estate Planning and Will Drafting". As a member of the Onondaga County Bar Association, he has chaired its Committee on Estates and Surrogate's Court, and been a member of its Board of Directors. He is a member and past President of The Central New York Estate Planning Council. He is also a director of the Syracuse University Tax Institute. Mr. O'Connor has participated in numerous community educational programs, TV and radio broadcast programs on estate planning issues, as well as having written for local publications on the subject.

This article was updated and expanded by Kelliann Kavanaugh, Esq.

Colleen F. Carew on How an Adult Competent Party Appears in Surrogate's Court

2008 Emerging Issues 1825

Colleen F. Carew on How an Adult Competent Party Appears in Surrogate's Court

By Colleen F. Carew and Kelliann Kavanaugh

January 25, 2008

SUMMARY: Surrogate's Court is unique as either the governing statute or the court determines the parties necessary to a determination of a proceeding. Many proceedings in Surrogate's Court are uncontested and an interested person may willingly appear and consent to the relief sought. This Expert Commentary, authored by Colleen F. Carew, who practices law in Yonkers, New York, examines the impact of a waiver and consent by a competent adult or by a guardian, the circumstances surrounding such a waiver and consent, appearances by a non-party or an attorney for a non-domiciliary party, and a discussion of two relevant cases: *In re Frutiger, 29 N.Y.2d 143, 324 N.Y.S.2d 36, 272 N.E.2d 543 (1971);* and *In re Hunter, 190 Misc. 2d 593, 739 N.Y.S.2d 916 (Sur. Ct. New York County 2002).*

PDF LINK: Click Here for Enhanced PDF of Commentary

ARTICLE: Insight

Surrogate's Court is unique as either the governing statute or the court determines the parties necessary to a determination of a proceeding. Many proceedings in Surrogate's Court are uncontested and an interested person may willingly appear and consent to the relief sought. Counsel must consider the method of appearance as it may affect rights in the underlying proceeding. For example, execution of a waiver and consent not only confers on the court personal jurisdiction over the party but consents to the relief requested by the petitioner. If waiver and consent are knowing, a subsequent decree binds the consenting party.

Analysis

Any competent adult person or guardian for an incapacitated person interested in proceeding may appear. Any competent adult person or guardian for an incapacitated person under SCPA 402 with an interest in a proceeding may appear by any of the following methods enumerated in SCPA 401:

1. Filing a responsive pleading (answer or objections);

2. Filing a notice of appearance by an attorney;

3. Filing a personal notice of appearance;

4. Signing a waiver of process; or

5. Personally appearing in Court on the return date of citation.

Non-party claiming interest in proceeding may intervene. Using non-testamentary assets to transfer assets is increasing. A proceeding concerning the transfer of non-testamentary assets may affect a third person. A non-party who claims to be interested in a proceeding may seek to intervene by filing a notice of appearance and a petition or affidavit setting forth his or her interest. *See* Uniform Surrogate's Court Rule 22 NYCRR § 207.9(a).

Attorney for non-domiciliary must substantiate authority to act and receive process. When a party is a non-domiciliary, the attorney must file an acknowledged authorization signed by the client to show authority to act and receive process for the client. *See* SCPA 401(2) and 22 NYCRR § 207.9(b). The attorney must obtain this authorization for each proceeding in which the attorney appears for the client. This requirement protects the court's order or decree by ensuring that the court has obtained personal jurisdiction over all parties. The attorney can solve this issue by obtaining a power of attorney from the non-domiciliary client and recording it with the Surrogate's Court. The power-of-attorney should be drafted to enable the attorney to obtain funds on behalf of the client, thus easing the process of distributing assets at a later date.

An adult competent party may waive citation and consent to relief requested. An adult competent party may waive citation and consent to the relief requested. Waiver and consent are widespread among Surrogate's Court practitioners; they are useful methods of obtaining personal jurisdiction and consent to the relief requested. As a general rule, the party signing the waiver and consent is presumed to understand it and is bound by its effect. As with any contract, it may be set aside on a showing of fraud, misrepresentation, or mistake.

For example, in *In re Frutiger, 29 N.Y.2d 143, 324 N.Y.S.2d 36, 272 N.E.2d 543 (1971),* distributees under a will signed documents waiving citation and consenting to the admission of the will to probate. Neither the executor nor its attorney explained the nature and effect of the waiver and consent. Almost three years later, the executor filed a probate petition. The distributees filed objections, and the waivers were filed. The court held the waiver and consent would not be destroyed without a showing of good cause, such as fraud, collusion, mistake, accident, etc. The executor's failure to explain the waivers contributed to any prejudice that ensued. The distributees were permitted to withdraw their waivers and consents.

Many practitioners are complacent in obtaining a waiver and consent from beneficiaries. The court may scrutinize the circumstances under which the waiver was obtained. Failure to ensure that full disclosure was given to the beneficiary may detriment the fiduciary client. For example, a court vacated a waiver and consent because the beneficiary lacked full knowledge of all material facts and circumstances regarding the account."

In *In re Hunter, 190 Misc. 2d 593, 739 N.Y.S.2d 916 (Sur. Ct. New York County 2002),* a beneficiary sought to vacate the court's approval of an accounting. Although the beneficiary signed a waiver and consent to the accounting, the trustee possessed superior knowledge and benefited from the beneficiary's waiver. The trustee was aware that the beneficiary was not given an opportunity, either with or without counsel, to review the account prior to the waiver's execution. The trustee failed to meet its burden of proving that the circumstances surrounding the waiver's execution were just and fair.

For further discussion, *see* New York Practice Guide: Probate and Estate Administration § 6.01: Appearance; New York Practice Guide: Probate and Estate Administration § 6.02: Citation; New York Practice Guide: Probate and Estate Administration § 11.09: FORM 11-3: Citation upon Filing Objections to Probate; New York Practice Guide: Probate and Estate Administration § 13.09: Return of Process; LexisNexis AnswerGuide New York Surrogate's Court § 15.03: Determining How Party May Appear; LexisNexis AnswerGuide New York Surrogate's Court § 15.04: Making Appearance; *Warren's Heaton on Surrogates Court § 4.05*: Attorneys in Surrogate's Court; Warren's Heaton on Surrogates' Court Ch. 7: Appearances; *Warren's Heaton on Surrogates' Court § 96.27*: Proceedings Upon Return of

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This article was updated and expanded by Kelliann Kavanaugh, Esq.

Michael E. O'Connor on Establishing Paternity after Death of Parent or Child

2008 Emerging Issues 1812

Michael E. O'Connor on Establishing Paternity after Death of Parent or Child

By Michael E. O'Connor and Kelliann Kavanaugh

January 24, 2008

SUMMARY: A non-marital child may want to inherit from its father on his death or to share in the proceeds of a wrongful death action. Similarly, a father may look for the same benefit on death of the non-marital child. Each potential inheritor faces the challenge of establishing the right to inherit by showing paternity through "clear and convincing evidence." This Expert Commentary, authored by Michael O Connor, a Fellow of the American College of Trust and Estate Counsel and a contributing author to Warrens Heaton on New York Estate Practice, examines filiation proceedings, DNA testing, and non-marital children, including a discussion of six relevant cases: *In re Corbett v. Corbett, 100 Misc. 2d 270, 418 N.Y.S.2d 981 (Fam. Ct. New York County 1979); In re Niles, 81 Misc. 2d 937, 367 N.Y.S. 2d 173 (Sur. Ct. New York County 1937); In re Davis, 27 A.D.3d 124, 812 N.Y.S.2d 543* (2d Dep't 2006); *In re Morningstar, 17 A.D.3d 1060, 794 N.Y.S.2d 205* (4th Dep't 2005); *In re Janice, 210 A.D.2d 101, 620 N.Y.S.2d 342* (1st Dep't 1994); and *In re Hoffman, 53 A.D.2d 55, 385 N.Y.S.2d 49* (1st Dep't 1976).

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ARTICLE: Insight

A non-marital child may want to inherit from its father on his death or to share in the proceeds of a wrongful death action. Similarly, a father may look for the same benefit on death of the non-marital child. Each potential inheritor faces the challenge of establishing the right to inherit by showing paternity through "clear and convincing evidence."

Analysis

Paternity can determine rights of inheritance. When representing a potential non-marital inheritor (whether child or father), it is critical to establish paternity as early as possible. There is no right of a child to take against the will of a parent who disinherits a child. Nonetheless, paternity may be important if the parent dies intestate or if there is a wrongful death action in which children could share. The non-marital child may also share as beneficiary of life insurance or a retirement plan where decedent has designated "children" to share generally.

Order of filiation or acknowledgment of paternity during father's lifetime establishes paternity. The requirement that the order of filiation be granted to the father during lifetime is not intended to impair the Family

Court's jurisdiction.

In *In re Corbett v. Corbett, 100 Misc. 2d 270, 418 N.Y.S.2d 981 (Fam. Ct. New York County 1979),* petitioner, the mother of a non-marital child, bought a paternity action against the estate of the childs putative father. The administratrix claimed New York inheritance law requires that an order of filiation be entered during the lifetime of the putative father. The mother responded that she was not asking for a finding that the child was entitled to share in the decedent's estate (which was a question for the Surrogates Court), but only for an adjudication of paternity and an order of filiation. The court held that New York law was not intended to impair the Family Court's jurisdiction. Therefore, it did not automatically prohibit the Family Court from entering an order of filiation subsequent to the putative father's death.

Where the Family Court had substantially completed the proceeding on filiation and the father died before the order was issued, the order was still effective to establish that the unborn infant was the father's child.

For example, in *In re Niles, 81 Misc. 2d 937, 367 N.Y.S.2d 173 (Sur. Ct. New York County 1937), aff'd, 53 A.D.2d 983, 385 N.Y.S.2d 876* (3d Dep't 1976), a 21-year old was killed in a car accident, resulting in a wrongful death action. At the time of death, decedent was involved in a filiation proceeding which was completed, except for the issuance of the actual order upon the birth of the child, and during which he admitted he was the father of the unborn child. The issue before the court was whether the child was entitled to proceeds from the wrongful death action. The court held that the child was the lawful distributee of the decedent because (1) there was a determination by a court of competent jurisdiction that the decedent was the father of the infant and all that remained to be done was the signing of the formal order, a ministerial act; and (2) the decedent admitted paternity.

Without order of filiation, party must establish paternity by clear and convincing evidence. Paternity must be established by clear and convincing evidence. If a filiation proceeding is not completed during the father's life, or if such a proceeding is undertaken in another state and not effective in determining inheritance in New York, facts established in such a hearing still may be relevant to prove paternity. However, such evidence would have to be accompanied by proof that the father openly and notoriously acknowledged the child as his own.

DNA tests. Posthumously-gathered DNA may be used as clear and convincing evidence of paternity, but only if the surviving child proves open and notorious acknowledgment of paternity.

In re Davis, 27 A.D.3d 124, 812 N.Y.S.2d 543 (2d Dep't 2006) illustrates this point. An alleged non-marital child sought biological material of a decedent to conduct genetic testing to enable the child to establish standing as a distributee. Two of the four ways in which a non-marital child can establish status as a distributee involve genetic testing. In one, posthumous genetic testing is not permissible. In the other, i.e., "paternity has been established by clear and convincing evidence and the father of the child has openly and notoriously acknowledged the child as his own," posthumous genetic testing may be permissible if it is first demonstrated that decedent openly and notoriously acknowledged paternity.

However, *In re Morningstar, 17 A.D.3d 1060, 794 N.Y.S.2d 205* (4th Dep't 2005) went further. In that case, alleged non-marital children sought to establish their inheritance rights to a portion of their purported fathers estate. The alleged non-marital children were required to establish paternity by clear and convincing evidence and to show that the decedent openly and notoriously acknowledged them as his children. The court held that the results of genetic testing could be used to satisfy their burden of establishing paternity and that there was no basis in the language of the law or the circumstances of the proceeding for requiring the alleged non-marital children to demonstrate first that the decedent openly and notoriously acknowledged them as his children before genetic testing could proceed.

Courts reluctant to order blood genetic marker test after death. The law does not contemplate administration of genetic tests after death of the decedent. *See* N.Y. Fam. Ct. Act § 519. Even though EPTL 4-1.2(a)(2)(D) does not

specifically prohibit exhumation to conduct genetic tests, courts are hesitant to render exhumation orders for that reason.

In I*n re Janis, 210 A.D.2d 101, 620 N.Y.S.2d 342* (1st Dep't 1994), an alleged non-marital child sought the exhumation of her purported fathers body for the purpose of taking samples on which a blood genetic marker test could be administered. The court held that the law clearly does not contemplate the administration of such a test post-death and the request for exhumation was unreasonable as a matter of law because, if the decedent was indeed the alleged non-marital childs father, he chose neither to acknowledge nor designate her in his will as an heir, but did make her a legatee, and assuming that she was ultimately found to have standing to challenge probate, she would still face the formidable task of demonstrating incompetence, fraud and undue influence to prevent probate.

Disinherited non-marital children must establish paternity and challenge will. When a decedent leaves a will that disinherits purported non-marital children, those children must establish that they are children of the decedent and successfully challenge the validity of the will.

"Issue" understood to refer to marital and non-marital children. If a will refers to "issue," that term should be understood to refer to marital and non-marital descendants in absence of clear intention to the contrary in the will.

In *In re Hoffman, 53 A.D.2d 55, 385 N.Y.S.2d 49* (1st Dep't 1976), decedents will provided that, when the first of two beneficiaries should die, his one-half share of the income should be paid for the remainder of the trust to his "issue". One beneficiary was eventually survived by two non-marital grandchildren. An order of filiation was never issued with regard to those children. The Surrogate, relying on precedents, ruled that the non-marital children could not inherit. The Appellate Division determined that, in light of changes in societal attitudes and constitutional law and in the absence of an express qualification by decedent, she intended, in her use of the word "issue", to include both marital and non-marital descendants.

Purported father and non-marital kindred may inherit. A purported father and paternal kindred are entitled to inherit from a deceased non-marital child if paternity is established in a fashion similar to that required for the death of a parent under EPTL 4-1.2.

