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Trusts and Estates Law Section Newsletter

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of the New York State Bar Association

A Message from the Section Chair

When we met in Albany on April 24th and 25th, the snow had just melted and the tulips were starting to poke their heads out of the ground. We just witnessed their splendor as we celebrated the Tulip Festival here on May 9th through May 11th.

Despite the lack of blossoms outside, our experiment with Round Table Discussion Groups was blooming indoors, with 86 persons participating at six tables, each covering a different topic and moderated by the following experienced attorneys:

Accountings	**Stephen B. Hand, Esq.**
Surrogate's Court Procedure	**Stacy L. Pettit, Esq.**
Litigation	**Gary B. Freidman, Esq.**
Will Drafting	**Richard J. Bowler, Esq.**
GAL Basics—Fiduciary Appointments	**Wallace L. Leinheardt, Esq.**
Tax Issues	**John Rausch, Esq.**

The mezzanine on the third floor of the New York State Museum, with the sun-drenched State Capitol reflected on the pool below, was a perfect setting for our reception and dinner, with music by Reggie's Red Hot Feetwarmers.

The 9/11 Exhibit in the Museum was a somber reminder of the events of that day and a tribute to the bravery of those who responded to the crisis.

The Friday program, entitled "Probate vs. Non-Probate: Is Surrogate's Court Still Relevant?" chaired by **Stacy L. Pettit, Esq.**, Chief Clerk of the Albany County Surrogate's Court, featured contributions by **John Barnosky, Esq.** of Farrell Fritz, P.C.; **Paul Richard Karan, Esq.** of Tofel Karan & Partners, P.C.; Distinguished Professor of Law **Ira Mark Bloom** of

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Albany Law School; Professor **David A. Pratt** of Albany Law School and of counsel at Hodgson Russ; and **Wallace L. Leinheardt, Esq**. of Jaspan Schlesinger Hoffman, LLP. It was agreed that the question in the program topic was rhetorical and should be answered in the affirmative and that the Surrogate's Court will be an important venue for our practices for many years to come.

At our luncheon we were enlightened on the origins of the names "Albany" and "New York" by amateur historian Henry L. Hamilton, who revealed that both Albany and New York City were owned and named by the Duke of Albany, who also held the title Duke of York. He was given a charter by his brother, King Charles II, for his bloodless dispossession of the Dutch in 1664, of what is now most of Pennsylvania, New Jersey, the eastern half of New York, the western halves of Massachusetts and Connecticut and all of Vermont. Albany (until then known as the Dutch settlement of Beverwyck) was given its name because it was then the largest city in what he named "Albania" which was the western part of his charter and was on the west side of the Hudson River. New York City (until then known as New Amsterdam) was so named because it was the largest city in what was then his eastern charter, "New York," which then included much of Massachusetts and Connecticut as well as all of Vermont. I'm sure all in attendance appreciated his slide presentation.

I would like to thank everyone who participated in the Spring Meeting for making it such a success.

Timothy B. Thornton

Did You Know?

Back issues of the *Trusts and Estates Law Section Newsletter* (2000-2003) are available on the New York State Bar Association Web site.

(www.nysba.org)

Click on "Sections/Committees/ Trusts and Estates Law Section/ Member Materials/ *Trusts and Estates Law Section Newsletter*"

For your convenience there is also a searchable index in pdf format. To search, click "Find" (binoculars icon) on the Adobe tool bar, and type in search word or phrase. Click "Find Again" (binoculars with arrow icon) to continue search.

Note: Back issues are available at no charge to Section members only. You must be logged in as a member to access back issues. For questions, log in help or to obtain your user name and password, e-mail webmaster@nysba.org or call (518) 463-3200.

Editor's Message

Summer is here and another *Newsletter* is in your hands to read. In this issue of the *Newsletter*, we have a variety of articles. Lee Snow who has been very generous in providing articles for the *Newsletter* has come through again with an article regarding the application of our estate tax to nonresidents. It is a must read. The new Part 36 of the Rules of the Chief Judge became effective on June 1st and applies to appointment of fiduciaries by judges. These rules evolved from the Birnbaum Commission. Wally Leinheardt has written a summary of these new rules. Another article on rules concerns the multi-jurisdictional practice. The article is the work of this Section's Committee on Multi-State Practice and authored by Deborah Kearns. David Pratt has provided his outline from the Spring meeting in Albany. It discusses special issues concerning life insurance, annuities and retirement benefits. A submission from a third year law student, Gail Goldfarb, rounds out the variety and is a study of the inheritance rights of children conceived after death. It is well documented and an interesting read.

