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Steve Leimberg's Estate Planning
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Subject: Linda Kotis: Reform School - Lessons on Rescuing an Undesirable Tax Plan after Death

"*Estate planners might be surprised at the New York County Surrogate's Court disparate decisions in a 2016 revocable trust/IRA beneficiary reformation case and a 2017 Will formula clause reformation case. In Sukenik, the passage of many years since documents were executed and the omission of the decedent's statement to save all taxes were construed to deny a request to switch the trust's charitable gift with the widow's designation as the IRA beneficiary, while in Brecher, the similar circumstances of a 27 year gap since the execution of a Will and the failure to mention state estate tax savings did not derail the petition. These cases offer lessons on the limits of a post-mortem reformation plan and the necessity of an attorney's diligence in working with a client during lifetime to ensure documents address the law and reflect client intent.*"

We close the week with **Linda Kotis**'s commentary on *Sukenik* and *Brecher* which offer lessons on the limits of post-mortem reformation planning.

Linda Kotis is a trusts and estates attorney in the Washington, DC office of **Ivins, Phillips & Barker** and a member of the District of Columbia, California, Indiana, and Maryland Bars. She designs complex estate plans, works with the principals of closely held business entities, assists clients with charitable gift planning and real property transfers, and analyzes estate, income, generation-skipping transfer, and gift taxation matters for individuals and families. Her most recent article, *Nonjudicial Settlement Agreements: Your Irrevocable Trust is Not Set in Stone*, was published in the March/April 2017 issue of *Probate & Property* magazine. She is also the author of articles in the *Washington Lawyer,* Bloomberg BNA Daily Tax Report, and Wealth Strategies Journal, and has made presentations at the American Bar Association, the District of Columbia Bar, and law firm briefings.

Here is her commentary:

EXECUTIVE SUMMARY:

Suppose a widower comes to your office with his late wife's "messed-up Will" in hand. His story is that she meant to change it to fix the "tax mistakes" of her former attorney, but sadly her unexpected death foreclosed that opportunity. Two recent cases, *Matter of Estate of Sukenik*, and *In the Matter of Brecher*, are instructive as to how a court might view such a reformation proceeding.

FACTS:

In *Matter of Estate of Sukenik,* 2016 NY Slip Op 31217, profiled by **Paul Hood** in Estate Planning Newsletter #2529, the Surrogate's Court of New York County rejected a widow's petition to reform her late husband's revocable trust. Charles Sukenik died in 2013 and his 2004 Will left his tangible personal property and a cooperative apartment to his wife, and his residuary estate to The Charles and Vivian Sukenik Philanthropic Fund, Inc. (the "Foundation"). The revocable trust gave his wife certain real property in Columbia County, New York, with the balance of the trust to be distributed to the Foundation. Mrs. Sukenik was seeking the addition of a pecuniary gift to her under the trust, in lieu of having the residuary trust estate pass to the Foundation, and the substitution of the Foundation as the beneficiary of a $3.2 million Individual Retirement Account, which had been given to her. Achieving her goal would have offset the income tax liability of the IRA with a charitable deduction and have assets pass to her that would receive a step-up in basis. The trust, originally created in 1996, had been restated in 2004 and the beneficiary designation signed five years later, in 2009.

In *In the Matter of Brecher*, 2017 N.Y. Slip Op 30022, profiled by **Bruce Steiner** in Estate Planning Newsletter #2530, the same Surrogate's Court granted the executor's petition to reform a 1989 Will benefiting the decedent's wife and descendants. Oskar Brecher died in 2016 and the goal of the reformation was to change the formula bequest of the marital gift and a credit shelter trust that would have reduced the decedent's federal estate tax to zero, to a formula that would reduce both federal and state estate taxes to zero. The court described the original formula as:

> the minimum amount necessary to provide a federal estate tax marital deduction sufficient to reduce [decedent's] federal estate tax to zero, after taking into account (a) all other interests

> in property passing to or for the benefit of [decedent's] wife under [his] Will or otherwise than under [his] Will, but only to the extent such interests are included in [his] gross estate for federal estate tax purposes and allowed as a marital deduction and (b) all credits and deductions available in calculating the federal estate tax on [decedent's] estate...

COMMENT:

What explains the different results in these two cases?