For further discussion of the issue, *see* New York Practice Guide: Probate and Estate Administration § 7.01: The Petition, Oath and Designation; New York Practice Guide: Probate and Estate Administration § 13.02: Distributees Eligible to Receive Letters; New York Practice Guide: Probate and Estate Administration § 13.15: Petition, Process and Waiver of Process; New York Practice Guide: Probate and Estate Administration § 31.01: Intestate Succession; *Warren's Heaton on Surrogates Court § 128.03*: Establishing Paternity for Purposes of Inheritance by Non-Marital Children.

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Skipping Tax; Use of Trusts and Gifts in Estate Planning. He has spoken, moderated and written for programs sponsored by the New York Society of CPAs, Central New York CPA Club, National Business Institute, Estate Planning Council of CNY, Estate Planning Council of the Capital District and Association of Real Estate Appraisers. He has authored articles, "US Savings Bonds in the Estate" and "Generation Skipping Tax-Questions and Answers for the Estate Planner" (New York State Bar Journal). He is a contributing author to Warrens Heaton on New York Estate Practice, and has authored numerous statutory commentaries for LexisNexis Publishing. He is Editor-in-Chief of a book "Estate Planning and Will Drafting". As a member of the Onondaga County Bar Association, he has chaired its Committee on Estates and Surrogate's Court, and been a member of its Board of Directors. He is a member and past President of The Central New York Estate Planning Council. He is also a director of the Syracuse University Tax Institute. Mr. O'Connor has participated in numerous community educational programs, TV and radio broadcast programs on estate planning issues, as well as having written for local publications on the subject.

This article was updated and expanded by Kelliann Kavanaugh, Esq.

Martin on Execution of Later Will, Not Its Probate, Revokes All Prior Wills

2008 Emerging Issues 1813

Martin on Execution of Later Will, Not Its Probate, Revokes All Prior Wills

By Andrew L. Martin and Kelliann Kavanagh

January 24, 2008

SUMMARY: The revocation of a will by a testator does not, of itself, revive any prior wills. Also, it is the execution of a later will, not its admission to probate, which revokes a prior will. This Expert Commentary, authored by Andrew L. Martin, the Chief County Attorney of the Surrogates Court of the State of New York, Nassau County, and a contributing author to Warrens Heaton on Surrogates Court Practice Legislative and Case Digest, examines the revocation of wills, the revivals of wills, the effect of lost or revoked later wills on earlier wills, and a discussion of nine relevant cases, including *In re Wiltberger, 70 A.D.2d 963, 417 N.Y.S.2d 325* (3d Dep't. 1979); *In re Leach, 3 A.D.3d 763, 772 N.Y.S.2d 100* (3d Dep't 2004); *In re Delutri, 12 Misc.3d 1159A, 819 N.Y.S.2d 209, 2006 N.Y. Misc. LEXIS 1260 (Sur. Ct. Nassau County 2006);* and *In re Huang, 11 Misc.3d 325, 811 N.Y.S.2d 885 (Sur. Ct. New York County 2005).*

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ARTICLE: Insight

The revocation of a will by a testator does not, of itself, revive any prior wills. Also, it is the execution of a later will, not its admission to probate which revokes a prior will. Thus, an attempt to admit the earlier will to probate as a lost or destroyed will pursuant to SCPA § 1407 will likely be unsuccessful, absent clear evidence of lack of capacity or other impediment.

Analysis

Act of revocation of will does not, of itself, revive any prior will of testator (EPTL § 3-4.6(a)). Revival of prior will can only be effected by:

1. Execution of a codicil which incorporates by reference all or part of the prior will;

2. Execution of a separate writing, executed in accordance with EPTL § 3-2.1, which expressly declares the revival of the prior will; or

3. Republication of the prior will, including re-execution and re-attestation in accordance with EPTL § 3-2.1.

Revocation of earlier will occurs upon execution of later will. The execution of an instrument which disposes of all of the property of a testator effectively revokes any prior wills, even without any express language of revocation.

In the case of *In re Cunnion's Will, 201 N.Y. 123 (N.Y. 1911),* a decedent executed two wills, but only the earlier was found after his death. His daughter challenged the admission into probate of the earlier will, but could not prove the contents of the later will. Since the contents of the later will were not shown, the Surrogate was right to admit the earlier will into probate. A later will is not necessarily a revocation of a prior will, unless (1) by it the prior will is in terms revoked and canceled, or (2) by it a disposition is made of all of the testator's property, or (3) the later will is so inconsistent with the former that the two cannot stand together, or (4) the former will is revoked *pro tanto*.

In *In re Estate of Wiltberger, 70 A.D.2d 963 (N.Y. App. Div. 1979),* decedent was survived by four children from his first marriage and three children from his second marriage. Under the terms of decedents first will, the children from his second marriage were beneficiaries of a residuary trust. One year later, the decedent executed another will disposing of all his property, but not mentioning the children from his second marriage. The court held that the testator intended to revoke the first will and disinherit the children from his second marriage. Therefore, the Surrogate correctly admitted the second will to probate.

If there is no proof that the later will was executed in accordance with the statutory formalities, it will not effect a revocation of the prior will.

For example, in *In re Application of Shinn, 7 Misc. 2d 623 (N.Y. Misc. 1956),* the original of the decedent's first will was filed with the court along with a copy of a document purporting to be a second will and a third testamentary instrument, which, while in the decedent's handwriting, was undated, unexecuted, and unwitnessed. The second will effectively revoked the first. However, the second will had to be denied probate because petitioners failed to produce the original or present any proof that it was in existence on the date of decedent's death. As the third instrument was not executed in the manner prescribed by New York law, it did not revoke the first or second will and was denied probate.

However, if there is evidence of due execution, or if the execution of the will was supervised by an attorney, or if the will contains an attestation clause or self-proving affidavit, the court will indulge the presumption that the will was duly executed and conclude that the earlier will was thereby revoked.

In *In re Estate of Philbrook, 185 A.D.2d 550 (N.Y. App. Div. 1992),* decedents will was prepared by an attorney. After her death, an executed will could not be found. The beneficiaries of the unexecuted will petitioned to have a copy of it admitted to probate. The Surrogates Court dismissed the petition and the petitioners appealed arguing that a presumption of proper execution attends a will that is prepared by an attorney. The Appellate Court held that, although "a presumption of regularity" applies when an attorney supervises the execution of a will, Surrogate's Court must otherwise be satisfied from all of the evidence that the will was properly executed. Here, the copy did not contain decedent's signature, nor the signature of either the attorney or his secretary who allegedly witnessed its execution.

In re Estate of Collins, 60 N.Y.2d 466 (N.Y. 1983), a decedent executed two wills 26 years apart. Upon decedent's death, her nephews offered the first will for probate. A beneficiary offered the second will. At trial, two witnesses of the second will identified their signatures. Other witnesses testified as to the second will's genuineness. The decedent's physician testified that he examined the decedent on the day she executed the second will and found her to be in good mental and physical condition. Relying on the attestation clause, the genuineness of the three signatures, and the testimony of the physician, the court found that the second will had been duly executed.

In *In re Estate of Leach, 3 A.D.3d 763 (N.Y. App. Div. 2004),* decedent's brother asserted that his will should not be admitted into probate because it may not have been properly executed. The court found that there was no evidence that the will was not duly executed. Although the attorney who drafted the will and the secretary who witnessed it could not recall the particulars of the will signing, both signed self-executing affidavits. When an attorney drafts a will and

supervises its execution, a presumption is raised that the will was properly executed. A self-executing affidavit also creates a presumption that the will was duly executed. This presumption cannot be overcome merely because the attesting witnesses are not able to specifically recall the wills execution.

Subsequent loss or revocation of later will has no effect on revocation of prior will. If the later will which effected a revocation of the prior will is itself later lost or revoked, there is no effect on the prior will, as it is the later will's execution, not its probate, which revokes the earlier will (*Matter of DeLutri, 2006 NY Slip Op 50966U (N.Y. Misc. 2006)).*

For example, in *Matter of Huang, 2005 NY Slip Op 25565 (N.Y. Misc. 2005),* decedent left a testamentary instrument, which was offered for probate. Petitioner asked the court to deny probate to seven other writings, each dated after the proffered instrument. The court found that the first six writings, being unattested, were inadmissible to probate. The seventh was a photocopy of an instrument executed under the supervision of an attorney; its due execution, therefore, was presumed. However, the original could not be located. The strong presumption was the decedent revoked the will by destruction. Accordingly, the photocopy was inadmissible. The decedent's clear intent was to revoke all prior wills by means of the seventh. Since there was no evidence the instrument offered for probate, or any other prior instrument, was revived; the decedent died intestate.

In *In re Estate of Lautz, 55 Misc. 2d 412 (N.Y. Misc. 1967),* a petition was presented to the court requesting probate of a will of the decedent. Evidence was presented that the decedent had executed several subsequent wills under the supervision of another attorney. The court found that the subsequent wills revoked the will that was presented and because the subsequent wills were not presented for probate, the court determined that the decedent died intestate. The court found that the subsequent execution of other wills, without proof that the decedent took any steps to affirmatively reinstate the prior will, revoked the prior will.

For further discussion of the issue, *see* 3-42 *Warren's Heaton on Surrogate's Court Practice § 42.08*: Revocation; 11-181 *Warren's Heaton on Surrogate's Court Practice § 181.02*: Codicils; 11-187 *Warren's Heaton on Surrogate's Court Practice § 187.03*: Construction of Separate Testamentary Clauses and Multiple Testamentary Documents.

This article was updated and expanded by Kelliann Kavanaugh, Esq.

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This article was updated and expanded by Kelliann Kavanagh, Esq.

Bartol on Verification of Pleadings

2008 Emerging Issues 1814

Bartol on Verification of Pleadings

By Ernest T. Bartol and Kelliann Kavanagh

January 24, 2008

SUMMARY: Unlike in the Supreme Court of New York, all pleadings filed in the Surrogates' Court must be verified. Ernest T. Bartol, the Managing Attorney of Murphy, Bartol & O'Brien, LLP, with extensive experience in estate, wills, and trust matters, explains the voluntary nature and methods of verification, and in addition discusses the case of *Air New York, Inc. v. Alphonse Hotel Corp., 86 A.D.2d 932 (N.Y. App. Div. 1982).*

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ARTICLE: Insight

Unlike in the Supreme Court, all pleadings filed in the Surrogates' Court must be verified.

Analysis

Counsel must verify pleadings in Surrogate's Court. All pleadings filed in the Surrogates' Courts must be verified in accordance with CPLR § 3020. Under the CPLR, verification of pleadings is predominantly voluntary. Counsel should have their clients verify the pleadings wherever and whenever possible. Even though an attorney is permitted to verify a pleading instead of the client in certain instances (such as when the client is not in the same county), judicial decisions have frowned on the attorney verifying the proceeding while acknowledging the statutory right to do so. *In re Ries, 170 A.D. 951 (N.Y. App. Div. 1915)* (where the applicants reside out of the county, and the matters are peculiarly within the attorney's knowledge, the attorney may properly verify a petition).

In *In re Estate of Ray, 150 Misc. 728 (N.Y. Misc. 1934)*, the petitioner, who resided in Canada, had a petition filed in Surrogates Court for limited letters of administration for his mothers estate. The petitioner gave a power of attorney to his counsel, who made and verified the petition. The court held that such verification is undoubtedly permitted by statute, but its use in Surrogate's Court should not be encouraged, for also by statute, petitions in the absence of answers or other appropriate papers questioning the allegations thereof are taken as true and proof of the facts alleged therein, so that wherever possible the allegations should be made by one having first hand knowledge thereof.

When an attorney does verify the pleading, the attorney must set forth the grounds for belief on all matters the

attorney does not know firsthand. The verification should state whether the attorney: (1) reviewed books, documents, and records; (2) had conversations with clients or others; (3) reviewed correspondence or other writings; or (4) performed or reviewed tests or analyses.

CPLR § 3020--3023 governs methods to verify pleadings. Verification shall be made by the affidavit of a party, or, if two or more parties united in interest are pleading together, by at least one of them acquainted with the facts. CPLR § 3020(b). If your client is a domestic corporation, verification should be made by an officer of that corporation.

Defective pleadings are null. If you receive a defectively verified pleading, you may treat it as a nullity, provided you give your adversary notice of such treatment. This notice requirement has been interpreted to mean notice given immediately, or at least within 24 hours, of receipt of defective pleading.

In *Air New York, Inc. v. Alphonse Hotel Corp., 86 A.D.2d 932 (N.Y. App. Div. 1982),* plaintiff brought an action against defendants for breach of contract. Plaintiff obtained a default judgment against defendants based upon the claimed failure of defendants to serve a properly verified answer. The trial court vacated the default judgment. The Appellate Division held that: (1) a party could treat a defectively verified pleading as a nullity provided he gave notice with due diligence to the adverse party that he elected so to do, and the term "due diligence" means immediately or at least within 24 hours of the receipt of the defective pleading; (2) plaintiff waited three days before giving notice of its rejection of the claimed defective answer; and (3) under all the circumstances presented, the trial court correctly concluded that plaintiff had waived its objection to the claimed defective verification, and the default judgment was properly vacated.

The best practice is to call or write the attorney for the adverse party to advise him or her of the default in the verification and request that such verification be provided. Courts generally frown on arguments over verification.

For further discussion of the issue, *see* 1-4 NY Practice Guide: Probate & Estate Admin § 4.02: Invoking the Surrogate's Court Jurisdiction; 1-20 NY Practice Guide: Probate & Estate Admin § 20.06: Petition for Ancillary Letters; 1-2 LexisNexis AnswerGuide New York Surrogate's Court § 2.03: Complying With Pleadings Requirements; 2-35 *Warren's Heaton on Surrogate's Court Practice § 35.03*: Order of Priority for Granting Letters of Administration.

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Ernest T. Bartol received a Juris Doctorate Degree from Villanova University School of Law in 1970. Admitted to the New York Bar in 1971, Mr. Bartol has served as a member of the Nassau County Bar Association, Estates and Trusts Law Committee from 1977 to date, the Professional Ethics Committee from 1979 to date, and the Tax Certiorari Committee from 1988 to date, and the New York State Bar Association Estates and Trusts Law Committee from 1973 to date.

Mr. Bartol, who has a Bachelor of Science Degree in Accounting from Fordham University, has concentrated in all phases of Estates, Wills and Trusts since leaving the employ of a major accounting firm in 1971.