I hope everyone has an enjoyable and productive summer. Please keep in mind our Fall Meeting that is scheduled for September 11th through September 14th in British Columbia. A summary of the topics which will be covered is included in this *Newsletter*. Hopefully the topics and the speakers as well as the location will make many members plan a vacation around this Section meeting and program. In addition to the program, golf and tennis tournaments will be in place and the temperate climate will make these events easy to enjoy. Unfortunately, CLE credits will not be available for these two events. Somehow, OCA did not see the educational value of golf and tennis.

Finally, a special thank you to Mike O'Connor and his new digital camera for providing the photos from the Spring Meeting in Albany.

Magdalen Gaynor

Upcoming Meetings of Interest

September 11-14, 2003	New York State Bar Trusts and Estates Law Section. Fall Meeting. Fairmont Empress (Inner Harbour), Victoria, British Columbia.
October 14-17, 2004	New York State Bar Trusts and Estates Law Section. Fall Meeting. Savannah, Georgia.
September 29-October 2, 2005	New York State Bar Trusts and Estates Law Section. Fall Meeting. New Orleans, Louisiana.

The Application of the New York Estate Tax to Nonresidents of New York State

By Lee A. Snow

A nonresident of New York State who owns real property or tangible personal property situated in New York State at the time of her death is potentially subject to New York estate tax. It is not uncommon for former New Yorkers, who may have relocated to sunnier climes, to continue to own real property in New York, and thereby face possible exposure to New York estate tax, despite their nonresident status. This article will explore the application of the New York estate tax to nonresidents of New York State, taking into account the changes made to the federal estate tax law by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and the EGTRRA effects on the New York estate tax.

"[F]or decedents dying in calendar years 2002 through 2004, the New York State estate tax is more *than the credit for state death taxes allowed against the federal estate tax. Thus, there is once again an estate tax cost to dying as a resident of New York State."*

As most estates and trusts practitioners know, EGTRRA increased the federal estate tax exemption to $1,000,000, effective for decedents dying during 2002 and 2003. EGTRRA also made substantial changes to the calculation of the federal credit for state death taxes. Under EGTRRA, the state death tax credit was reduced by 25% for deaths occurring during 2002, by 50% for deaths occurring during 2003, and by 75% for deaths occurring during 2004. For deaths occurring in 2005, the state death tax credit will be eliminated and replaced by a deduction. This deduction in lieu of a credit will apply in calculating the federal estate tax for estates of persons dying between January 1, 2005, and December 31, 2009.

New York significantly changed its estate tax law in 1997. Prior to the 1997 law changes, New York imposed a state death tax that exceeded the federal credit for state death taxes. Under the 1997 (and subsequent) New York estate tax law changes, the New York estate tax for persons dying on or after February 1, 2000, is equal to the federal credit for state death taxes, based upon the federal estate tax law in effect on July 22, 1998. Thus, for decedents dying between February 1, 2000, and December 31, 2001, New York was, in effect, a "sponge" or "sop" tax state, whereby the state estate tax was equal to, and no more than, the state death tax credit for federal estate tax purposes. Thus, for persons dying during this time period, there was no true estate tax cost to dying as a resident of New York State.

Unlike a number of other states, New York does not automatically conform its estate tax law to federal estate tax law changes. The New York estate tax laws must be affirmatively amended by the New York State Legislature to conform to changes in the federal estate tax law. Thus, as a result of the passage of EGTRRA and New York's not automatically conforming its estate tax law to the federal estate tax changes, New York ceased to be a sop tax state, beginning for decedents dying on or after January 1, 2002.