Similarities in the Cases

Both petitions for reformation were unopposed. Both sought tax savings for the beneficiaries of the estate. If the court would have granted the *Sukenik* reformation, the widow argued she would save approximately $1.6 million in income tax. By granting the *Brecher* reformation, the amount passing to the credit shelter trust was reduced by about $1.26 million. The marital gift was increased by about $1.77 million. Overall, the estate saved more than $500,000 in New York estate taxes. In both cases, the decedent had time to fix his own plan, with testamentary documents executed long before the decedent's death – a Will and a revocable trust executed almost nine years before death for Charles Sukenik, with a beneficiary designation four years before death, and a Will executed almost 27 years before death for Oskar Brecher. And, it isn't clear in either case why that was not done.

Different Views by the Same Court

In both *Sukenik* and *Brecher*, the court discussed the decedent's intention in terms of minimizing tax consequences, but put a different spin on each situation. To support its denial of Mrs. Sukenik's petition to switch IRA beneficiaries, the court framed the situation in stark terms, as offering no support for the testator's intent to minimize income tax consequences and as the product of the testator's own fault. The court said that the Will and the Revocable Trust were (i) "clear and unambiguous instruments," with (ii) "no authority to support the reformation" . . . in order to remedy the adverse tax consequences of poor estate planning," and (iii) "neutral as to the tax consequences of distributions by giving his fiduciaries the power to distribute assets without regard to 'income tax basis.'" The court went on to note that the decedent had "four years before his death" to cure the situation and dismissed the petitioner's explanation that the decedent became too ill to

follow-up on suggestions made “at some unspecified time” by the decedent’s estate planning attorney, who predeceased him, to leave the IRA to charity and leave certain non-IRA accounts to his wife.

The court concluded with an admonishment to those seeking reformation:

> To reform instruments such as those at issue here based only upon the presumption that one who executes testamentary instruments intends to minimize taxes would expand the reformation doctrine beyond recognition and would open the flood gates to reformation proceedings aimed at curing any and all kinds of inefficient tax planning (see *Matter of Manville*, 112 Misc.2d 355 [Sur Ct, Westchester County 1982]; see also *Matter of Rubin*, 4 Misc.3d 634, 640 [Sur Ct, New York County 2004] [rejecting argument that presumption applied in reformation case where the instrument did not contain "technical drafting errors"]). As the Appellate Division, First Department, stated in *Matter of Dickinson* (273 A.D.2d 89, 90, supra), a case in which the court affirmed dismissal of a reformation proceeding: “When the purpose of the testator is reasonably clear by reading his words in their natural and common sense, the courts have not the right to annul or pervert that purpose upon the ground that a consequence of it might not have been thought of or intended by him (*Matter of Tamargo*, 220 N.Y. 225, 228 [1917].”

In contrast, the *Brecher* court gave a curious explanation for the failure of the formula clause to mention the state estate taxes in existence at the time the Will was originally drafted:

> Petitioners seek a court order reforming decedent’s probated will in order to avoid a New York estate tax that will otherwise be imposed under a New York tax law that was not in effect when the will was executed.
>
> . . . .
>
> As an incident of the relationship between the two tax systems, any New York estate that had no federal estate tax liability would also be free of liability for New York estate tax. It would therefore have been a redundancy if the Marital Formula had

> expressed an aim, not only to reduce the federal estate tax to zero, but also, to reduce the state estate tax to zero.

Bruce Steiner noted in his commentary that the court's explanation is based on "the Surrogate incorrectly describ[ing] the New York estate tax in 1989 as a sponge tax (an estate tax limited to the old Federal state death tax credit). . . . New York did not limit its estate tax to a sponge tax until February 1, 2000." Through September 30, 1998, an estate exceeding $115,000 was subject to New York estate tax, and from October 1, 1998, through January 31, 2000, state estate tax applied to estates of more than $300,000. Beginning February 1, 2000, no state estate tax was due and no estate tax return was required if the value of the estate was equal to or less than $675,000, which was the federal "exemption equivalent."[1]

According to Bruce's commentary, if the original formula had been preserved, the $8 million estate would have been distributed as follows: $5,450,000 to the credit shelter trust, $505,455 for New York estate taxes, and $2,044,545 to the widow. Under the reformation formula, $4,187,500 would pass to the credit shelter trust and $3,812,500 to the widow, with no New York estate tax.

The court's opinion also failed to question why Mr. Brecher made no effort to change his Will during the nearly three decades that had passed since it was written. Further, the court broadly interpreted the decedent's stated intent to reduce federal taxes as one that would embrace an increased marital gift at the expense of the credit shelter trust because the family as a whole would benefit:

> As is obvious from the will's dispositive provisions, testator's intent to protect his estate from tax erosion was but an aspect of his main intent, *i.e.*, to benefit his wife and their descendants as much as possible. The tax-driven nature of his allocation of benefits among them suggests that he viewed a gift to one as being, in effect, a gift to the others.