On the planning side, he has been engaged in all phases of Estate asset protection by drafting, inter alia, (1) Wills with Unified Credit Shelter Trusts and provisions, (2) Irrevocable and Revocable Trusts, including Life Insurance Trusts, (3) Qualified Personal Residence Trusts, (4) Family Limited Partnerships and Limited Liability Companies, (5) Private Annuities, (6) GRATS, GRITS and GRUTS and (7) other planning devices for use by individuals, shareholders of family and closely-held businesses and partners of family and closely-held businesses.

On the litigation side, he has been engaged in all types of proceedings in the Surrogate's Courts located in New York City, Nassau, Suffolk and upstate Counties, including contested probate proceedings, contested accounting proceedings, discovery proceedings, etc. His estate work also includes the preparation and filing of Federal and New York State Estate tax returns.

A member of the New York State Bar Association Trusts and Estates Law Committee wherein he frequently lectures on estate-related topics, Mr. Bartol also has recently been inducted as a member of the Federal Bar Council, and has become a member in the Fellows of the American Bar Foundation and the New York State Bar Association. He is a member of various Who's Who registers, including Who's Who in American Law.

Mr. Bartol is admitted to practice before all the Courts of the State of New York, a number of United States District Courts, the United States Court of Appeals for the Second Circuit, and the United States Supreme Court. While Mr. Bartol is a seasoned litigator, he is also the Managing Attorney of MURPHY, BARTOL & O'BRIEN, LLP.

This article was updated and expanded by Kelliann Kavanagh, Esq.

Bartol on Using Virtual Representation to Streamline Notice

2008 Emerging Issues 1815

Bartol on Using Virtual Representation to Streamline Notice

By Ernest T. Bartol and Kelliann Kavanagh

January 24, 2008

SUMMARY: Virtual representation can save significant time and money by streamlining the notice process. Ernest T. Bartol, the Managing Attorney of Murphy, Bartol & O'Brien, LLP, with extensive experience in estate, wills, and trust matters, discusses some of the benefits of utilizing virtual representation, as well the courts role in ensuring that parties are represented adequately when virtual representation is employed.

PDF LINK: Click Here for Enhanced PDF of Commentary

ARTICLE: Insight

Virtual representation can save significant time and money by streamlining the notice process. Taking time to determine whether virtual representation is appropriate is worth the effort because it can reduce dramatically the list of persons to be served.

Analysis

Virtual representation dispenses with service on persons whose interests another party adequately represents. To take advantage of virtual representation, the practitioner should first determine that the proposed representees fit within SCPA § 315 and that the virtual representation is adequate.

For example, in *In re Will of Silver, 72 Misc. 2d 963 (N.Y. Misc. 1973),* decedent's son and his unborn children were contingent remaindermen of trusts. Son was also an income beneficiary and brought an action to remove the trustee because he refused to exercise his power of invasion. Virtual representation is based upon similarity of economic interests. It is presumed that the representor, in pursuing his own economic self-interest, will necessarily protect the rights of the representees having the same interest. Here, the interests of son and his unborns were likely to be adverse. A combined income beneficiary-remainderman does not represent the "same interest" as straight remaindermen.

When there is a contingent disposition to a class, the practitioner need only serve those persons in being who would be members of the class if the contingency had happened immediately prior to commencement of the proceeding. In

addition, where an interest in the estate is assigned to a party and the same interest is limited on occurrence of a future event to a class of persons described in terms of their relationship (e.g., "issue"), only the party need be cited. When a party has a power of appointment, the potential appointees do not need to be served as they are not necessary parties.

In *In re Estate of Putignano, 82 Misc. 2d 389 (N.Y. Misc. 1975),* testator created a sprinkling trust whose income beneficiaries were his wife and 16 "descendants" (i.e., children and grandchildren). Upon the death of the widow, the principal was to be distributed to testator's then living descendants or, in the contingency that there were no such descendants, to the descendants of the parents of testator and his wife. In an executor's accounting proceeding, the five children of testator who, as descendants, would solely take under the will if the widow had died prior to the commencement of the proceeding, could virtually represent the class of grandchildren and the other contingent remaindermen.

If members of a class are unborn or unascertained persons, they need not be served if there is a living person having the same interest. If no such person exists, the court will appoint a guardian ad litem. Also, a person with a future contingent interest does not need to be served if that person can be represented by a party to the proceeding having the same interest. The person with a contingent remainder does not have to be a class and does not have to be described in terms of their relationship to the party.

The rules are somewhat different in probate proceedings, since focus is not on whether persons have a like interest in principal or interest but, rather, whether they have a common interest in proving or disproving the will. If the beneficiaries have an interest in the same trust or fund, a common interest in proving or disproving the will, and the representee will not receive a greater benefit whether the instrument is denied or admitted to probate, virtual representation will be permitted. Virtual representation can also be used when an account is settled by receipt and release, unless the instrument provides otherwise.

If instrument expressly authorizes horizontal virtual representation, persons under disability need not be served when party to proceeding has same interest. When a person under disability has the same interest as a party to the proceeding, the person under a disability need not be served if the instrument expressly provides for virtual representation. This is known as "horizontal representation" because the representor can represent the interest of a person on the same level. To use horizontal virtual representation, the instrument must express it by explicit reference to SCPA § 315(5). For example, if a will provides for establishment of a sprinkling trust, and both the proposed representor and representee are sprinklees of the income, their interests are concurrent, not successive, and horizontal virtual representation may occur if the instrument provides for it. Until the instrument's validity is shown, provision for horizontal virtual representation has no effect and the person under a disability must be served.

In a probate proceeding in *In re Estate of Ginsburg, 115 Misc. 2d 122 (N.Y. Misc. 1982),* proponent of the will sought horizontal virtual representation of decedents infant distributees by a party to the proceeding who had the same interest as the infants. The court found that the will expressly provided for such representation by explicit reference to SCPA § 315(5). However, the court held that the precondition to virtual representation, namely, that the will expressly provided for it, could not be met by an instrument whose validity was still subject to question by the interested persons who it was sought to deny the issuance of process to. The infant distributees were required to be served with process.

When seeking horizontal virtual representation, the practitioner must remember to submit an affidavit from petitioner concerning the terms and adequacy of the proposed representation.

Court will scrutinize adequacy of representation. SCPA § 315(6) states that the decree or order in any proceeding where virtual representation is used to dispense with service is binding and conclusive on all persons on whom service is not required. Consequently, the court will scrutinize the representee's interests. The court cautioned that developments during a proceeding could result in an advantage to a representor.

In *In re Estate of Putignano, 82 Misc. 2d 389 (N.Y. Misc. 1975),* the court advised that representors could virtually represent two classes of representees. However, the court cautioned that even if it rightly concludes at the outset that virtual representation is available, there is never any absolute assurance that its decree will not be vulnerable to direct or collateral attack. If, in consequence of developments *during* a proceeding, the decree results in an advantage to the representors vis-a-vis the representees, this is prima facie proof of inadequacy of representation. Where infants or incompetents are concerned, virtual representation never assures the same finality as does representation by a guardian ad litem.

Therefore, the court has discretion to order service if it has any doubt, at any point of the proceeding, that the representee's interests are not protected.

For further discussion of the issue, *see* -5 NY Practice Guide: Probate & Estate Admin § 5.02: Necessary Parties to the Probate Proceeding; 2-28 NY Practice Guide: Probate & Estate Admin § 28.08: Contingent or Unliquidated Claims; 2-30 NY Practice Guide: Probate & Estate Admin § 30.08: Petition for Authority to Dispose of Real Property; 2-40 NY Practice Guide: Probate & Estate Admin § 40.03: Compulsory Judicial Accountings; 2-40 NY Practice Guide: Probate & Estate Admin § 40.04: Voluntary Judicial Accountings; 2-40 NY Practice Guide: Probate & Estate Admin § 40.05: Informal Accountings; 2-40 NY Practice Guide: Probate & Estate Admin § 40.08: Voluntary Judicial Accountings; 2-40 NY Practice Guide: Probate & Estate Admin § 40.11: FORM 40-2: Status Report as to Not Fully Distributed Estate Under 22 NYCRR § 207.42; 2-41 NY Practice Guide: Probate & Estate Admin § 41.02: Account Schedules; 2-41 NY Practice Guide: Probate & Estate Admin § 41.03: Account Schedules; 1-2 LexisNexis AnswerGuide New York Surrogate's Court § 2.17: Considering Virtual Representation; 1-2 LexisNexis AnswerGuide New York Surrogate's Court § 2.19: Determining If Virtual Representation Applies; 1-2 LexisNexis AnswerGuide New York Surrogate's Court § 2.20: Requesting Virtual Representation; 1-2 LexisNexis AnswerGuide New York Surrogate's Court § 2.21: Understanding Court's Discretion to Deny Virtual Representation; 1-2 LexisNexis AnswerGuide New York Surrogate's Court § 2.22: Using Virtual Representation in Non-Judicial Settlement of Accountings; 1-7 *Warren's Heaton on Surrogate's Court Practice § 7.05*: Virtual Representation; 3-41 *Warren's Heaton on Surrogate's Court Practice § 41.04*: Obtaining Jurisdiction Over Parties; 11-187 *Warren's Heaton on Surrogate's Court Practice § 187.05*: Procedure for Construction of Wills.

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Ernest T. Bartol received a Juris Doctorate Degree from Villanova University School of Law in 1970. Admitted to the New York Bar in 1971, Mr. Bartol has served as a member of the Nassau County Bar Association, Estates and Trusts Law Committee from 1977 to date, the Professional Ethics Committee from 1979 to date, and the Tax Certiorari Committee from 1988 to date, and the New York State Bar Association Estates and Trusts Law Committee from 1973 to date.

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Mr. Bartol is admitted to practice before all the Courts of the State of New York, a number of United States District Courts, the United States Court of Appeals for the Second Circuit, and the United States Supreme Court. While Mr. Bartol is a seasoned litigator, he is also the Managing Attorney of MURPHY, BARTOL & O'BRIEN, LLP.

This article was updated and expanded by Kelliann Kavanagh, Esq.

Andrew L. Martin on Appointment of Trust Property to Supplemental Needs Trust

2008 Emerging Issues 1807

Andrew L. Martin on Appointment of Trust Property to Supplemental Needs Trust

By Andrew L. Martin and Kelliann Kavanaugh

January 23, 2008

SUMMARY: EPTL 10-6.6(b)(1) authorizes a trustee who has the absolute discretion to invade trust principal for the benefit of a beneficiary to exercise that power by appointing all or part of the principal of the trust to the trustee of another trust, created under a separate instrument, provided certain requirements are met. This section permits the trustee of a trust for the benefit of a disabled person that does not qualify as a supplemental needs trust to appoint the principal of the trust to the trustee of a supplemental needs trust, even if the supplemental needs trust is established only to accept the appointment from the existing trust. This commentary, authored by Andrew L. Martin, the Chief County Attorney of the Surrogates Court of the State of New York, Nassau County, and a contributing author to Warrens Heaton on Surrogates Court Practice Legislative and Case Digest, examines EPTL 10-6.6(b)(1) and two relevant cases: *In re Kaskel, 163 Misc. 2d 203, 620 N.Y.S.2d 217 (Sur. Ct. New York County 1994);* and *In re Mayer, 176 Misc. 2d 562, 672 N.Y.S.2d 998 (Sur. Ct. New York County 1998).*

PDF LINK: Click Here for Enhanced PDF of Commentary

ARTICLE: Insight

EPTL 10-6.6(b)(1) authorizes a trustee who has the absolute discretion to invade trust principal for the benefit of a beneficiary to exercise that power by appointing all or part of the principal of the trust to the trustee of another trust, created under a separate instrument, provided certain requirements are met. This section permits the trustee of a trust for the benefit of a disabled person which does not qualify as a supplemental needs trust to appoint the principal of the trust to the trustee of a supplemental needs trust, even if the supplemental needs trust is established only to accept the appointment from the existing trust.

Analysis

Trustee of existing trust must have absolute discretion to invade. The statute is clear that its provisions are only applicable where the existing trust from which the appointment is to be made contains a grant of absolute discretion to the trustee to invade for the benefit of one or more of the beneficiaries. Where the discretion to invade is not absolute, the petition will be denied. EPTL 10-6.6(b)(1); *In re Barkman*, N.Y.L.J., May 20, 2003, at 23, col. 3 (Sur. Ct. Nassau

County).

In re Mayer, 176 Misc. 2d 562, 672 N.Y.S.2d 998 (Sur. Ct. New York County 1998) illustrates this point. Decedent created a trust for the benefit of his wife, his son, and his son's issue. At wifes and son's deaths, the trust was to be divided into equal parts for his issue. During the term of the trust, trustee was authorized to distribute principal in his sole and absolute discretion as he may deem necessary *for the health, support, maintenance and education of any beneficiary*. The trustee proposed to appoint three million dollars of the trust to a new trust to insulate it from transfer tax. The court held that invasions for estate planning fell outside the parameters of the trustees powers even when reviewed with the greatest possible leniency and trustees application for authority to appoint principal was denied.

By contrast, in *In re Kaskel, 163 Misc. 2d 203, 620 N.Y.S.2d 217 (Sur. Ct. New York County 1994)*, a trustee applied for permission to terminate several trusts in favor of proposed trusts with almost identical terms. The purpose of the applications was to minimize potential liabilities. The trustee was authorized to distribute or apply from the principal of each trust, to or for the use of any income beneficiary, such sums as the trustee may deem appropriate for such person's maintenance, education or welfare *or for any other purpose in the discretion of the trustee.* The court held that if the trustee has total discretion to distribute trust principal to an income beneficiary, the trustee may, upon notice to all beneficiaries, apply to the court for permission to place the corpus in another trust for that beneficiary. The trustees application was granted.

Other criteria. The other criteria necessary for a successful petition are that the exercise of the power will not reduce any fixed income interest of any income beneficiary of the trust, is in favor of the beneficiary of the trust, and does not violate EPTL 11-1.7 by attempting to insulate the trustee from liability.