For persons dying on or after January 1, 2002, the New York State estate tax is equal to the amount of the federal credit for state death taxes, based upon the federal state death tax credit table in effect for decedents dying in calendar year 2001, i.e., the federal state death tax credit in effect in 2001 *without* the percentage reductions described above. Therefore, for decedents dying in calendar years 2002 through 2004, the New York State estate tax is *more* than the credit for state death taxes allowed against the federal estate tax. Thus, there is once again an estate tax cost to dying as a resident of New York State.

For nonresidents subject to New York State estate tax (and for New York resident decedents whose estates are subject to estate tax in another state), the calculation is more complicated. In these cases, the estate tax calculation takes into account the amount of state death taxes paid to other states as well as the value of the decedent's New York gross estate relative to the value of the decedent's federal gross estate. In the case of a nonresident decedent, the New York estate tax is calculated as if the decedent were a New York resident and is equal to the federal credit for state death taxes (based on the pre-EGTRRA, i.e., 2001, state death tax credit table without the percentage reductions described above) reduced by the lesser of: (1) the amount of the death tax(es) paid to other states that is/are allowed as a federal credit for state death taxes or (2) an amount determined by multiplying the maximum federal credit for state death taxes (under pre-EGTRRA law)

by a fraction, the numerator of which is the difference between the decedent's federal gross estate and the decedent's New York gross estate, and the denominator of which is the decedent's federal gross estate.

As will be seen below, where a decedent is a resident of a state that accepts the federal credit for state death taxes as its estate tax (i.e., a true sop tax state) and where the decedent's gross estate relative to the value of the decedent's New York situated real estate or tangible personal property is large enough, this calculation can result in New York's imposing an estate tax upon the nonresident decedent's estate that is disproportionate to, or even in excess of, the value of the New York situated real or tangible personal property.

Example 1

Joan Taxpayer, a former New York resident who moved to and established Arizona as her domicile fifteen years ago, died during 2002. Joan's gross estate (and taxable estate) for federal estate tax purposes is $5,680,000. Included in her gross estate is her former New York residence (a house valued at $475,000). Joan's New York nonresident estate tax is $146,444, calculated as follows:

New York Estate Tax = Pre-EGTRRA Federal Credit for State Death Taxes - Lesser of (1) Arizona Estate Tax or (2) Pre-EGTRRA Credit x (Gross Estate - New York Gross Estate) / Gross Estate

The starting point in the tax computation is the pre-EGTRRA federal credit for state death taxes without the percentage reductions (see Table 1 below). For a $5,680,000 taxable estate, the pre-EGTRRA credit for state death taxes is $472,400. This amount is then reduced by the lesser of (i) the death tax paid to other states that is allowed as a federal credit for state death taxes or (ii) the pre-EGTRRA

Table 1
Pre-EGTRRA maximum credit for state death taxes
(Based on federal adjusted taxable estate (taxable estate - $60,000))

(1) Adjusted taxable estate equal to or more than-	(2) Adjusted taxable estate less than -	(3) Credit on amount in column (1)	(4) Rate of credit on excess over amount in column (1)
			(Percent)
$ 0	$ 40,000	$ 0	None
40,000	90,000	0	0.8
90,000	140,000	400	1.6
140,000	240,000	1,200	2.4
240,000	440,000	3,600	3.2
440,000	640,000	10,000	4.0
640.000	840,000	18,000	4.8
840,000	1,040,000	27,600	5.6
1,040,000	1,540,000	38,800	6.4
1,540,000	2,040,000	70,800	7.2
2,040,000	2,540,000	106,800	8.0
2,540,000	3,040,000	146,800	8.8
3,040,000	3,540,000	190,800	9.6
3,540,000	4,040,000	238,800	10.4
4,040,000	5,040,000	290,800	11.2
5,040,000	6,040,000	402,800	12.0
6,040,000	7,040,000	522,800	12.8
7,040,000	8,040,000	650,800	13.6
8,040,000	9,040,000	786,800	14.4
9,040,000	10,040,000	930,800	15.2
10,040,000	----------	1,082,800	16.0

credit for state death taxes multiplied by a fraction representing Joan's non-New York gross estate relative to her gross estate.

