Matter of Lipton
2020 NY Slip Op 32435(U)
July 21, 2020
Surrogate's Court, New York County
Docket Number: 2013-2711/D
Judge: Nora S. Anderson
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``SURROGATE'S COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

New York County Surrogate's Court
MISCELLANEOUS DEPT.
JUL 21 2020
FILED
Clerk

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In the Matter of the Petition of Audrey Lipton for a Judicial Determination of the Effect of Her Election as Surviving Spouse of

DAVID LIPTON,

File No. 2013-2711/D

Pursuant to SCPA 1421.

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A N D E R S O N , S . :

This proceeding under SCPA 1421 was commenced by Audrey Lipton, the surviving spouse of David Lipton, who asks the court to determine that she is entitled to payment of $1,891,596 as the balance of her elective share under EPTL 5-1.1-A. Now pending is Audrey's motion for summary judgment.

The material facts are as follows. Decedent died on April 12, 2013, at the age of 95, leaving a probate estate of approximately $8.5 million. He was survived by Audrey, his second wife, and by Arthur, Robert, and Heidi, his children with his predeceased first wife, Hortense. Arthur is executor of decedent's will and a co-trustee, along with Robert, of trusts under Articles SIXTH and SEVENTH of Hortense's will (the "Trusts"). Decedent was the Trusts' lifetime income beneficiary and their discretionary principal beneficiary under the following terms:

> "[M]y Trustees shall be authorized and empowered, at any time or from time to time, to pay or to apply for the benefit of [David] any amount or amounts out of the principal of said trust which my Trustees, in their sole discretion, shall deem necessary or advisable for his maintenance, health, care or support...."

The record indicates that, on June 25, 2012, *i.e.,* within ten months of his death, decedent wrote to Robert, in the latter's capacity as Co-Trustee, as follows:

> "Please cease any and all additional distributions to me from the [Articles SIXTH and SEVENTH Trusts] and use your discretion for other distributions as you deem appropriate."

About three weeks later, the Trustees drew a series of checks from the Trusts' accounts, payable to the separate order of the three children in various amounts. Shortly thereafter, the Trustees formally forgave Arthur's personal indebtedness, to one or both of the Trusts, in the sum of $1 million. The checks and the loan forgiveness totalled $4,674,784 (the "Payments").

The central premise of Audrey' s petition is that the Payments constituted transfers of property subject to her right of election under EPTL 5-1.1-A and that her elective share was thereby enlarged to the $1.89 million to which she here lays claim. Arthur, now executor of decedent's estate, for his part contends that the Payments (although treated as transfers by decedent for technical tax purposes) are the type of transactions contemplated by the elective-share statute.

The relevant provisions of the elective-share statute under EPTL 5-1.1-A are as follows:

> "(a) Where a decedent ... is survived by a spouse, a personal right of election is given to the surviving spouse to take a share of the decedent's estate, subject to the following:
>
> (1) For the purpose of this section, the decedent's estate includes the capital value, as of the decedent's death, of any property described in subparagraph (b)(1).
>
> ....
>
> (3) The term "testamentary provision", as used in this paragraph, includes ... any transaction described as a testamentary substitute in subparagraph (b)(1).
>
> ....
>
> (b) Inter vivos dispositions treated as testamentary substitutes for the purpose of election by surviving spouse.
>
> (1) ... [t]he transactions affected by and property interests of the decedent described in clauses (A) through (H) ... shall be included in the net estate subject to the ... elective right ....
>
> ....

(B) The aggregate transfers of property ... within one year of the death of the decedent, to the extent that the decedent did not receive adequate and full consideration in money or money's worth for such transfers...."

Analysis

The parties' respective positions can be properly assessed only in light of the purposes of the elective-share statute whose safeguards Audrey expressly invokes here. The overall aim of the statute could not be clearer: to prevent one spouse from entirely disinheriting the other. To that end, the statute assures a surviving spouse a one-third share of the property that the deceased spouse owned at death, net of administration and other expenses. Accordingly, whenever the deceased spouse leaves a probate estate, its value is subject to the surviving spouse's fractional share; the larger the probate estate, the larger the share to which the surviving spouse will be entitled.

However, the statute allows for the possibility of an additional factor in the calculation of the elective share: what the statute denominates as "testamentary substitutes." In creating that category of transfers, the statute has a purpose that is very clear: to prevent one spouse from using lifetime transfers of his property as a device to subvert the elective-share protections that public policy intends for the other spouse. The premise of the testamentary-substitute provisions is that an owner's lifetime transfer of his property – which removes that property from his probate estate and thus diminishes the surviving spouse's elective share – is insidious where the transferor retains some interest in the property until the end, or near-end, of his lifetime. Put simply, the objective of the testamentary-substitute provisions is to prevent one spouse from having his cake (continuing to enjoy his property) and eating it too at the other spouse's expense (by placing his property, at his death, beyond the other spouse's reach). Thus, by the provisions' operation, the values of testamentary substitutes are added to the base upon which the elective share is calculated, in effect compensating for what the probate estate lost by such transfers.