Application of statute to creation of supplemental needs trusts. While the statute was originally enacted for generation skipping tax purposes, it has been used successfully to appoint the principal of an existing trust which may not qualify as a supplemental needs trust to a trust which does qualify as a supplemental needs trust. *In re Grosjean,* N.Y.L.J., Dec. 10, 1997, at 35, col. 6 (Sur. Ct. Nassau County); *In re Hazan,* N.Y.L.J., Apr. 11, 2000, at 30, col. 5 (Sur. Ct. Nassau County); *In re McAllister,* N.Y.L.J., Aug. 20, 2001, at 36, col. 2 (Sur. Ct. Nassau County). Consent of a beneficiary is not required to create the trust.

Petition for court's approval available, but unnecessary; virtual representation statute applicable. Where the trustee has the requisite absolute authority to invade on behalf of the beneficiary, the trustee may appoint the property to the new trust without court approval. However, the trustee may nevertheless seek the court's approval of the proposed exercise of the power. If court approval is sought, the trustee presents the petition to the court. Process will then issue to all persons interested in the trust, with service thereof to be made personally, or by certified mail, return receipt requested, or as otherwise directed by the court. Service of process will not be necessary on those whose interests can be virtually represented by another party to the proceeding pursuant to SCPA 315.

For further discussion of the issue, see *Warren's Heaton on Surrogate's Court § 69.09*: Invasion of Principal for Benefit of Income Beneficiary; *Warren's Heaton on Surrogate's Court § 209.08*: Alienation of the Beneficiary's Interest; *Warren's Heaton on Surrogate's Court §§ 211.01* et seq.: Supplemental Needs Trusts.

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This article was updated and expanded by Kelliann Kavanaugh, Esq.

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Radigan on Wrongful Death & Survival Action Recovery for Personal Injuries

2008 Emerging Issues 1808

C. Raymond Radigan on Wrongful Death & Survival Action Recovery for Personal Injuries

By C. Raymond Radigan and Kelliann Kavanaugh

January 23, 2008

SUMMARY: While a wrongdoer causing the death of a decedent may retain an interest in property owned with a decedent, that interest may be captured in a wrongful death and survival personal injury action. This commentary, authored by the Honorable C. Raymond Radigan, a long-time author for LexisNexis Matthew Bender who served as the Judge of the Nassau County Surrogate's Court for 20 years and now is Of Counsel to the firm of Ruskin Moscou Faltischek, P.C., where he serves as counsel to the Trusts & Estates Department, examines the wrongdoer's survival interest in such property and the recovery of the wrongdoer's vested rights in such property, including a discussion of two relevant cases: *In re Guldbrandsen, 2007 NY Slip Op 50443U, 14 Misc. 3d 1240, 836 N.Y.S.2d 499 (Sur. Ct. Dutchess County 2007);* and *In re Mathew, 270 A.D.2d 416 (2d Dept. 2000).*

PDF LINK: Click Here for Enhanced PDF of Commentary

ARTICLE: INSIGHT While a wrongdoer causing the death of a decedent may retain an interest in property owned with decedent, that interest may be captured in a wrongful death and survival personal injury action.

ANALYSIS

Wrongdoer's survival interest in property. A wrongdoer who causes the death of a decedent and, but for the wrongful act, would have succeeded as survivor to an interest in the decedent's property may thus be precluded because of his wrongdoing to survivorship rights, but nonetheless does not forfeit rights vested previous to the commission of the wrongdoing because he had a vested right in his own right and not by survivorship rights. Accordingly, wrongdoing survivors generally are entitled to the commuted value of a life estate in one-half of the property in question or, if the property be sold, in the commuted value of one-half of the sale proceeds of a life interest therein (*In re Guldbrandsen, 14 Misc. 3d 1240A, 836 N.Y.S.2d 499 (Sur. Ct. Dutchess County 2007); See Wrongdoers Entitlement New York*, by Radigan and Gottlieb, N.Y.L.J., July 6, 2007, at 3, col. 1).

For example, in *In re Mathew, 270 A.D.2d 416* (2d Dept., 2000), petitioner allegedly killed his wife and, while awaiting trial, arranged for the sale of a house which he and his wife had owned as tenants by the entirety. Proceeds from the sale were placed in an escrow account. Petitioner commenced a proceeding to compel the administratrix of his

wifes estate to consent to the release of a share of the proceeds to him. Under New York law, it has long been held that one who wrongfully takes the life of another is not allowed to profit thereby. However, the criminal conviction of a person does not work a forfeiture of any right or interest in real or personal property. Accordingly, the petitioner did not forfeit his own undivided interest in the house which he and his wife held as tenants by the entirety and was entitled to the commuted value of a life estate in one-half of the property or the proceeds from its sale.

Recovery of wrongdoer's vested rights. Although the wrongdoer may retain his or her vested rights, that interest may be recovered by the fiduciary of the decedent's estate through the commencement of a wrongful death action pursuant to EPTL 5-4.1 on behalf of the decedent's distributees suffering a pecuniary loss and a recovery for his estate for personal injuries pursuant to EPTL 11-3.2 (*See Wrongdoers Entitlement New York*, by Radigan and Gottlieb, N.Y.L.J., July 6, 2007, at 3, col. 1).

The case of *In re Guldbrandsen, 14 Misc. 3d 1240A, 836 N.Y.S.2d 499* (Sur. Ct. Dutchess County 2007 illustrates this point. Decedents wife was criminally charged with his death. The Surrogate held that one who causes the death of another is precluded from survivorship rights, but does not forfeit property rights vested previous to the wrongdoing. However, such property rights can be subsequently forfeited. The court noted that the decedents fiduciary retained an option to pursue a wrongful death action against the wife, for the benefit of the decedents surviving distributees who suffered a pecuniary loss as a result of her actions, and a claim for personal injury, for the benefit of the decedents estate by way of a survival action against the wife for the injuries inflicted upon the deceased.

For further discussion of the issue, *see* New York Practice Guide: Probate and Estate Administration § 2.07: Duties of the Voluntary Administrator; New York Practice Guide: Probate and Estate Admin § 15.01: Appearance by Guardian Ad Litem; New York Practice Guide: Probate and Estate Administration § 27.03: Actions for Wrongful Death; New York Practice Guide: Probate and Estate Administration § 31.01: Intestate Succession; New York Practice Guide: Probate and Estate Administration § 41.03: Account Schedules; LexisNexis AnswerGuide New York Negligence § 2.06: Determining Applicable Statute of Limitations; LexisNexis AnswerGuide New York Negligence § 3.03[5]: Conducting Initial Client Interview; LexisNexis AnswerGuide New York Negligence § 3.06[2]: Determining Applicable Statute of Limitations; LexisNexis Answer- Guide New York Negligence § 5.14: Evaluating Applicable Statute of Limitations; LexisNexis AnswerGuide New York Negligence § 6.03: Identifying Statutes That Provide for Shortened Time for Commencement of Action; *Warren's Heaton on Surrogates Court § 34.04*: Powers and Duties of the Temporary Administrator; *Warren's Heaton on Surrogates Court § 62.06*: Personal Property; *Warren's Heaton on Surrogates Court § 122.02*: Actions by or Against Personal Representatives for Injury to Person or Property of Decedent; *Warren's Heaton on Surrogates Court § 124.01*: Action for Wrongful Death; *Warren's Heaton on Surrogates Court § 124.03*: Wrongful Death Action Distinguished from Other Actions; *Warren's Heaton on Surrogates Court § 124.13*: Allocation and Distribution of Wrongful Death Damages to Distributees; Warren's Weed: New York Real Property Ch. 44: Equitable Distribution.

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This article was updated and expanded by Kelliann Kavanaugh, Esq.

Bartol on Presumption of Jurisdiction

2008 Emerging Issues 1809

Bartol on Presumption of Jurisdiction

By Ernest T. Bartol and Kelliann Kavanagh

January 23, 2008

SUMMARY: In New York, a Surrogates Court is presumed conclusively to have jurisdiction based on the jurisdictional facts contained in the pleadings unless there is proof of fraud or collusion. Ernest T. Bartol, the Managing Attorney of Murphy, Bartol & O'Brien, LLP, with extensive experience in estate, wills, and trust matters, discusses how the courts jurisdiction can be attacked, and includes an analysis of *Maurer v. Johns-Manville, Inc., 126 A.D.2d 524 (N.Y. App. Div. 1987).*

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ARTICLE: Insight

The court is presumed conclusively to have jurisdiction based on the jurisdictional facts contained in the pleadings unless there is proof of fraud or collusion. The statute does not apply to direct attacks on jurisdiction, but only to collateral attacks made in a different proceeding or different court.

Analysis

With presumption of regularity, collateral attack requires showing fraud or collusion. SCPA § 204 provides a necessary presumption of regularity in Surrogate's Court proceedings, most often coming into play in the case where a party attempts to attack appointment of a fiduciary. For example, if a fiduciary commences a proceeding on behalf of an estate, such as a wrongful death proceeding, the defendant may attack the fiduciary's authority collaterally in an attempt to end litigation. A collateral attack is difficult because jurisdiction is presumptively and, in the absence of fraud or collusion, conclusively established by allegation of jurisdictional facts contained in the original pleading.

For example, in *Maurer v. Johns-Manville, Inc., 126 A.D.2d 524 (N.Y. App. Div. 1987),* plaintiff brought an action to recover for injuries caused by the inhalation of asbestos. After the injured party died, his daughter/executrix filed a motion to be substituted as plaintiff. The defendant filed a motion to dismiss the complaint on the grounds that the court

lacked jurisdiction because the decedent was domiciled in another state at the time of death. The court granted daughters motion, holding that, in the absence of fraud or collusion, jurisdiction was presumptively established in the verified pleading. There was no fraud because the pleading disclosed that decedent died in an out-of-state nursing home.

A practitioner attempting to attack the court's jurisdiction collaterally should take heart. An exception exists if there is an innocent or unintentional misrepresentation concerning the "very essence" of the court's subject matter jurisdiction. The misrepresentation is a constructive fraud on the court.

Lapiedra v. American Surety Co., 247 N.Y. 25 (N.Y. 1928) illustrates this point. Appellant petitioned the Surrogates Court to be appointed administratrix of decedent's estate. The petition unwittingly contained an untrue allegation, that the prior administrator had been removed. Letters were issued and appellant instituted an action for an accounting. The Appellate Division dismissed the complaint because the record showed that a prior administrator was living and that his letters were never revoked, thus rendering appellant's appointment void. The Court of Appeals affirmed, concluding that the Surrogates Court did not have jurisdiction to appoint appellant administratrix because the untrue allegation, though innocently made, constituted a constructive fraud upon the court directly affecting its jurisdiction.

A note of caution: if the constructive fraud does not go to the essence of the court's jurisdiction, and does not prejudice the parties, no collateral attack will be permitted.

In *Stolz v. New York C. R. Co., 7 N.Y.2d 269 (N.Y. 1959),* the administratrix of decedents estate represented herself as his widow. The lower court held that her appointment as administratrix was invalid because their marriage was void. The Court of Appeals reversed, holding that the Surrogate at all times had valid jurisdiction over the subject matter of decedent's estate, including the appointment of a legal representative. If he made a mistake in the exercise of his power derived from his jurisdiction, it cannot be collaterally attacked in the absence of fraud or collusion. The only type of fraud or collusion which permits collateral attack is the kind which goes to the very essence of the courts jurisdiction.

Mere procedural errors, which can easily be remedied and result in no prejudice, do not serve as a basis for overcoming the presumption of regularity.

Personal jurisdiction is never conclusive. The practitioner should remember that personal jurisdiction is presumptive and based on the jurisdictional recitations contained in the decree.

In *In re Estate of Baker, 189 Misc. 159 (N.Y. Misc. 1947),* the designee of decedents maternal cousins, who alleged they were decedent's only distributees, applied for letters of administration. An alleged paternal cousin objected to the issuance of the letters. The designee filed a motion to strike out the objections based on a decree that the decedent was not the legitimate child of the brother of the alleged paternal cousin's father. The court held that the decree was binding on the alleged paternal cousin. The issue had already been litigated and, though she was not a party, she was in privity with her father. That all of the necessary parties were before the Surrogates Court when the decree was made was presumptively proved by recitals to that effect in the decree.

Unlike subject matter jurisdiction, personal jurisdiction is never conclusive, even in the absence of fraud or collusion.

For further discussion of the issue, *see* 2-40 NY Practice Guide: Probate & Estate Admin § 40.06: Necessary Parties to an Accounting; 2-40 NY Practice Guide: Probate & Estate Admin § 40.07: Proceedings to Compel an Accounting; 1-2 Warren's Heaton on Surrogate's Court Practice Ch. 2: Jurisdiction; Powers of the Surrogate; 7-102 *Warren's Heaton on Surrogate's Court Practice § 102.01*: Accounting Decrees Generally.

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On the litigation side, he has been engaged in all types of proceedings in the Surrogate's Courts located in New York City, Nassau, Suffolk and upstate Counties, including contested probate proceedings, contested accounting proceedings, discovery proceedings, etc. His estate work also includes the preparation and filing of Federal and New York State Estate tax returns.

A member of the New York State Bar Association Trusts and Estates Law Committee wherein he frequently lectures on estate-related topics, Mr. Bartol also has recently been inducted as a member of the Federal Bar Council, and has become a member in the Fellows of the American Bar Foundation and the New York State Bar Association. He is a member of various Who's Who registers, including Who's Who in American Law.

Mr. Bartol is admitted to practice before all the Courts of the State of New York, a number of United States District Courts, the United States Court of Appeals for the Second Circuit, and the United States Supreme Court. While Mr. Bartol is a seasoned litigator, he is also the Managing Attorney of MURPHY, BARTOL & O'BRIEN, LLP.

This article was updated and expanded by Kelliann Kavanagh, Esq.

Bartol on Non-Domiciliaries Establishing Jurisdiction and Venue

2008 Emerging Issues 1810

Bartol on Non-Domiciliaries Establishing Jurisdiction and Venue

By Ernest T. Bartol and Kelliann Kavanagh

January 23, 2008

SUMMARY: The practitioner often needs to administer the estate of a non-domiciliary, usually when the decedent dies leaving property in New York. Ernest T. Bartol, the Managing Attorney of Murphy, Bartol & O'Brien, LLP, with extensive experience in estate, wills, and trust matters, discusses some of the issues that arise with respect to the estates of a non-domiciliaries, such as the types of personal property that will permit ancillary administration in New York, as well jurisdictional and venue issues.

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ARTICLE: Insight

The practitioner often needs to administer the estate of a non-domiciliary, usually when the decedent dies leaving property in New York. It is important to remember for purposes of SCPA § 206, that "property" can include a cause of action for wrongful death.