Because Joan died a resident of Arizona and Arizona accepts the current federal credit for state death taxes (after taking into account the percentage reductions), Joan's Arizona estate tax would be $325,956. The fraction representing Joan's non-New York gross estate relative to her entire gross estate is equal to 92% (($5,680,000 - $475,000) ÷ $5,680,000). 92% multiplied by the pre-EGTRRA credit for state death taxes ($472,400) yields $434,608. The New York State estate tax imposed upon Joan's estate is thus equal to the $472,400 pre-EGTRRA credit for state death taxes reduced by the lesser of the state death taxes paid to Arizona ($325,956) or the $434,608 figure calculated immediately above. Since $325,956 is less than $434,608, the $325,956 figure is utilized for the reduction. Therefore, the New York State estate tax is equal to $146,444 ($472,400 - $325,956).

"Since Arizona conforms its estate tax to federal law and does *take into account the percentage reductions in calculating its state death tax, New York, in the author's opinion, greedily, absorbs the difference."*

What New York has done, in effect, is to pick up as part of its estate tax the federal credit for state death taxes calculated under the pre-EGTRRA 2001 table (without the percentage reductions) to the extent that that credit has not been utilized by any other state (in this case, Arizona). Since Arizona conforms its estate tax to federal law and *does* take into account the percentage reductions in calculating its state death tax, New York, in the author's opinion, greedily, absorbs the difference. This results in a tax of $146,444 on a property valued at $475,000, or a 31% effective tax rate.

The result becomes even more egregious when a decedent's gross estate greatly exceeds the value of the decedent's New York real property.

Example 2

Assume all the same facts as in Example 1 except that Joan's gross estate (and taxable estate) is now $20,000,000. In this case, Joan's New York estate tax will be $706,702, calculated as follows:

The pre-EGTRRA federal credit for state death tax based upon a $20,000,000 estate is $2,666,800. This amount is reduced by the lesser of (i) the Arizona estate tax or (ii) the pre-EGTRRA credit for state death taxes multiplied by a fraction representing Joan's non-New York gross estate relative to her gross estate.

The Arizona estate tax in this situation is $1,960,098. The fraction representing Joan's non-New York gross estate relative to her entire gross estate is now equal to 98% (($20,000,000 - $475,000) ÷ $20,000,000). 98% multiplied by the $2,666,800 pre-EGTRRA credit for state death taxes yields $2,613,464. The New York estate tax imposed upon Joan's estate is thus equal to the $2,666,800 pre-EGTRRA credit reduced by the lesser of (i) the Arizona estate tax ($1,960,098) or (ii) the $2,613,464 figure calculated immediately above. Since, $1,960,098 is less than $2,613,464, the $1,960,098 figure is utilized for the reduction. Therefore, the New York estate tax is equal to $706,702 ($2,666,800 - $1,960,098).

In this situation, the New York State estate tax of $706,702 imposed upon a property valued at $475,000 represents almost a 150% effective tax rate!

The author recently represented the personal representatives of a nonresident decedent's estate that owned New York real property and faced New York estate taxation similar to that described above. The author brought this matter before the attention of estate tax attorneys in the New York State Department of Taxation and Finance in Albany. The author argued to the Tax Department attorneys that the estate tax results were illogical and perhaps unconstitutional. The Tax Department attorneys acknowledged that the New York estate tax imposed upon the New York real property of a nonresident decedent could, under certain circumstances, represent a substantial percentage of or even exceed the property's value. However, the attorneys also stated that the New York estate tax form (Form ET-706) and the instructions thereto carried out the law and that they had no authority to deviate from the form or the instructions. In response to this discussion, the author filed the decedent's New York estate tax return under protest and subsequently filed a claim for refund.

The author's view is that a nonresident's New York estate tax should not be calculated in strict accordance with the above formula. Instead, a more logical result would be obtained if, notwithstanding the above formula, a nonresident's New York estate tax were, in all cases, limited to the pre-EGTRRA federal credit for state death taxes multiplied by the percentage of New York assets. In Examples 1 and 2 above, this would result in New York estate taxes of $37,792 ($472,400 x 8%) and $53,336 ($2,666,800 x 2%), respectively. When the author brought this posi-

tion to the attention of the estate tax attorneys in Albany, he was advised that the Department of Taxation will stand by its estate tax form and its instructions unless a policy decision holding otherwise is made at the highest levels in Albany.