Finally, the court in *Brecher* acknowledged that "as a rule, however, the courts have been more liberal in their regard for petitions seeking reformation when that relief is needed to avert tax problems caused by a defective attempt to draft a will provision in accordance with the then tax law or instead

caused by a change in law, subsequent to execution of the will, that renders a tax-driven will provision counterproductive."

The Takeaways

These two cases illustrate how the same court may apply a completely different perspective to a testator's intent: characterizing the testator's intent in *Sukenik* as rejecting the desire to save all taxes resulting from his death because "nothing in the trust or will indicates that decedent intended to minimize the income tax consequences of distributions to any beneficiary," while arguably expanding the testator's intent in *Brecher* to embrace the desire to save all taxes, even those not mentioned in the testamentary documents. Note this quote in the *Sukenik* decision about silence in a will on specific taxes that could have easily been used to deny the *Brecher* reformation:

> the court in [*In Matter of Dunlop* (162 Misc.2d 329 [Sur Ct, Hamilton County 1994],] refused to reform an instrument to secure GST exemptions for decedent and his spouse where testator expressed an intent to maximize only the marital deduction and was silent as to the GST, which had been in existence when the will was drafted.

The cases also show the court's predilection for reformation when a change of law is involved. There was no change of law involved in the *Sukenik* case. The unfavorable income tax liability for an individual IRA beneficiary existing at the time of the decedent's death in 2013, was present in 2004 when the Will and revocable trust were executed, and in 2009, when the IRA beneficiary designation was made.

In *Brecher*, the method for calculating New York estate tax liability was modified, and the state estate tax exemption amount increased over the years, but the existence of a law establishing a state estate tax did not change. A New York state estate tax was in effect at the time the Will was originally drafted in 1989, as it was in 2016. Mr. Brecher's Will could have been updated with a reformulated provision that specifically addressed the saving of state estate taxes, several times over the years, to reflect the various incarnations of the tax.

Also, it is worth examining the relative ratio of the state estate tax to the total taxable estate, had Mr. Brecher died in 1989, rather than in 2016. Based on the figures in Bruce's commentary, the New York estate tax liability in 1989

would have been 4.37% of his taxable estate ($28,045/$642,425 = 4.37%), while in 2016, the New York estate tax liability would have been 9.27% of his taxable estate ($505,455/$5,450,000 = 9.27%). Though the percentage increase of the potential 2016 state estate tax over the potential 1989 state estate tax is sizable, the ratio of the state estate tax to the total taxable estate during such years is not as significant.

Applying the Lessons

As you go over the "messed-up Will" brought in by the prospective client, you realize the situation is not unlike the *Sukenik* and *Brecher* cases. Here are some lessons to consider as you decide how to proceed on rescuing an undesirable tax plan after the testatrix's death:

- A defective provision and/or a change in law are favored by courts to support a reformation. If the undesirable plan lacks those characteristics, reform may be less likely.
- The petitioner could hope that the court ignores the testatrix's failure to fix her own plan, but reliance on this strategy is inadvisable.
- The narrative in the reformation petition should give compelling reasons as to why the passage of several years between the document's execution and the testatrix's death was not sufficient for the testatrix to fix her defective Will or trust.
- The court may base its decision on a mischaracterization of applicable law. This may support or thwart the client's position.
- The court may find ways to describe the testatrix's intent to fit the desired result, but again, this may not produce the desired outcome.

Concluding Observation

Probably the most important lesson of all embraces Paul Hood's conclusion regarding *Sukenik*. To rely on a court as the rescuer of an undesirable estate plan may lead to disappointment. Estate planners must understand the law and give proper tax advice to their clients. Moreover, attorneys should check in with their clients periodically to ensure client documents are up-to-date, reflect relevant changes in the law, and adequately describe their client's intent.

WE KNOW THIS WILL HELP YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Linda Kotis

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Matter of Estate of Sukenik, 2016 NY Slip Op 31217 (U) (Surr. Ct. N.Y. Co. June 28, 2016); *In the Matter of Brecher,* 2017 N.Y. Slip Op 30022(U) (Surr. Ct. N.Y. Co. Jan. 11, 2017); Paul Hood on *Sukenik*: Attempted Reformation Shot Down, a Bridge Too Far? Steve Leimberg's Estate Planning Newsletter Archive Message #2529; Bruce Steiner on the Estate of Oscar Brecher: Reformation of Will to Eliminate State Estate Tax. Steve Leimberg's Estate Planning Newsletter #2530; 1 Harris N.Y. Estates: Probate Admin. & Litigation § 17:43 (6th ed.), January 2017 Update.