Analysis

"Property" is a many-splendored thing. If trying to prove the existence of personal property in New York, the practitioner should remember that personal property can include more than bank accounts or cash and securities held in brokerage accounts. Personal property can also include ownership of limited partnership interests in a New York corporation or entitlement to tax refunds from New York.

For example, in *In re Estate of Edwards, 87 Misc. 2d 337 (N.Y. Misc. 1976),* petitioner, a New York resident-creditor of a nonresident decedent, requested the issuance of ancillary letters of administration in New York so he could pursue a claim against the decedent. The domiciliary executors opposed the application claiming decedent left no property in New York. Before ancillary administration can be granted it is necessary that there be assets within the state. Decedent's interest in a limited partnership and the estate's claim for New York income tax refunds were sufficient assets within the state to grant ancillary administration.

Property location is complicated when property comes into New York after decedent's death, but jurisdiction exists unless there is fraud. It is usually simple to determine where property is located. It becomes more complex when decedent's property is brought into New York after death. The court must be satisfied that this occurred in good faith. Significantly, the court will not decline jurisdiction if property was brought into the county specifically to create jurisdiction, as long as there is no showing of wrongful intention.

In re Estate of Nelson, 125 Misc. 2d 451 (N.Y. Misc. 1984) illustrates this point. Decedent died in Pennsylvania where he was domiciled. A petition for probate of decedent's will was filed in New York by the nominated executors. Surrogates Court jurisdiction was invoked on the basis that personal property of the decedent had come into New York County after his death. Jurisdiction should not be declined merely because property was brought into the county for the purpose of conferring jurisdiction, if there was no wrongful intention. The court found no evidence to show there was any improper purpose in bringing stock certificates into New York County.

Venue determined by location of property or defendant in wrongful death and by location of corporate offices. If the court has jurisdiction over the estate of a non-domiciliary, focus shifts to venue. Location of property can determine venue. If venue lies in multiple counties, proper venue is where the first proceeding commenced. Thus, the practitioner should consider carefully where to commence the initial proceeding. The domicile of the defendant in a wrongful death proceeding also confers proper venue. If the decedent's cause of action is against a corporate defendant, the proper county is where the corporation maintains its offices.

Subject matter jurisdiction in ancillary proceedings embraces less. Analyzing the role of SCPA § 206 in ancillary proceedings, the Court of Appeals refused to extend the Surrogate's Court jurisdiction to a non-domiciliary decedent's extraterritorial assets in a discovery proceeding commenced by an ancillary administrator.

In *In re Stern, 91 N.Y.2d 591 (N.Y. 1998)*, in a discovery, turn-over proceeding brought by an ancillary administrator in New York with respect to an estate being administered primarily in Mexico, the subject matter jurisdiction of the Surrogate's Court did not extend to the Cayman Islands assets of decedent, a Texas resident and Mexican domiciliary, when the issuance of ancillary letters of administration in New York was predicated solely on a small bank account in the state. The essential, underlying function of ancillary proceedings is to obtain control and possession of New York assets of a non-domiciliary, to satisfy New York creditors, and to transfer remaining assets to the domiciliary administrator.

The court focused on the "fundamental" and "pivotal" distinction between original and ancillary proceedings, noting that ancillary proceedings complement the principal domiciliary proceeding and do not "eclipse it." Thus, the Surrogate's Court subject matter jurisdiction embraces less in ancillary proceedings in non-domiciliary estates than in original proceedings.

For further discussion of the issue, *see* 1-2 NY Practice Guide: Probate & Estate Admin § 2.04: Summary Procedure for Appointment as Voluntary Administrator; 1-4 NY Practice Guide: Probate & Estate Admin § 4.04: Jurisdiction and Venue; 1-20 NY Practice Guide: Probate & Estate Admin § 20.02: Assets Within New York; 2-35 NY Practice Guide: Probate & Estate Admin § 35.12: FORM 35-1: ET-90, Filing Summary, NYS; 2-40 NY Practice Guide: Probate & Estate Admin § 40.06: Necessary Parties to an Accounting; 1-1 LexisNexis AnswerGuide New York Surrogate's Court § 1.10: Determining Jurisdiction and Venue of Estate of Nondomiciliary; 1-4 LexisNexis AnswerGuide New York Surrogate's Court § 4.06: Filing Petition in Proper County; 1-6 LexisNexis AnswerGuide New York Surrogate's Court § 6.08: Determining Appropriate Court; 1-10 LexisNexis AnswerGuide New York Surrogate's Court § 10.04: Determining Venue; 1-2 Warren's Heaton on Surrogate's Court Practice Ch. 2: Jurisdiction; Powers of the Surrogate; 2-35 *Warren's Heaton on Surrogate's Court Practice § 35.04*: The Petition for Letters of Administration; 3-47 *Warren's Heaton on Surrogate's Court Practice § 47.04*: Ancillary Letters of Administration.

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This article was updated and expanded by Kelliann Kavanagh, Esq.

Michael E. O'Connor on Access to Exempt Property Can Be Lifeline

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Michael E. O'Connor on Access to Exempt Property Can Be Lifeline

By Michael E. O'Connor and Kelliann Kavanaugh

January 23, 2008

SUMMARY: A surviving spouse, or if none exists, a child under age 21, is entitled to certain specified property, free of claims of creditors and notwithstanding contrary terms contained in a will. To a widow with minor children whose main concern is how to keep the family fed and sheltered, the availability of assets that can be accessed quickly and are not subject to creditors' claims can be of great comfort. This Expert Commentary, authored by Michael O Connor, a Fellow of the American College of Trust and Estate Counsel and a contributing author to Warrens Heaton on New York Estate Practice, examines the interpretation of EPTL § 5-3.1 and explains how it can be used to protect the financial stability of family members, including a discussion of five relevant cases: *In re Winkler, 112 Misc. 2d 932, 447 N.Y.S.2d 642 (1982); In re Itzkowitz, 51 A.D.2d 726, 379 N.Y.S.2d 142* (2d Dep't 1976); *In re Jadd's Estate, 89 Misc. 2d 453, 391 N.Y.S.2d 965 (Sur. Ct. 1977); In re Heedes Will, 29 Misc. 2d 103, 210 N.Y.S.2d 947 (Sur. Ct. Kings County 1961);* and *In re De Roo, 148 Misc. 2d 856, 562 N.Y.S.2d 925 (Sur. Ct. Yates County 1990).*

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ARTICLE: Insight

A surviving spouse, or if none exists, a child under age 21, is entitled to certain specified property, free of claims of creditors and notwithstanding contrary terms contained in a will. If a decedent owns sufficient property as defined in EPTL § 5-3.1, a total of $ 56,000 could pass to the surviving spouse or child under 21. To a widow with minor children whose main concern is how to keep the family fed and sheltered, the availability of assets that can be accessed quickly and are not subject to creditors' claims can be of great comfort.

Analysis

EPTL 5-3.1 may protect family members. Family exempt property is immediately available to the family member on decedent's death. The surviving spouse can take possession of household furniture or other tangible property directly. For an automobile, re-registration can be accomplished at the Department of Motor Vehicles with a death certificate and appropriate forms to demonstrate the property is subject to the exemption statute. Up to $ 15,000 in cash can also be taken directly by the spouse. If funds are in a bank account, then a fiduciary may be required in order to recover the money. If the fiduciary refuses to turn over exempt property, then a petition to the court can be made to obtain an order

(SCPA 2102(2)). Since only the funeral bill has any potential impact on the exempt property, such a petition would not have to wait to allow creditors to present claims.

Courts have applied equitable resolutions in enforcing the family exempt property statute. For example, the court found that an automobile owned by a corporation wholly owned by the decedent was subject to the statute.

In *In re Winkler, 112 Misc. 2d 932, 447 N.Y.S.2d 642 (1982),* a decedent's widow applied to the executors for the proceeds from the sale of the decedent's car. The car was registered in the name of a corporation owned solely by the decedent, but was used by the family and kept in the family garage. The court noted that New York law provides the surviving spouse with property exempt from the decedent's estate, including one motor vehicle. The court concluded that the interests of justice required the liberal construction of estate law in order to characterize the automobile as exempt property, even though it was registered in the name of the corporation. The executors were directed to pay the proceeds from the sale of the automobile to the decedent's widow.

The court will construe EPTL 5-3.1 liberally to resolve questions in favor of the beneficiary.

In *In re Itzkowitz, 51 A.D.2d 726, 379 N.Y.S.2d 142* (2d Dep't 1976), the executor of decedents estate sold decedents automobile for $6,000. If the value of the automobile had been $5,000 or less, it would have been exempt property under the statute. Exemption statutes require a liberal interpretation, so as to resolve all reasonably doubtful questions in favor of the beneficiary. Therefore, the court held that the decedents spouse should receive the sum of $5,000, as an exemption, out of the proceeds received by the executor upon the sale of the decedent's motor vehicle, and that the balance of the sales proceeds, $1,000, was an asset of the estate.

Family exempt property vests in surviving spouse or child immediately on decedent's death. Property subject to EPTL 5-3.1 vests immediately on the decedent death and does not constitute an estate asset.

In re Jadd's Estate, 89 Misc. 2d 453, 391 N.Y.S.2d 965 (Sur. Ct. 1977) illustrates this point. At the time of death, decedent had $1,484 on deposit with Chase Manhattan Bank. The bank withdrew most of this sum in repayment of loans made to the decedent. The decedent had pledged and assigned the funds as security for the loan. Petitioner requested that the bank pay part of these funds to the decedents widow as exempt property. The court held that exempt property vests in the surviving spouse at the date of death and does not constitute estate assets. However, the bank's assignment and lien on the proceeds of the account had priority over the widows statutory exemption. The widow did not acquire, by reason of decedents death, any right superior to the lien of a creditor existing prior to death.

If the surviving spouse received jewelry, clothing, or personal effects by specific bequest, and is also entitled to an intestate share, the tangibles that constitute exempt property will not be taken into account in calculating the surviving spouse's intestate share.

For example, in *In re Heedes Will, 29 Misc. 2d 103, 210 N.Y.S.2d 947 (Sur. Ct. Kings County 1961),* decedent left 25 percent of his estate to his two sisters. The remainder was placed in a trust out of which the widow was entitled to certain funds from principle and income. The widow was also bequeathed all of decedent's jewelry, clothing, household and personal effects. The widow exercised her right of election under which she was entitled to a one-half share of the net estate of the decedent. The bequest to the widow of jewelry, clothing, household and personal effects came within the definition of exempt property and was excluded in computing the widow's one-half share.

Waiver of right to family exempt property permissible if specific. A pre-nuptial agreement by which each spouse waived all statutory interests in each other's estates is insufficient to waive the right to family exempt property.

In *In re DeRoo, 148 Misc. 2d 856, 562 N.Y.S.2d 925 (Sur. Ct. Yates County 1990),* decedent and her spouse had entered into a prenuptial agreement whereby each party waived all statutory interests in the other's estate. At the time of decedents death, she and her husband co-owned an automobile. The executor of the decedents estate claimed that the estate was entitled to one-half the value of the automobile, while the widower claimed that he was entitled to the entire

automobile, as exempt property. The law provides that certain property, including a motor vehicle, is exempted for the benefit of the family. These items are not assets of the estate but vest in the surviving spouse. Thus, the surviving spouse was entitled to full ownership of the automobile.

As the language of a waiver becomes more specific, the likelihood a court will find a valid waiver increases. In drafting waivers, best practice is to refer specifically to EPTL 5-3.1 or any successor statute and so leave no doubt that the waiver is intended to include family exempt property.

Exempt property excluded from computation of surviving spouse's intestate or elective share. Family exempt property vests immediately in the surviving spouse, or, in default, in a child under age 21. The exempt property is not subject to any creditors' claims, although the right depends on there being sufficient funds to pay the funeral bill. On the family exempt property being set off, all other estate calculations apply. Note that such property is neither commissionable nor included in computing the spousal right of election or intestate shares.

For further discussion of the issue, *see* New York Practice Guide: Probate and Estate Administration § 1.05: Assets Not to Be Collected; New York Practice Guide: Probate and Estate Administration § 2.01: Small Estate Administration-Definition and Purpose; New York Practice Guide: Probate and Estate Administration § 2.02: Property Excluded from Administration as Small Estate; New York Practice Guide: Probate and Estate Administration § 2.09: Payment of Certain Debts Without Administration; New York Practice Guide: Probate and Estate Administration § 4.08: Types of Probate Proceedings; New York Practice Guide: Probate and Estate Administration § 24.03: Commencement of the Proceeding; New York Practice Guide: Probate and Estate Administration § 25.02: Assets Not Subject to Collection; New York Practice Guide: Probate and Estate Administration § 25.07: Identification and Location of Assets; New York Practice Guide: Probate and Estate Administration § 30.16: Other References; New York Practice Guide: Probate and Estate Administration § 31.01: Intestate Succession; New York Practice Guide: Probate and Estate Administration § 31.13: Family Exemption; New York Practice Guide: Probate and Estate Administration § 31.14: Right of Election; New York Practice Guide: Probate and Estate Administration § 41.02: Account Schedules; New York Practice Guide: Probate and Estate Administration § 41.03: Account Schedules; *Warren's Heaton on Surrogates Court § 37.03*: Composition of Small Estate; *Warren's Heaton on Surrogates Court § 63.01* et seq.: Exemption for Benefit of Family; *Warren's Heaton on Surrogates Court § 74.08*: Deduction of Debts and Expenses.

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This article was updated and expanded by Kelliann Kavanaugh, Esq.