Suggested Solutions

Unless or until a new policy decision is made in Albany, practitioners advising non-New York residents who own property in New York should consider recommending that their clients either divest themselves of their New York property or convert the nature of the property into intangible property, and thereby remove themselves from exposure to New York estate tax. To illustrate, a nonresident owning real property in New York could create a partnership and transfer the real property to the partnership in exchange for a partnership interest. Partnership interests are considered intangible property and therefore would not subject the nonresident taxpayer to New York estate taxation. The partnership should have other partners and there should be business purposes to justify its organization and continuation. Partnership formalities should, of course, also be observed. Alternatively, the nonresident taxpayer could consider selling her New York property or perhaps transferring the property to a trust or other entity that is not included in the taxpayer's estate for estate tax purposes.

Conclusion

New York's position regarding the calculation of New York estate tax for a nonresident decedent owning real or tangible property situated in New York is clear but seemingly unfair. The position may be unconstitutional but few clients will want to be the test case. Unless or until a legislative or Tax Department policy change is made in calculating a nonresident's New York estate tax, practitioners should advise their nonresident clients to divest themselves of their New York property or convert their ownership into some form of intangible personal property that will not expose their estates to the New York estate tax.

Lee A. Snow is a partner and head of the Trusts and Estates Department at Krass, Snow & Schmutter, P.C. in New York City. Mr. Snow acknowledges the assistance of his partner, Paul C. de Freitas, in the preparation of this article.

New Rules for Court Appointments

By Wallace Leinheardt

Effective June 1, 2003, existing lists of qualified attorneys for fiduciary appointments by the courts will be terminated. On that date, a new Part 36 of the Rules (the "Rule") of the Chief Judge will become effective.

From that date forward, judges may only appoint fiduciaries from the "official" Office of Court Administration (OCA) list of applicants.

The Rule applies to fiduciary appointments for:

1. Guardians;
2. Guardians ad litem (primarily in the Surrogate's Court, but in all other courts as well);
3. Law guardians not paid for by public funds;
4. Court evaluators for incapacitated persons;
5. Court attorneys;
6. Court examiners;
7. A trustee of a Supplemental Needs Trust (SNT);
8. Receivers;
9. Referees; and
10. The following persons or entities performing services for guardians or receivers:
    a. Counsel;
    b. Accountants;
    c. Auctioneers;
    d. Appraisers;
    e. Property managers;
    f. Real estate brokers.

In order to be qualified for appointment, the appointee must file an application and attend OCA-approved education courses. Application forms are available at most courthouses and on the OCA Web site (www.courts.state.ny.us). The appointee must also complete and file revised OCA forms at the time of the appointment and when requesting compensation.

The New York State Bar Association (NYSBA) and many local bar associations have submitted curricula to OCA for courses to be made available at various times and locations. Prospective appointees should contact the NYSBA or their local bar association for the dates of approved programs. The dates and locations of approved programs are also listed on the OCA Web site.

It is expected that some of the courses will be video-recorded and made available for screening on convenient dates and locations, particularly in the smaller upstate counties.

An appointee must attend and complete the course for each of the specific type(s) of appointment the appointee seeks to be eligible for.

The rules limiting appointment based on compensation awarded are the results of recommendations made by the "Birnbaum Commission" which studied the current fiduciary appointment process.

Among the significant recommendations to disqualify persons or entities which have been adopted are attorneys or entities which:

1. Received any appointment within the past twelve months for which he or she expects to be awarded a fee in excess of $15,000;[1] and
2. Have been awarded more than $50,000 in any calendar year.

That attorney or entity is barred the following year from receiving any appointments.[2]

It should be noted that "compensation" is determined as of the date awarded. Included are all fees, commissions or other compensation, excluding costs and disbursements. The compensation limits also apply to Court Examiner fees, which were not previously covered by Part 36.

It appears that the $50,000 "cap" is inclusive of all funds awarded in the calendar year, regardless of when the original appointment was made, and when or whether the fee is actually received.