In that light, the merits in this case pose a single question: whether or not the Payments are testamentary substitutes within the meaning of the elective-share statute. The answer becomes apparent when one considers the nature of decedent's lifetime interests in the Trusts. One of those interests was an entitlement (to Trust income); the other was a mere possibility (that the Trustees might invade Trust principal for decedent's benefit). In the June 25, 2012 letter, decedent had relinquished one of those interests, *i.e.,* his right to further Trust income for life. That transfer clearly constituted a testamentary substitute within the statute's meaning, since the transfer diverted from the transferor's eventual probate estate the value of the future Trust income that he would have received until he died, and such diversion occurred within one year of the transferor's death (EPTL 5-1.1-A[b][1][B]). But, as it was, this testamentary substitute makes only a very modest difference to the size of Audrey's elective share, given the actuarial value of future income for the balance of a 95-year-old's life.

Decedent's other interest in the Trusts was no more than an expectancy, subject as it was to the Trustees' limited and discretionary power to invade principal for his benefit. That principal was derived from property that had been Hortense's, and at no point thereafter had it become decedent's. Thus, decedent was never in a position to relinquish or otherwise transfer such principal. Even if, arguendo, he had purported to make such a transfer, his eventual probate estate would have been unaffected, since his mere expectancy as to a discretionary invasion of principal did not amount to an asset that would have otherwise been part of his probate estate. Having had no effect on the size of decedent's ultimate probate estate, decedent's loss of such expectancy also had no effect on the size of Audrey's elective share. Audrey therefore cannot rationally ask that this major part of the Payments be factored into the calculation of her elective share as purported testamentary substitutes.

Audrey nevertheless insists that the Payments in their entirety were "testamentary substitutes" within the meaning of 5-1.1-A(b)(1) (B) and that as such they are requisite factors in the calculation of her elective share under the statute. She points to a federal gift tax return (Form 709) filed by Arthur on behalf of the estate -- reporting the Payments as taxable gifts – as conclusive on the point.

Evaluation of Audrey's contention requires a basic understanding of federal tax law as it relates to Qualified Terminal Interest Property ("QTIP") trusts. Such trusts (including the Trusts now at issue) are created by spouses for the lifetime benefit of their surviving spouses (with the remainders left to third parties designated by the settlor-spouse). QTIP trusts share one central attribute: the surviving spouse is assured net income from the trust for life but is never entitled to trust principal. The Internal Revenue Code (the "Code") has its own invariable trait in this connection: it requires that property held by two spouses be taxed in the estate of one of the two.

The Code ordinarily does not allow the estate of a settlor-spouse to take a marital deduction in respect of the surviving spouse's limited interest in a QTIP trust (*see* 26 USC 2056[b][1]). If the general rule were otherwise (*i.e.,* if the marital deduction were allowed), no estate tax would ever be payable by either of the spouses' estates, since the limited interest of the surviving spouse also would not be subject to estate tax. However, as a matter of legislative largesse, the Code gives the fiduciary of the settlor-spouse's estate a choice, allowing added flexibility in that fiduciary's tax planning: either to claim the QTIP trust as a marital deduction (the "QTIP Election") (26 USC 2056[b][7]) or to decline to do so. If the fiduciary of the settlor-spouse's estate makes the QTIP Election and thus does not pay estate tax in respect of the QTIP trust, the fiduciary of the survivor's estate will ultimately be required to pay the piper, by paying estate tax on the value of the QTIP trust upon the survivor's death (USC 2044). Hence, the value of the QTIP trust does not escape estate tax, whether the tax is paid in the estate of one spouse or the other.

There is thus a fiction underlying this particular aspect of the Code -- that the settlor-spouse gave, and the surviving spouse received, an interest in trust principal tantamount to ownership.