Funeral Expense Paid from Self-Settled Supplemental Needs Trust Is Dangerous

2008 Emerging Issues 1802

Martin on Funeral Expense Paid from Self-Settled Supplemental Needs Trust Is Dangerous

By Andrew L. Martin and Kelliann Kavanagh

January 22, 2008

SUMMARY: It is dangerous to draft a supplemental needs trust that provides for the payment of a disabled person's funeral and burial expenses prior to repayment to the state for medical assistance that has been rendered. The trust may be considered an available resource for Medicaid and SSI purposes, disqualifying the disabled person from receiving those benefits. This commentary, authored by Andrew L. Martin, the Chief County Attorney of the Surrogates Court of the State of New York, Nassau County, and a contributing author to Warrens Heaton on Surrogates Court Practice Legislative and Case Digest, examines the application of the Social Security "Program Operations Manual System," or POMS handbook, to supplemental needs trusts, including a discussion of two relevant cases: *Tejada v. Apfel, 167 F.3d 770 (2d Cir. 1999);* and *Bubnis v. Apfel, 150 F.3d 177 (2d Cir. 1998).*

PDF LINK: Click Here for Enhanced PDF of Commentary

ARTICLE: Insight

It is dangerous to draft supplemental needs trusts that provide for payment of a disabled person's funeral and burial expenses prior to repayment to the state for medical assistance rendered. The trust may be considered an available resource for Medicaid and SSI purposes, disqualifying the disabled person from receiving those benefits.

Analysis

Social Security Administration handbook for processing claims receives deference. In addition to statutory enactments at both the state and federal levels with which supplemental needs trusts must comply to ensure continued enjoyment of both governmental assistance and private provision for supplemental needs, the Social Security Administration has published a handbook for processing of Social Security claims which, while not carrying the force of law, is entitled to substantial deference.

For example, in *Tejada v. Apfel, 167 F.3d 770 (2d Cir. 1999),* appellant, a woman suffering from diabetes, sought reversal of a district court ruling upholding the Social Security Commissioners determination that she was not entitled to disability benefits. The Commissioner did not consider a podiatrists report concerning the appellants leg edema when

making his determination. The federal regulations exclude podiatrists from serving as "acceptable medical sources," but the Social Security handbook (POMS) specifically includes podiatrists as acceptable medical sources. The court, while recognizing that POMS has no legal force, and does not bind the Commissioner, agreed with the appellant that the circumstances of this case warranted attaching some, although not controlling, weight to the podiatrist's report.

In *Bubnis v. Apfel, 150 F.3d 177 (2d Cir. 1998)*, appellant, a recipient of federal disability payments and a state workers' compensation lump-sum settlement, disputed the way in which the Social Security Commissioner reduced his disability payments. When state benefits are paid in a lump-sum, federal benefits must be reduced in such amounts as will approximate the reductions necessary if the state benefits had been paid on a monthly basis. The court gave considerable deference to the POMS offset rate used by the Commissioner and would not disturb it as long as it was reasonable and consistent with federal law. The court concluded that the offset rate was reasonably close to the rate by which plaintiff's disability benefits would have been reduced if the workers' compensation benefits had been paid monthly instead of as a lump sum.

Supplemental needs trusts not conforming to requirements will render disabled person ineligible for benefits until trust has been spent down. The Social Security Administration handbook is called the "Program Operations Manual System," or POMS. The POMS guidelines provide that a supplemental needs trust must list the state as first payee, with priority over funeral and administration expenses. Supplemental needs trusts not conforming to these requirements will be considered available resources for purposes of Medicaid and SSI eligibility, rendering the disabled person ineligible for these benefits until the trust has been spent down. POMS SI 01120.203 B.1.f.

Supplemental needs trust applications must comply with POMS. While acknowledging that its practice had been to approve supplemental needs trusts which made provision for payment of the deceased disabled person's funeral expenses prior to repayment to the state for medical assistance, one court, on being apprised of the requirements in the POMS guidelines, has given notice that all future applications for approval of supplemental needs trusts must comply with these POMS guidelines. *In re Solinto*, N.Y.L.J., Oct. 22, 2003, at 30 (Surr. Ct. Nassau County).

Supplemental needs trust must not provide for payment of funeral and burial expenses post-mortem prior to repayment to state for medical assistance. An application to purchase a cemetery plot during the lifetime of the disabled person will be granted. The purchase of a cemetery plot during the lifetime of the disabled person is permitted under the POMS guidelines, similar to a pre-paid funeral trust, which is also permitted. It is clear that to fully protect the disabled person's right to receive Medicaid or SSI benefits, the supplemental needs trust must not provide for payment of funeral and burial expenses post-mortem prior to the repayment to the state for medical assistance rendered, but may provide for pre-death payments, in the nature of a funeral trust. To make sure that you do not jeopardize your ward's receipt of Medicaid or SSI benefits, be sure to draft the trust to meet these requirements. POMS SI NY01130.420.B; *In re Solinto*, N.Y.L.J., Oct. 22, 2003, at 30 (Surr. Ct. Nassau County).

POMS guidelines are online. The POMS handbook is used by employees of the Social Security Administration to determine, among other things, if a supplemental needs trust will be counted as an available resource for purposes of Medicaid and SSI eligibility. A version of the handbook is available online for public use. SSA's Program Operations Manual System *available* at http://policy.ssa.gov/poms.nsf/aboutpoms

For further discussion of the issue, *see Warren's Heaton on Surrogate's Court § 69.09*: Invasion of Principal for Benefit of Income Beneficiary; *Warren's Heaton on Surrogate's Court § 209.08*: Alienation of the Beneficiary's Interest; *Warren's Heaton on Surrogate's Court §§ 211.01* et seq.: Supplemental Needs Trusts.

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This article was updated and expanded by Kelliann Kavanagh, Esq.

Bartol on General Jurisdiction of the Surrogate's Court

2008 Emerging Issues 1804

Bartol on General Jurisdiction of the Surrogate's Court

By Ernest T. Bartol and Kelliann Kavanagh

January 22, 2008

SUMMARY: A New York statute provides broad subject matter jurisdiction to the Surrogate's Court over "all matters relating to estates and the affairs of decedents." With few exceptions, matters relating to the affairs of a decedent are safely brought in the Surrogate's Court. Ernest T. Bartol, the Managing Attorney of Murphy, Bartol & O'Brien, LLP, with extensive experience in estate, wills, and trust matters, discusses the scope of the courts jurisdiction and explains how some legal matters are within or outside of the courts jurisdictional purview.

PDF LINK: Click Here for Enhanced PDF of Commentary

ARTICLE: Insight

SCPA § 201 provides broad subject matter jurisdiction to the Surrogate's Court over "all matters relating to estates and the affairs of decedents." With few exceptions, matters relating to the affairs of a decedent are safely brought in the Surrogate's Court. Only those matters ancillary to the affairs of a decedent, or individual controversies between living persons, do not have proper venue in the Surrogate's Court.

Analysis

Surrogate's Court exercises jurisdiction over decedent's affairs. The Surrogate's Court has jurisdiction over actions and proceedings relating to decedent's affairs or the estate's administration, to avoid "the fragmentation of the treatment of the affairs of an estate." Since the Surrogate's Court has no jurisdiction over disputes between living persons, it cannot adjudicate a creditor's claim against a distributee unless the creditor is the Department of Social Services (DSS).

In *In re Estate of Maier, 178 Misc. 2d 1061 (N.Y. Misc. 1998)*, decedents death was the subject of a wrongful death action. Decedents daughter/distributee renounced her interest in the action because she was the recipient of public assistance. The DSS has an interest in certain properties that come into the possession of a recipient of public assistance. Therefore, the court held, it stands to reason that the DSS has a right to assert any interest it may have in a distributee's wrongful death proceeds and the Surrogates Court has the jurisdiction to entertain the assertion of that right.

The practitioner must remember that the Surrogate's Court jurisdiction is decided on a case-by-case basis. For example, while the Surrogate's Court has jurisdiction over landlord-tenant disputes involving a decedent's estate, the court will not exercise jurisdiction over "garden variety" summary proceedings. The Surrogate's Court will exercise jurisdiction over shareholder derivative actions only if the relief sought would directly benefit the estate.

Surrogate's Court is "most appropriate venue" for legal malpractice and fee disputes. Despite the broad jurisdiction SCPA § 201 confers, some have argued that the Surrogate's Court does not have jurisdiction over a particular matter, especially legal malpractice claims or award of legal fees in estate matters. It is settled that the Surrogate's Court is "manifestly the most appropriate venue" for these matters since "nearly all of the legal proceedings relevant to the administration of the subject estate took place there." *In re Estate of Tarka, 293 A.D.2d 396 (N.Y. App. Div. 2002)* (Surrogates Court fixed and determined a law firm's compensation for representing the administratrix of an estate and settled claims of malpractice). In *Tarka*, the court's jurisdiction extended to malpractice claims since they arose in connection with the administration of the estate. It follows that the determination of an appropriate legal fee "necessarily decides that there was no malpractice."

In re Estate of Finkle, 90 Misc. 2d 550 (N.Y. Misc. 1977) illustrates this point. Surrogate's Court's jurisdiction to fix attorney's compensation for services rendered to unsuccessful clients in their probate contest encompasses clients' counterclaims for legal malpractice. The court has full jurisdiction to determine all questions arising among the parties to any action over which jurisdiction has been obtained. The determination of an appropriate legal fee is necessarily intertwined with the question of whether the attorney has negligently performed his duties. A judicial determination fixing the value of professional services necessarily decides that there was no malpractice.

Surrogate's Court lacks jurisdiction over ancillary proceedings. The practitioner should remember that, while SCPA § 201 confers expansive jurisdiction on the Surrogate's Court, it does not extend to subject matter jurisdiction over ancillary proceedings. For example, the court's jurisdiction did not extend to a discovery proceeding seeking return of the decedent's out of state assets when an ancillary administrator commenced the proceeding.

In *In re Stern, 91 N.Y.2d 591 (N.Y. 1998)*, in a discovery, turn-over proceeding brought by an ancillary administrator in New York with respect to an estate being administered primarily in Mexico, the subject matter jurisdiction of the Surrogate's Court did not extend to the Cayman Islands assets of decedent, a Texas resident and Mexican domiciliary, when the issuance of ancillary letters of administration in New York was predicated solely on a small bank account in the state. The essential, underlying function of ancillary proceedings is to obtain control and possession of New York assets of a nondomiciliary, to satisfy New York creditors, and to transfer remaining assets to the domiciliary administrator.

For further discussion of the issue, *see* 1-4 NY Practice Guide: Probate & Estate Admin § 4.01: Plenary Powers Over Estates and Decedents' Affairs; -11 NY Practice Guide: Probate & Estate Admin § 11.12: FORM 11-9: Order Framing Issues Where Objections Filed by Distributee; 1-1 LexisNexis AnswerGuide New York Surrogate's Court § 1.03: Determining If Surrogate's Court Has Subject Matter Jurisdiction; 1-1 *Warren's Heaton on Surrogate's Court Practice § 1.02*: Jurisdiction; 1-2 Warren's Heaton on Surrogate's Court Practice Ch. 2: Jurisdiction; Powers of the Surrogate; 2-32 Warren's Heaton on Surrogate's Court Practice Ch. 32: Elements to Be Proven in a Probate or Administration Proceeding; 5-54 Warren's Weed New York Real Property § 54.39; 8-86 Warren's Weed New York Real Property Ch. 86: Life Estates and Tenancy Proceedings.

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Mr. Bartol, who has a Bachelor of Science Degree in Accounting from Fordham University, has concentrated in all phases of Estates, Wills and Trusts since leaving the employ of a major accounting firm in 1971.

On the planning side, he has been engaged in all phases of Estate asset protection by drafting, inter alia, (1) Wills with Unified Credit Shelter Trusts and provisions, (2) Irrevocable and Revocable Trusts, including Life Insurance Trusts, (3) Qualified Personal Residence Trusts, (4) Family Limited Partnerships and Limited Liability Companies, (5) Private Annuities, (6) GRATS, GRITS and GRUTS and (7) other planning devices for use by individuals, shareholders of family and closely-held businesses and partners of family and closely-held businesses.

On the litigation side, he has been engaged in all types of proceedings in the Surrogate's Courts located in New York City, Nassau, Suffolk and upstate Counties, including contested probate proceedings, contested accounting proceedings, discovery proceedings, etc. His estate work also includes the preparation and filing of Federal and New York State Estate tax returns.

A member of the New York State Bar Association Trusts and Estates Law Committee wherein he frequently lectures on estate-related topics, Mr. Bartol also has recently been inducted as a member of the Federal Bar Council, and has become a member in the Fellows of the American Bar Foundation and the New York State Bar Association. He is a member of various Who's Who registers, including Who's Who in American Law.

Mr. Bartol is admitted to practice before all the Courts of the State of New York, a number of United States District Courts, the United States Court of Appeals for the Second Circuit, and the United States Supreme Court. While Mr. Bartol is a seasoned litigator, he is also the Managing Attorney of MURPHY, BARTOL & O'BRIEN, LLP.

This article was updated and expanded by Kelliann Kavanagh, Esq.

Bartol on Flexibility of Surrogate's Court Jurisdiction

2008 Emerging Issues 1805

Bartol on Flexibility of Surrogate's Court Jurisdiction

By Ernest T. Bartol and Kelliann Kavanagh

January 22, 2008

SUMMARY: A New York statute allows the Surrogate's Court to exercise jurisdiction over proceedings not specifically enumerated in the SCPA or proceedings commenced under the wrong section of the statute. Ernest T. Bartol, the Managing Attorney of Murphy, Bartol & O'Brien, LLP, with extensive experience in estate, wills, and trust matters, discusses the scope of the courts jurisdiction, including how that jurisdiction is impacted by the discretion vested in the surrogates.

PDF LINK: Click Here for Enhanced PDF of Commentary

ARTICLE: Insight

SCPA § 202 allows the Surrogate's Court to exercise jurisdiction over proceedings not specifically enumerated in the SCPA or proceedings commenced under the wrong section of the statute. SCPA § 202 acts in conjunction with section 2-b(3) of the Judiciary Law, which grants a court of record ability to make new forms of proceedings as necessary to carry out the powers and jurisdiction it possesses.

Analysis

SCPA § 202 prevents fragmentation of cases. SCPA § 202 has been hailed as opening up "a virtually unlimited set of jurisdictional possibilities tempered only by the discretion of the surrogate." *In re Estate of Artope, 144 Misc. 2d 1090 (N.Y. Misc. 1989),* illustrates this point. Decedent left her entire estate outright to her granddaughter. Decedents daughter contended that the granddaughter agreed to accept the property, but promised to then transfer it to the daughter. Daughter sought establishment of a constructive trust to hold the property. The court held that SCPA § 202 empowers the court in any proceeding to exercise any of the jurisdiction granted to it by the SCPA or any other provision or law. While a constructive trust issue is not incidental to a probate proceeding in the technical sense, it does not matter, as long as there is a logical fit and common questions of fact.