Attorneys will no longer be able to act as their own counsel, or retain other counsel, for example, to act as attorney for a Receiver, or as attorney for a Guardian in the sale of real property or in a discovery proceeding. Such "secondary appointments" must be made by the court, subject to the Rule.[3]

Exempted from the application of the Rule are:

1. Family Court guardians pursuant to section 243;

2. Guardians ad litem pursuant to Surrogate's Court Procedure Act 403-a; and

3. The Mental Hygiene Legal Service.[4]

The Rule does not apply to a relative of the subject of the guardianship proceeding, or the beneficiary of a proceeding to create a supplemental needs trust; or to a person or entity nominated by a party to the proceeding to serve as guardian or trustee of an SNT. Also exempt from the application of the Rule are persons or entities having a legally recognized duty or interest with respect to the subject of the proceeding; guardians ad litem nominated by infants more than 14 years of age; nonprofit institutions performing property management or personal needs services, or acting as court evaluators; banks or trust companies acting as depositories or as SNT trustees; public administrators; persons or institutions whose appointment is required by law; physicians whose appointment as GAL is necessary for emergency medical or surgical procedures; and appointments without compensation, although the appropriate OCA appointment forms still need to be filed.

Judges (including housing judges) and their relatives, by blood or marriage (to the 6th degree of relationship) are barred from receiving any appointments for two years from the time they leave the bench.[5]

Judicial hearing officers may be appointed, but not in a court in a county where he or she serves.[6] Also barred are any employees of the Unified Court System, as well as certain of their relatives.

Perhaps most significantly affected are chairs, executive directors, or the equivalent of state or county political parties, their spouses, siblings, parents or children as well as the members, associates, counsel and employees of any law firm or entity with which such official is affiliated. The ban applies while the person is serving in such capacity and for two years afterward.

Similarly, campaign chairs, coordinators, managers, treasurers or finance chairs for judicial candidates, and their relatives and persons associated with their law firms are ineligible for appointment for two years following the election, and in the case of a sitting judge, from the time the person assumes the office.

OCA forms provided by the court must be filed with both the court and OCA at the time of appointment, certifying that the appointee is not disqualified from appointment. The appointee must annex a list of all appointments received during the current and preceding calendar year including:

1. The name of the judge;

2. The compensation awarded; or,

3. Where the compensation has not been awarded:

   a. The compensation anticipated being awarded

   b. Separate identification of appointments

   c. Where compensations of $5,000 or more are expected, including the current appointment.

Appointees seeking a compensation of more than $500 must file OCA forms with the Fiduciary Clerk of the county. The Fiduciary Clerk must confirm to the court that the appointee has filed all of the previously required forms.[7]

Judges must state the reasons for awards of $5,000 or more, and file a copy of the order with the Fiduciary Clerk at the time of signing the order.[8]

In addition, law firms whose members, associates or employees have been awarded a total of $50,000 or more in a single calendar year must now file a report with OCA.

Rule 36.5 makes the filed forms public records and provides that the Chief Administrator arrange for periodic publication of names of appointees by each appointing judge and the compensation awarded.

Endnotes

1. Rules of the Chief Judge § 36.2(d)(1).
2. *Id.*
3. Rules of the Chief Judge § 36.1(10).
4. Rules of the Chief Judge § 36.1(b)(1).
5. Rules of the Chief Judge § 36.2(c)(1).
6. Rules of the Chief Judge § 36.2(c)(2).
7. Rules of the Chief Judge § 36.4(b)(1).
8. Rules of the Chief Judge § 36.4(b)(3).

Multi-Jurisdictional Practice and the New Model Rules

By Deborah S. Kearns

I. Background

The increasing mobility and complexity of the legal profession has stirred a debate across the country over the multi-jurisdictional practice (MJP) of law.[1] All fifty states have laws to restrict the activities of out-of-state lawyers within their borders,[2] although the laws vary from state to state. Protection of the public from minimally qualified counsel has been the main justification for the unauthorized practice of law rules, but as a practical matter, protection of economic interests is equally as important.

