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Why New York Attorneys Should Consider Inter Vivos Trusts in Estate Planning

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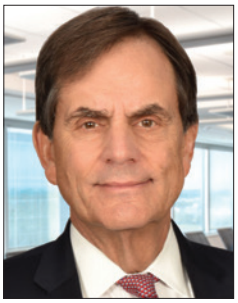

By **C. Raymond Radigan**

And **David N. Milner**

Though often used in many jurisdictions such as California and Florida where the probate process and the administration of estates often can be problematic, historically, inter vivos trusts, whether be they revocable or irrevocable, were rarely used in New York. New York estate planning lawyers relied on wills since in New York, for most estates, the probate process was historically a quick and easy process and the administration of estates was equally simple.

In practice, for most estates, once the will was admitted to probate there would be little, if any, interaction with the court absent a litigation or a special proceeding. In jurisdictions such as Florida, the personal representative is often required to regularly file reports with the court and at times explain why the administration of the estate had not been completed.

To demonstrate how simple it was to probate a will and administer an estate, Surrogate John Bennett often described a situation where the decedent died on a Friday. The attorney and family met on Saturday wherein the attorney prepared all of the necessary documents for probate. Since all parties were competent adults and waivers and consents were obtained, on Monday, the attorney went to the court to file the papers.

The will was admitted to probate, a decree signed, and letters issued, all by Tuesday morning. The attorney met with the clients Tuesday afternoon and delivered the Letters Testamentary. The family then went to the bank, withdrew funds and then went to the local Cadillac dealership. They each purchased a Cadillac and were thus able to go to the funeral on Wednesday in style.

This was not an exaggeration, and is something that Judge C. Raymond Radigan often experienced in Nassau County when he was surrogate.

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David N. Midler had a similar experience when he was able to obtain Preliminary Letters Testamentary in New York County on the same day that he submitted the application for preliminary letters coupled with an affdavit of urgency setting forth the need for the immediate issuance of Preliminary Letters.

Sadly, over the years, there have been many developments that have adversely impacted upon the ability to achieve speedy probate. All courts have experienced a significant decline in court personnel. The pandemic contributed to even greater court delays. In some New York counties, the delay in achieving probate in a simple, uncontested proceeding, with all interested parties signing waivers and consents, is taking months.

In a recent uncontested filing, it took six weeks to have a file number assigned and, while, to the court's credit, preliminary letters were issued at the same time, it has been almost four months since submission of the probate petition and no further communication has been received from the court. We understand that this is not the fault of the court but rather the circumstances under which they are operating.

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To the extent a decedent is able to transfer assets to an inter vivos trust, the need for probate is diminished. It should also be noted that probate can be avoided by having assets pass upon death through the use of will substitutes such are beneficiary designations on bank and brokerage accounts. However, to rely on the use of will substitutes for estate planning purposes can be cumbersome.

There are reasons other than the avoidance of probate to consider using inter vivos trusts as an estate planning tool. Our population is living longer and some of our elderly experience dementia or other capacity limitations. As a result, costly Article 81 proceedings must be commenced to have a guardian appointed to manage the assets of the incapacitated person. The use of less costly options to deal with these difficult situations is encouraged by the Mental Health Law. The existence of a funded inter vivos trust avoids the need for an Article 8 proceeding.

There has also been a growing concern about privacy. Filings with the Surrogate's Court are open for public inspection. Accordingly, there can be no expectation of privacy. However, the records of inter vivos trusts are not open to public inspection. Transparency is something the attorney and client must consider.

Even an unfunded inter vivos trust can prove beneficial when coupled with a pour-over will. While probate will need to be achieved over the decedent's assets, once probate is achieved and the assets are poured-over into the trust, the provisions of the trust will govern the administration of the trust eliminating the need for court intervention.

By way of example, trustee and successor trustees of trusts created by a will need to have Letters of Trusteeship issued to them by the Surrogate's Court before assuming their role. Given the backlog faced by Surrogate's Courts, this can take several months, leaving the potential for a trust to not be administered during the intervening period.

This can be problematic, especially if the need for the successor trustee is sudden and unplanned for. Successor trustees appointed in inter vivos trusts take their office immediately upon the occurrence of the event leading to their appointment subject to their written acceptance of their appointment.

It should be noted that prior to Oct. 4, 2019, because of an ambiguity in New York law, there was a question as whether a "dry" or unfunded trust was valid. EPTL 3-3.7, first enacted in 1966, permitted a testator to pour-over assets into a lifetime trust "…regardless of the existence of the corpus." However, EPTL 7-1.18, enacted in 1997, provided that a trust was only valid to the extent assets had been transferred to it.

The ambiguity was eliminated in 2019 when the language of EPTL 3-3.7 was changed to replace the words "…regardless of the existence of the corpus" with the words "…regardless of whether any assets have been transferred to the trust"

When considering the use of an inter vivos trust as part of the estate plan it is important that the practitioner understand that there are estate, gift and income tax considerations that must be considered. The use of a revocable inter vivos trust will not by itself achieve any estate tax benefits for the grantor.

Assets transferred to a revocable inter vivos trust will be included in the decedent's gross estate for estate tax purposes. However, since the transfer is considered to be an incomplete transfer for gift tax purposes, the transfer will not be subject to gift tax. Assets transferred to an irrevocable inter vivos trust, assuming that incidents of ownership are not found to exist (IRC §2036, etc.), will be excluded from the decedent's estate, but will be subject to gift taxation. Income tax consequences must also be considered.

While transfers to an irrevocable inter vivos trust will be excluded from the decedent's estate, since these transfers represent completed gifts, the trust's tax basis in the assets received will be the donor's basis in the asset. While any appreciation in the value of the assets between the date of the transfer and date of death will escape estate taxation, the appreciation will be subject to income taxation when the asset is sold. Whether this is a good or bad result will depend upon the circumstances.

Consideration should also be given to having an irrevocable inter vivos trust drafted to qualify as a "grantor trust" trust for income tax purposes. While assets transferred to a grantor trust will be removed from the grantor's estate for estate tax purposes, assuming the trust is otherwise irrevocable and that there are no incidents of ownership retained by the grantor, the grantor will be treated as the owner of the assets for income tax purposes.

There are also non-tax factors that must be considered when choosing between a revocable or irrevocable inter vivos trust. Assets transferred to an irrevocable trust will typically remove the assets from the reach of the donor's future creditors and from the creditors of the beneficiaries of the trust. However, the donor will lose control of the assets. Transfers to a revocable trust will not, in New York, protect the assets from the reach of creditors, present or future.

Todays' trust and estate practitioners should not limit their engagement to the preparation of a will. While the preparation of a will is almost always necessary attorneys must also consider whether the use of testamentary revocable and irrevocable inter vivos trusts are appropriate, as well as the use of healthcare proxies, living wills, powers of attorney and other documents and planning devices in order to meet the needs of their clients.