Equally important, the statute obviates the need for fragmented lawsuits. The practitioner should note that prior to the 1993 revision of SCPA § 2103, Surrogate's courts often relied on Section 202 to expand their jurisdiction and

entertain discovery proceedings involving items other than money or personal property. Thus, SCPA § 202 has been the basis for jurisdiction in discovery proceedings involving a variety of issues.

For example, in *In re Estate of Goldstein, 79 Misc. 2d 4 (N.Y. Misc. 1974),* petitioner sought recovery of funds due her as well as possible rights afforded her in the decedent's estate, even though debts and contract obligations were involved. Within SCPA Article 21 proceedings there is a basis of jurisdiction concerning bank books, papers and other specific items together with the right of inquiry to establish discoverable items. The mere mention of a contract does not oust the court of jurisdiction in discovery proceedings. To limit the court to jurisdiction over some discoverable items would delay justice and go against the spirit of the legal authorities for concentrating jurisdiction over the affairs of decedents in the Surrogate's Court.

For example, in *In re Estate of Young, 80 Misc. 2d 937 (N.Y. Misc. 1975),* decedents estate alleged that a publishing company owed decedent/author $53,452 in unpaid royalties. The Surrogate's Court has jurisdiction not only over all actions and proceedings relating to the affairs of decedents, probate of wills and administration of estates, but also actions and proceedings arising thereunder or pertaining thereto. For the Surrogate's Court to decline jurisdiction, it should be abundantly clear that the matter in controversy in no way affects the affairs of a decedent or the administration of his estate. Therefore, the Surrogate's Court has jurisdiction to entertain a discovery proceeding to collect a common debt or contract obligation, i.e., the unpaid royalties.

For example, *In re Estate of Barrie, 134 Misc. 2d 440 (N.Y. Misc. 1987),* decedents son claimed to have received a gift of a real property deed from his mother during her lifetime. Son, a notary public, took his mother's acknowledgement of the deed. Although a discovery proceeding seeking the recovery of money or other personal property belonging to an estate is not the proper method to determine ownership of real property, the Surrogate's Court nonetheless retains jurisdiction to adjudicate the estate's claim that the acknowledgement of his mother's deed was a nullity because it was taken by a purported grantee. The dispute over the ownership of real property which affects the decedent's estate falls squarely within the broad constitutional powers of the Surrogate's Court over all proceedings relating to the affairs of decedents.

Surrogate Court discretion ultimately controls jurisdictional questions. Although the Surrogate's courts continue to rely on SCPA § 202 to fashion appropriate relief in non-traditional matters, Section 202 does not operate automatically to confer jurisdiction. The threshold question of whether the matter relates to the affairs of a decedent is still subject to interpretation by the individual court. *Compare In re Winkler,* N.Y.L.J., Oct. 15, 1993, at 28 (Surr. Ct. Nassau County) with *In re McMath,* N.Y.L.J., Dec. 12, 1994, at 35 (Surr. Ct. Queens County), both disputes involving insurance proceeds where the court reached different results.

For further discussion of the issue, see 1-24 NY Practice Guide: Probate & Estate Admin § 24.01: Background; 2-40 NY Practice Guide: Probate & Estate Admin § 40.02: How and When to Account; 1-1 LexisNexis AnswerGuide New York Surrogate's Court § 1.06: Expanding Jurisdiction to Matters Not Enumerated in SCPA; 1-2 Warren's Heaton on Surrogate's Court Practice Ch. 2: Jurisdiction; Powers of the Surrogate; 8-103 *Warren's Heaton on Surrogate's Court Practice § 103.05*: Commissions of Corporate Trustees; 9-122 *Warren's Heaton on Surrogate's Court Practice § 122.04*: Procedural Aspects of Actions by or Against Personal Representative; 5-54 Warren's Weed New York Real Property § 54.39.

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This article was updated and expanded by Kelliann Kavanagh, Esq.

Martin on Appointment of Trust Property to Supplemental Needs Trust

2008 Emerging Issues 1781

Martin on Appointment of Trust Property to Supplemental Needs Trust

By Andrew L. Martin

January 14, 2008

SUMMARY: NY CLS EPTL § 10-6.6(b)(1) authorizes a trustee who has the absolute discretion to invade trust principal for the benefit of a beneficiary to exercise that power by appointing all or part of the principal of the trust to the trustee of another trust, created under a separate instrument, provided certain requirements are met. This section permits the trustee of a trust for the benefit of a disabled person which does not qualify as a supplemental needs trust to appoint the principal of the trust to the trustee of a supplemental needs trust, even if the supplemental needs trust is established only to accept the appointment from the existing trust. In this expert commentary, Andrew L. Martin discusses the statutory requirements for the creation of a supplemental needs trust, as well, the procedures for appointing property to such a trust.

PDF LINK: Click Here for Enhanced PDF of Commentary

ARTICLE: Insight

NY CLS EPTL § 10-6.6(b)(1) authorizes a trustee who has the absolute discretion to invade trust principal for the benefit of a beneficiary to exercise that power by appointing all or part of the principal of the trust to the trustee of another trust, created under a separate instrument, provided certain requirements are met. This section permits the trustee of a trust for the benefit of a disabled person which does not qualify as a supplemental needs trust to appoint the principal of the trust to the trustee of a supplemental needs trust, even if the supplemental needs trust is established only to accept the appointment from the existing trust.

Analysis

Trustee of existing trust must have absolute discretion to invade. The statute is clear that its provisions are only applicable where the existing trust from which the appointment is to be made contains a grant of absolute discretion to the trustee to invade for the benefit of one or more of the beneficiaries. Where the discretion to invade is not absolute,

the petition will be denied. NY CLS EPTL § 10-6.6(b)(1); *In re Barkman*, N.Y.L.J., May 20, 2003, at 23, col. 3 (Sur. Ct. Nassau County).

In re Estate of Mayer, 176 Misc. 2d 562, 672 N.Y.S. 2d 998 (Sur. Ct. New York County 1998) illustrates this point. Decedent created a trust for the benefit of his wife, his son, and his son's issue. At wifes and son's deaths, the trust was to be divided into equal parts for his issue. During the term of the trust, trustee was authorized to distribute principal in his sole and absolute discretion as he may deem necessary for the health, support, maintenance and education of any beneficiary. The trustee proposed to appoint three million dollars of the trust to a new trust to insulate it from transfer tax. The court held that invasions for estate planning fell outside the parameters of the trustees powers even when reviewed with the greatest possible leniency and trustees application for authority to appoint principal was denied.

By contrast, in *In re Kaskel, 163 Misc. 2d 203, 620 N.Y.S.2d 217 (Sur. Ct. New York County 1994),* a trustee applied for permission to terminate several trusts in favor of proposed trusts with almost identical terms. The purpose of the applications was to minimize potential liabilities. The trustee was authorized to distribute or apply from the principal of each trust, to or for the use of any income beneficiary, such sums as the trustee may deem appropriate for such person's maintenance, education or welfare or for any other purpose in the discretion of the trustee. The court held that if the trustee has total discretion to distribute trust principal to an income beneficiary, the trustee may, upon notice to all beneficiaries, apply to the court for permission to place the corpus in another trust for that beneficiary. Trustees application was granted.

Other criteria. The other criteria necessary for a successful petition are that the exercise of the power will not reduce any fixed income interest of any income beneficiary of the trust, is in favor of the beneficiary of the trust, and does not violate NY CLS EPTL § 11-1.7 by attempting to insulate the trustee from liability.

Application of statute to creation of supplemental needs trusts. While the statute was originally enacted for generation skipping tax purposes, it has been used successfully to appoint the principal of an existing trust which may not qualify as a supplemental needs trust to a trust which does qualify as a supplemental needs trust. *In re Grosjean*, N.Y.L.J., Dec. 10, 1997, at 35, col. 6 (Sur. Ct. Nassau County); *In re Hazan*, N.Y.L.J., Apr. 11, 2000, at 30, col. 5 (Sur. Ct. Nassau County); *In re McAllister*, N.Y.L.J., Aug. 20, 2001, at 36, col. 2 (Sur. Ct. Nassau County). Consent of a beneficiary is not required to create the trust.

Petition for court's approval available, but unnecessary; virtual representation statute applicable. Where the trustee has the requisite absolute authority to invade on behalf of the beneficiary, the trustee may appoint the property to the new trust without court approval. However, the trustee may nevertheless seek the court's approval of the proposed exercise of the power. If court approval is sought, the trustee presents the petition to the court. Process will then issue to all persons interested in the trust, with service thereof to be made personally, or by certified mail, return receipt requested, or as otherwise directed by the court. Service of process will not be necessary on those whose interests can be virtually represented by another party to the proceeding pursuant to NY CLS SCPA § 315.

For further discussion of the issue, *see* 5-69 *Warren's Heaton on Surrogate's Court Practice § 69.09*: Invasion of Principal for Benefit of Income Beneficiary; 12-209 *Warren's Heaton on Surrogate's Court Practice § 209.08*: Alienation of the Beneficiary's Interest; 12-211 *Warren's Heaton on Surrogate's Court Practice § 211.01* et seq.: Supplemental Needs Trusts.

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This article was updated and expanded by Kelliann Kavanagh, Esq.

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Michael E. O'Connor on Importance of Disinterested Attesting Witnesses

2008 Emerging Issues 1783

Michael E. O'Connor on Importance of Disinterested Attesting Witnesses

By Michael E. O'Connor

January 14, 2008

SUMMARY: Although an attesting witness/beneficiary is competent to testify about execution of a will, the beneficiary forfeits the benefit by testifying. Best practice suggests selecting disinterested persons to serve as attesting witnesses, or having more witnesses so testimony of the beneficiary is unnecessary. This Expert Commentary, authored by Michael O Connor, a Fellow of the American College of Trust and Estate Counsel and a contributing author to Warrens Heaton on New York Estate Practice, examines the importance of using only disinterested attesting witnesses for the execution of a will, including a discussion of the relevant case of *In re Fracht, 94 Misc. 2d 664, 405 N.Y.S. 2d 222 (Sur. Ct. Bronx County 1978).*

PDF LINK: Click Here for Enhanced PDF of Commentary

ARTICLE: Insight

Although an attesting witness/beneficiary is competent to testify about execution of a will, the beneficiary forfeits the benefit by testifying. Best practice suggests selecting disinterested persons to serve as attesting witnesses, or having more witnesses so testimony of the beneficiary is unnecessary.

Analysis

Witness-beneficiary forfeits interest by testifying. The Dead Man's Statute prevents a person interested in the event from testifying against the interests of the decedent or his estate. CPLR 4519. Consistent with this conflict resolution, EPTL 3-3.2 subjects a will beneficiary to loss of benefit if such beneficiary's testimony is necessary to probate the will. By forfeiting the benefit provided by the will, the witness is presumed to lose any incentive to testify untruthfully to maintain a larger inheritance.

If will is probated without witness-beneficiary testimony, disposition is preserved. The testimony of two attesting witnesses is required to admit the will to probate. *See* SCPA 1404(1). If three witnesses attest to execution of a will, the two non-beneficiary attesting witnesses obviate the necessity of the witness-beneficiary's testimony and thereby avoid forfeiture. Even if one or both of the other witnesses is dead when probate is to be accomplished, forfeiture could be

avoided if those deceased witnesses had executed affidavits pursuant to SCPA 1406. A distributee could force the witness-beneficiary to testify by objecting to probate. Even if the witnesses had executed affidavits at the time the will was executed, filing of objections to probate would require witnesses to testify again in the probate proceeding.

If distributee receives intestate share, benefit is preserved. If a distributee receives no more than an intestate share under the will, then there is no forfeiture since the beneficiary would have no conflicting incentive to testify untruthfully to establish the will. If the witnesses are required to testify in probate, and if a witness is a distributee, then the maximum benefit of that witness-beneficiary becomes the intestate share. Whether the witness-beneficiary would receive even that much would depend on the terms of the will. For example, if the beneficiary is to receive an automobile valued at $ 20,000, but has an intestate entitlement of $ 40,000, then only the automobile would pass. If, on the other hand, the beneficiary was entitled to a bequest of $ 40,000, but the intestate share would have amounted to $ 20,000, then only the lesser amount would be payable.

EPTL 3-3.2 forfeiture applies to property dispositions not fiduciary appointments. A witness to a will also named as executor under the will would not lose the fiduciary appointment or resulting commission, even if the witness-fiduciary's testimony is necessary to prove the will.

For example, in the case of *In re Fracht, 94 Misc. 2d 664, 405 N.Y.S.2d 222 (Sur. Ct. Bronx County 1978),* petitioner, a nephew of the decedent, was also the attorney who prepared the will, supervised its execution, was nominated as the executor, was an attesting witness and was named as the residuary legatee. The beneficial dispositions made in the will to all of the attesting witnesses, including the petitioner, were void. However, the nomination of an attesting witness as an executor is not deemed a beneficial disposition to him under the theory that he is being compensated for services rendered rather than being the recipient of a testamentary disposition from the decedent. In the absence of an objection by an interested party, the petitioner/nephew was not precluded from serving as an executor in this estate.

For further discussion of the issue, *see* New York Practice Guide: Probate and Estate Administration § 3.03: Attestation of Will; *Warren's Heaton on Surrogates Court § 115.01*: Competency of Witnesses; *Warren's Heaton on Surrogates' Court § 185.01*: Capacity to Take Property by Devise or Bequest; *Warren's Heaton on Surrogates' Court § 207.01*: Statutes Affecting Validity of Will Provisions.