Historically, regulation of multi-jurisdictional practice was of concern because most clients' legal needs were limited to a single state, and knowledge of a state's laws was of particular importance. Today, however, the law and the transactions in which clients seek assistance have become more complex, and specialized knowledge of a particular practice area has become more valuable than an overall general knowledge of state law. Advancements in technology and transportation have also globalized business and personal transactions, and as a result, clients seek assistance with transactions that implicate multiple jurisdictions.

The reality is that many lawyers today engage in cross-border activities that could potentially invoke state disciplinary rules. This is especially true for transactional lawyers, such as corporate, real estate and trust and estate counsel, who do not have the benefit of the *pro hac vice* admission rules to protect their activities outside of the licensing state. Accordingly, there is a general consensus across the country that it is time to update our multi-jurisdictional practice rules.[3]

Modernization of the MJP rules has been the subject of national debate for the past three years, and the American Bar Association, state judiciaries and bar associations around the country have recently released proposals for change. These proposals seek to strike a balance between the realities of today's legal practice, protection of the public and protection of the integrity of the respective state bar associations.

II. American Bar Association

In July 2000, the American Bar Association (ABA) appointed its Commission on Multijurisdictional Practice (the "MJP Commission") to make policy recommendations on the multi-jurisdictional practice of law that take into account the realities of today's legal practice. To carry out this directive, the MJP Commission solicited testimony and written submissions from state and local bar associations, law firms, governments and in-house corporate counsel, and conducted public hearings in major cities across the country. As a result, the MJP Commission issued an Interim Report in November 2001 outlining its preliminary recommendations for modernization of the ABA's MJP Model Rules. After a brief comment period, the Report was finalized in August 2002, and was subsequently adopted by the ABA House of Delegates.[4]

The ABA's Unauthorized Practice of Law Model Rules have been revised as follows:

- Rule 5.5 of the Model Rules of Professional Conduct ("Model Rule 5.5") was renamed: "Unauthorized Practice of Law; Multi-jurisdictional Practice of Law."
- Model Rule 5.5(a) was amended and provides that a lawyer shall not practice in a jurisdiction, or assist another in doing so, in violation of the regulations of the legal profession in that jurisdiction.
- Proposed Model Rule 5.5(b) was adopted and prohibits a lawyer from establishing an office or other systematic and continuous presence in a jurisdiction, unless permitted to do so by law, or another provision of Model Rule 5.5; or holding out to the public or otherwise representing that the lawyer is admitted to practice law in a jurisdiction in which the lawyer is not admitted.
- Proposed Model Rule 5.5(c) was adopted and identifies circumstances in which a lawyer who is admitted in a United States jurisdiction, and not disbarred or suspended from the practice in any jurisdiction, may provide legal services on a temporary basis in another jurisdiction. A lawyer not admitted in a U.S. jurisdiction may provide such services that:

  1. are undertaken in association with a lawyer admitted to practice law in the jurisdiction who actively participates in the representation;
  2. are in or reasonably related to a pending or prospective proceeding before a tribunal in the jurisdiction in a state where the lawyer, or the person the lawyer is assisting, is admitted or expects to be admitted *pro hac vice* or is otherwise authorized to appear;
  3. are in or reasonably related to a pending or potential alternative dispute resolution set-

ting, such as arbitration or mediation, if the services arise out of or are reasonably related to the lawyer's practice in a jurisdiction in which the lawyer is admitted to practice and are not services for which the forum requires *pro hac vice* admission; and

4. are not within paragraphs (c)(2) or (c)(3) and arise out of or are reasonably related to the lawyer's practice in a jurisdiction in which the lawyer is admitted to practice.