It is not disputed that the fiduciary of Hortense's estate made a QTIP Election and took a marital deduction in respect of the Trusts and that as a result (pursuant to 26 USC 2056[b][1]) those Trusts would ordinarily have been reportable in the estate-tax return eventually filed by the fiduciary of the estate of decedent as the surviving spouse. However, as it happened, the Trusts were not reportable on decedent's estate-tax return. Instead, as a result of decedent's lifetime transfer, *i.e.,* his relinquishment of future Trust income, the Trusts were reportable on his federal gift tax return. Acting in parallel with the estate-tax chapter of the Code, the gift-tax chapter of the Code attempts to achieve in the gift-tax context the same type of counterbalance to the marital deduction (*see* 26 USC 2519) as is afforded by 26 USC 2044 in the estate-tax context. Thus, although a surviving spouse's income interest in a QTIP trust by definition amounts to something less than entitlement to trust principal, where, as here, that limited interest is relinquished, section 2519 of the Code nevertheless provides as follows:

> "[A]ny disposition of ... a qualifying income interest for life in any property [for which a deduction was allowed under 26 USC 2056(b)(7) with respect to the transfer of such property to the donor] shall be treated as a transfer of all interests in such property other than the qualifying income interest ...."

The above provision of the Code's gift-tax chapter proceeds from the same fiction as underlies section 2056(b)(7) of the Code's estate-tax chapter, *i.e.*, that the settlor-spouse gave the surviving spouse an ownership interest in trust principal and that the surviving spouse in turn was thus able to gift that ownership interest.

The foregoing leaves no room for Audrey's theory that Arthur's gift-tax filing as preliminary executor estops him from denying that decedent gifted millions of dollars of Trust assets to his children shortly before he died and that such gifts constituted testamentary substitutes within the meaning of EPTL 5-1.1-A(b)(1)(B). The Payments were deemed gifts by decedent for the particular purposes of federal tax law. However (apart from the Trust income that decedent did in fact give away), the Payments cannot be categorized as testamentary substitutes under the elective-share statute, since such categorization would serve none of the elective-share statute's own purposes as described above.

Audrey maintains, however, that the Payments in effect constituted indirect distributions of principal to or for the benefit of decedent, since the three children were presumably objects of his bounty. The theory does not survive scrutiny.

For the sake of argument, we can accept Audrey's reading of decedent's June 2012 letter as a veiled request of the Trustees that they exercise their discretion to invade principal

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under Articles SIXTH and SEVENTH. Even so, the ensuing Payments cannot reasonably be viewed as an exercise of such discretion: these multi-million-dollar one-time outlays from the Trusts had no correlation with the standard by which the Trustees' discretion to invade principal was limited (for "decedent's maintenance, health, care or support"). Where the magnitude of payment bears no relation to the terms under which payment may properly be made, the payment cannot reasonably be attributed to a performance of those terms. The Payments must instead be seen as something else entirely: rogue actions by fiduciaries (*i.e.*, disconnected from the terms of the will that defined their duties) in favor of themselves individually.

Nor could the Payments be viewed as an acceleration of the children's remainder interests in the Trusts at the behest of decedent. Acceleration resulting in early termination requires judicial authorization under a standard for which the Trusts clearly would not have qualified if an application for such authorization had been made (*see* EPTL 7-1.19; *Matter of Rahal*, NYLJ, Dec. 2, 2015, at 24, col 6 [Sur Ct, NY County]; *Matter of Dauman*, 12 Misc 3d 1173[A] [Sur Ct, Nassau County 2006]; *Matter of De Marco*, NYLJ, Nov. 1, 2006, at 21, col 3 [Sur Ct, Kings County]).

Finally, Audrey cannot claim that some collusive agreement between decedent and the Trustees would be rewarded if she is prevented from factoring the Payments in their entirety into the calculation of her elective share (*see* EPTL 7-1.19). The circumstances of this case, as discussed above, simply do not support such a claim. No collusion between decedent and the Trustees could have resulted in a diversion of substantial Trust property that would otherwise have enlarged Audrey's elective share. Decedent's only property interest in the Trusts that was unconditional -- and therefore subject to Audrey's elective share when he gave it away -- was his right to future Trust income, which he relinquished by the June 2012 letter but which by that point was actuarially insubstantial in view of his advanced age.

The essential point bears repeating: under EPTL 5-1.1-A, testamentary substitutes extend the elective share's reach to property that had belonged to the deceased spouse and therefore would have been in his probate estate if he had not made a lifetime transfer of it. In this case, Trust principal had never belonged to decedent, and his probate estate therefore would not have included it even if the Trusts had remained intact. Accordingly, Audrey has no basis for complaint that the millions of dollars of Trust principal that decedent never owned are beyond the reach of her elective share.

For the foregoing reasons, Audrey's motion for summary judgment is granted to the extent that the actuarial value of the future income of the Trusts as of June 25, 2012 is determined to be a testamentary substitute within the meaning of EPTL 5-1.1-A and therefore a factor in the calculation of Audrey's elective share. The motion is otherwise denied.

This decision constitutes the order of the court.

Dated: 21 July, 2020

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