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He has been an adjunct professor of taxation in the Syracuse University School of Law Masters Program. He has acted as Chairman of State-wide New York State Bar Association continuing education programs for attorneys on Contested Estates and Fiduciary Income Taxation. He has been Moderator and Lecturer on New York State Bar Association programs on Will Drafting; Use of Trusts in Nursing Home Planning; Estate Settlement; Valuation of Business Interests; Estate Problems in Real Property Titles; Business Interests; Fiduciary Income Tax; Generation Skipping Tax; Use of Trusts and Gifts in Estate Planning. He has spoken, moderated and written for programs sponsored by the New York Society of CPAs, Central New York CPA Club, National Business Institute, Estate

Planning Council of CNY, Estate Planning Council of the Capital District and Association of Real Estate Appraisers. He has authored articles, "US Savings Bonds in the Estate" and "Generation Skipping Tax-Questions and Answers for the Estate Planner" (New York State Bar Journal). He is a contributing author to Warrens Heaton on New York Estate Practice, and has authored numerous statutory commentaries for Lexis Nexis Publishing. He is Editor-in-Chief of a book "Estate Planning and Will Drafting". As a member of the Onondaga County Bar Association, he has chaired its Committee on Estates and Surrogate's Court, and been a member of its Board of Directors. He is a member and past President of The Central New York Estate Planning Council. He is also a director of the Syracuse University Tax Institute. Mr. O'Connor has participated in numerous community educational programs, TV and radio broadcast programs on estate planning issues, as well as having written for local publications on the subject.

This article was updated and expanded by Kelliann Cavanaugh, Esq.

Andrew L. Martin on Application for Termination of Uneconomical Trust

2008 Emerging Issues 1784

Andrew L. Martin on Application for Termination of Uneconomical Trust

By Andrew L. Martin and Kelliann Kavanaugh

January 14, 2008

SUMMARY: NY CLS EPTL § 7-1.19 now exists for the termination of private trusts prior to the termination event described in the governing instrument where the trust's continuation is deemed to be economically unfeasible. The parties' consent to an application for early termination will be helpful, but may not guarantee approval, depending on the circumstances. This Expert Commentary, authored by Andrew L. Martin, the Chief County Attorney of the Surrogates Court of the State of New York, Nassau County, and a contributing author to Warrens Heaton on Surrogates Court Practice Legislative and Case Digest, examines the criteria for the early termination of an uneconomical trust, including a discussion of three relevant cases: *In re Frank, 57 Misc. 2d 446, 293 N.Y.S.2d 16 (1968); In re Kistner, N.Y.L.J., 2006 N.Y. Misc. LEXIS 8887, 235 N.Y.L.J. 14 (2006);* and *In re Dauman, 12 Misc. 3d 1173A, 820 N.Y.S.2d 842 (2006).*

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Statutory authority now exists for the termination of private trusts prior to the termination event described in the governing instrument where the trust's continuation is deemed to be economically unfeasible. The parties' consent to an application for early termination will be helpful, but may not guarantee approval, depending on the circumstances. The interests of persons under disability or of unborns may be represented by guardians ad litem, or by virtual representation. The statute is inapplicable if its application would jeopardize any charitable or generation-skipping tax benefit.

Analysis

The petitioner must satisfy these criteria for early termination of a trust.

1. Continuation of the trust must be economically impracticable;

2. The express terms of the governing instrument do not prohibit early termination;

3. Early termination would not defeat the specified purpose of the trust; and

4. Early termination of the trust would be in the best interests of the beneficiaries.

Statute does not define what constitutes "uneconomical trust," but case law and other statutes provide some guidance. EPTL 7-1.19 does not contain any guidepost or ceiling above which a trust will not be deemed an uneconomical trust. In the arena of charitable trusts, EPTL 8-1.1(C)(2) authorizes early termination where the trust assets do not exceed $ 100,000 "and the expense of administering the trust is uneconomic when considered relative to income." EPTL 7-1.19 provides neither a cap nor a direct reference to the income earned by the trust. Thus, it is conceivable that a private trust may be terminated early which exceeds $ 100,000 in value, or where economic unfeasibility includes factors other than solely the relation between income earned and the costs of maintaining the trust. Even prior to the statute's enactment, the courts authorized early termination where the income earned by the trust clearly was not providing a meaningful income stream to the income beneficiary (*In re Walter,* N.Y.L.J., Dec. 18, 2003, at 29, col.6 (Sur. Ct. Bronx County) (trust corpus $ 10,000); *In re Bartell,* N.Y.L.J., July 9, 1997, at 34, col. 6 (Sur. Ct. Nassau County) (trust corpus less than $ 46,000)); or where the purpose of the trust could no longer be accomplished.

For instance, in *In re Frank, 57 Misc. 2d 446, 293 N.Y.S.2d 16 (Sur. Ct. Kings County 1968)* decedents will devised a parcel of real property in trust in order to furnish her daughter with a free apartment for life. Upon the daughters death, the property was to become part of the residuary estate. The daughter vacated the premises and she and the other beneficiaries consented to sell the parcel because it had deteriorated. The court held that the trust had terminated early and that the proceeds realized from the sale of the property were distributable in equal shares to the beneficiaries. The court examined the purpose for which the trust was created and found that the necessity of a continuance of the trust ceased when the trustee vacated the premises and sold the property.

Since the statute's enactment, cases have permitted early termination for trusts approaching $ 100,000 (*In re Bleibtreu,* N.Y.L.J., Nov.18, 2004, at 31, col. 3 (Sur. Ct. New York County) (trust corpus $ 85,000)).

In *In re Kistner, N.Y.L.J., Jan 23, 2006, at 35, col, 1, 2006 N.Y. Misc. LEXIS 8887, 235 N.Y.L.J. 14* (Sur. Ct. Suffolk County), the trustee of a testamentary trust naming decedents daughter as an income beneficiary sought to terminate the trust during daughters lifetime on the grounds that it would be uneconomical to continue. The value of the trust was approximately $91,000, while the annual cost of administering it was $ 4,000. The Trustee argued that little, if any, income would be available to benefit the daughter over the remainder of her life and continuation of the trust would be uneconomical under any definition. The court granted the application to terminate.

In *In re Dauman, 12 Misc. 3d 1173A, 820 N.Y.S.2d 842, 2006 N.Y. Misc. LEXIS 1562 (Sur. Ct. Nassau County 2006),* the trustee of a trust created by a decedents will for the benefit of his wife (as income beneficiary) and children (as remaindermen) sought early termination of the trust on the grounds of economic impracticability. The assets in the trusts were worth approximately $300,000. The trustee contended that given the size of the trust, it would be in the best interest of the income beneficiary to terminate it, thereby avoiding both exorbitant trustee commissions and the difficult task of replacing the trustee when he resigned. The court held that the administration costs were not so burdensome nor the trust assets so minimal as to render the continuation of the trust economically impracticable.

Petition for early termination will be denied if all criteria are not satisfied, despite consents of interested parties. Consents on behalf of parties under disability or not in being may be provided by guardians ad litem or by application of virtual representation statute, SCPA 315, or dispensed with by court. Clearly, adult competent parties may consent on their own behalf to a petition for early termination. The consents of parties under disability may be obtained from their guardians ad litem, or by application of SCPA 315 (*In re Kistner, N.Y.L.J., Jan 23, 2006, at 35, col, 1, 2006 N.Y. Misc. LEXIS 8887, 235 N.Y.L.J. 14* (Sur. Ct. Suffolk County) (beneficiaries of a trust were permitted to virtually represent their infant and unborn issue's interests when there were no conflicts of interest among them, their economic interests were identical, and their representation was adequate), or the court, in its discretion, may decide to dispense with the necessity of their even being made parties to the proceeding (EPTL 7-1.19(b)). While the consents of

the interested parties will surely make approval of the petition more likely, approval will be withheld where one or more of the statutory criteria are not met. Failure to prove that continuing the trust will be financially unfeasible will result in denial of the petition. Also, even where the express language of the instrument does not prohibit early termination, where the language limits the trustee's invasion power to an ascertainable standard and clearly indicates that the testator wanted to have an income stream available to his widow, the petition will likely be denied.

In *In re Dauman, 12 Misc. 3d 1173A, 820 N.Y.S.2d 842, 2006 N.Y. Misc. LEXIS 1562 (Sur. Ct. Nassau County 2006)*, the trustee of a trust created by the decedents will for the benefit of his wife (as income beneficiary) and children (as remaindermen) sought early termination of the trust on the grounds of economic impracticability. Two of the presumptive remaindermen consented to the termination and the third failed to appear. Regardless of this consent, the court denied the application for termination because, although early termination was not expressly prohibited by decedents will, it appeared that the proposed early termination would defeat the trust purpose of having a fund available for decedents spouse during her lifetime. The testator limited the trustees power to invade the principal to a support and comfort standard rather than providing for unlimited discretion to invade principal.

Distribution of assets upon termination. The statute leaves the issue of the allocation of the trust assets among the income and remainder beneficiaries up to the court to decide, though most petitions are likely to provide that the corpus be paid entirely to the income beneficiary, supported by the consents of the remainder beneficiaries, who, in many cases, are the children of the testator and the income beneficiary.

In *In re Kistner, N.Y.L.J., Jan 23, 2006, at 35, col, 1, 2006 N.Y. Misc. LEXIS 8887, 235 N.Y.L.J. 14* (Sur. Ct. Suffolk County), the trustee of a trust created by the decedents will, naming his daughter as an income beneficiary, sought to terminate the trust during daughters lifetime on the grounds that it would be uneconomical to continue. Under the trust terms, upon the daughters death, the principal was to pass to her issue per stirpes. The court granted the application to terminate and directed distribution of trust assets to the daughter because such distribution effectuated the intention of the creator and the presumptive remaindermen had all submitted waivers and consents to the petition seeking distribution to the income beneficiary.

No adverse tax consequences to ensue. Finally, the statute provides that if its application, or the possibility of its application, would jeopardize a charitable or generation-skipping tax benefit otherwise available to any person, the statute shall not apply to any such trust (EPTL 7-1.19(c)).

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This article was updated and expanded by Kelliann Kavanaugh, Esq.

OConnor on Death as a Requirement to Establish Property Rights of Beneficiaries

2008 Emerging Issues 1771

OConnor on Death as a Requirement to Establish Property Rights of Beneficiaries

By Michael E. OConnor and Kelliann Kavanagh

January 11, 2008

SUMMARY: A presumption of death arises after an unexplained absence for three years and a diligent search. If a missing person has dependents, the needs of these dependent beneficiaries may require prompt attention, even though final disposition of the estate may be delayed for three years. This Expert Commentary, authored by Michael O Connor, examines the determination of death as a requirement to establish property rights of beneficiaries, including discussion of three relevant cases: *In re Podkowik, 114 N.Y.S.2d 710 (1952), In re Estate of Simpson, 5 Misc. 3d 1026A, 799 N.Y.S.2d 164 (2004),* and *Chiaramonte v. Chiaramonte, 106 Misc. 2d 822, 435 N.Y.S.2d 523 (1981).*

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A presumption of death arises after an unexplained absence for three years and a diligent search. If a missing person has dependents, the needs of these dependent beneficiaries may require prompt attention, even though final disposition of the estate may be delayed for three years.

Analysis

Specific peril of death reduces time period. While unexplained absence will raise the presumption of death at the conclusion of the three-year period, the presumption may arise earlier in certain circumstances. There is no fixed period of absence when the facts demonstrate that death occurred in a clearly identified disaster.

For example, in the case of *In re Podkowik, 114 N.Y.S.2d 710 (1952),* decedent, who died in 1951, was potentially survived by an absentee sister and brother. Both sister and brother were known to be alive and residing in Lithuania in 1939. Nothing had been heard from them subsequent to that year. The court took judicial notice of the fate of persons of Jewish extraction residing in Lithuania between 1939 and 1945. The absentee sister and brother disappeared under circumstances of fatal danger. Jewish individuals in Lithuania during the period in question were in mortal peril. No fixed period of time is necessary where the facts demonstrate that death occurred in some clearly identified disaster, such as the Holocaust.

The facts of disappearance due to a life threatening catastrophe can be presented to the court prior to expiration of three years and the resulting order can establish death as having occurred on the date of the catastrophe even though that date is the beginning of the three-year period.

In the case of *In re Estate of Simpson, 5 Misc. 3d 1026A, 799 N.Y.S.2d 164 (2004)*, absentee, a man with a history of mental illness, disappeared one day after returning to work and was never seen or heard from again. The day of his disappearance, the absentees car was found abandoned on a bridge and an eyewitness reported seeing a person leap from the same bridge. No body was ever discovered. The court found that the clear and convincing evidence with respect to the specific peril alleged, to wit, the absentees plunging into water from a great height, warranted the conclusion that the date of the absentee's disappearance was the date of his death.

In *Chiaramonte v. Chiaramonte, 106 Misc. 2d 822, 435 N.Y.S.2d 523 (1981)*, defendant paid alimony and child support until he disappeared during a flight on a private airplane, along with the pilot and the aircraft. No survivors or wreckage were found. If a person was exposed to a specific peril of death, that may be sufficient basis for determining that he died less than five years after the date his absence commenced, i.e., there is a distinction between mere unexplained absence and a disappearance under circumstances that strongly point to immediate death. The court held that alimony and child support arrears were recoverable by his former wife out of certain of his assets held by the court.

Court may appoint temporary administrator for absentee prior to presumption of death. With proof that a person has disappeared and, with diligent inquiry, cannot be found, the court may appoint temporary administrator. *See* SCPA § 901(2). Until determination of death is made by the court, a beneficiary's property rights will not be established. As with the temporary administrator of a decedent's estate, the principal objective is to collect and preserve assets. Payments from the property may be made only as authorized by the court.

Temporary administrator may support absentee's spouse and children with court order. When a temporary administrator is appointed for an absentee, it is possible that a spouse and children may be deprived of support by the absentee pending the presumption of death. The court may authorize the temporary administrator to pay amounts for support of dependent family members, akin to payment of debts. In the alternative, the Surrogate may prefer to have the family court make an order of support and then authorize the temporary administrator to satisfy that order. Due to the financial crisis that may be caused by the sudden disappearance of an income earner, the attorney's role may become critical at an early point.

For further discussion of the issue, see New York Practice Guide: Probate and Estate Administration § 12.01: When Letters of Temporary Administration May Be Granted; New York Practice Guide: Probate and Estate Administration § 12.11: Final Determination and Distribution of an Absentee's Estate; New York Practice Guide: Probate and Estate Administration § 12.11a: Springing Power of Attorney; New York Practice Guide: Probate and Estate Administration § 16.19: Applicability of SCPA Article 17; *Warren's Heaton on Surrogates' Court §§ 32.01* et seq.: Elements to Be Proven in a Probate or Administration Proceeding; *Warren's Heaton on Surrogates' Court § 74.16*: Estate of Absentee; *Warren's Heaton on Surrogates' Court § 102.02*: Special Distribution Issues In Accounting Decrees.

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