- Proposed Model Rule 5.5(d) was adopted and identifies multi-jurisdictional practice standards relating to (i) services provided to the lawyer's employer or its organizational affiliates that are not services for which the forum requires *pro hac vice* admission or (ii) legal services that the lawyer is authorized by federal or other law to render in a jurisdiction in which the lawyer is not licensed to practice law.
- Rule 8.5 of the ABA Model Rules was amended to clarify the authority of a jurisdiction to discipline lawyers licensed in another jurisdiction who practice within their jurisdiction pursuant to the provisions of Model Rule 5.5 or other law.
- Rules 6 and 22 of the ABA Model Rules for Lawyer Disciplinary Enforcement were amended to promote effective disciplinary enforcement with respect to lawyers who engage in the multi-jurisdictional practice of law and to renew efforts to encourage states to adopt Rule 22, which provides for reciprocal discipline.
- Proposed Model Rule on *Pro Hac Vice* Admission was adopted and sets forth the rules and procedures for *pro hac vice* admission and provides regulatory guidance for the granting state.
- Proposed Model Rule on Admission by Motion was adopted and facilitates the licensing of the lawyer if the lawyer is admitted to practice in another United States jurisdiction, has been engaged in the active practice of law for a significant period of time and is in good standing in all jurisdictions where admitted.
- Proposed Model Rule on Temporary Practice by Foreign Lawyers was adopted and identifies circumstances where it is not the unauthorized practice of law for a lawyer admitted in a non-United States jurisdiction to provide legal services on a temporary basis for a client in a United States jurisdiction.

The new Model Rule 5.5(d) would allow a lawyer to establish an office or other continuous presence in a jurisdiction in which he or she was not admitted in two limited circumstances. Except as provided therein, a lawyer not admitted to practice in a jurisdiction, who establishes an office or other systematic presence in the jurisdiction, would be in violation of such jurisdiction's unauthorized practice of law rules.

III. New York

In response to the ABA's MJP study, the New York State Bar Association's (NYSBA) Special Committee on Multi-Jurisdictional Practice ("Special Committee") conducted an analysis of the ABA's proposed[5] MJP revisions.[6] The report was submitted to the MJP commission, and was approved and endorsed by the NYSBA's House of Delegates on June 22, 2002, with slight modifications.[7]

The Special Committee agreed that the ABA's proposed amendments to its MJP rules are a major improvement to the existing rules, and generally supports the adoption of similar amendments to the rules in New York. It recognized that the amendments to Model Rule 5.5 expand the activities in which lawyers can engage in a host jurisdiction without fear of being accused of the unauthorized practice of law, but falls short of legitimizing the activities in which lawyers "routinely engage in host jurisdictions in connection with numerous areas of transactional and other non-litigation practice that are in fact national in scope today."[8]

The Special Committee Report recommends (i) the addition of clarifying language or commentary to Model Rule 5.5, (ii) modification to the ABA's Model Rule recommendations dealing with *pro hac vice* admission and (iii) modification to the ABA's Model Rule recommendations dealing with Admission by Motion. The recommendations and comments of the NYSBA are reproduced, in relevant part, as follows:

With Regard to the ABA's Model Rule 5.5:

- The opening sentence of proposed Rule 5.5(c) should be amended by substituting "not in violation of Paragraph (b) of this Rule" for "on a temporary basis."

  Proposed Rule 5.5(b) would prohibit lawyers from establishing in a jurisdiction in which the lawyer is not admitted "an office or other systematic and continuous presence in this jurisdiction for the practice of law" and from holding out to the public or otherwise representing that the lawyer is admitted to practice law in the jurisdiction where the lawyer is not admitted. Rule 5.5(c) would authorize lawyers to provide certain legal services as described in four subparagraphs "on a temporary basis." The commentary to the proposed Rule[9] admits that the line

between the temporary practice of law and the regular or established practice of law is not a bright one. Lawyers could be at risk of disciplinary action in jurisdictions in which they are not admitted if activities that do not involve establishing "an office or other systematic and continuous presence" may be deemed more than "temporary." It is felt that the NYSBA's amendment would eliminate this uncharted and apparently unintended middle category.

- The last sentence of proposed Commentary 14[10] to proposed Model Rule 5.5(c) should be amended to substitute "a particular area of practice or body of law, including federal, nationally-uniform, foreign or international law" for "a particular body of federal, nationally-uniform, foreign, or international law."

  Paragraphs (3) and (4) of proposed Rule 5.5(c) authorize legal services in the jurisdiction in which the lawyer is not admitted that "arise out of or are reasonably related to the lawyer's practice in a jurisdiction in which the lawyer is admitted to practice." Commentary 14 lists a variety of factors that may evidence such a relationship and concludes that, "[i]n addition, the services may draw on the lawyer's recognized expertise developed through the regular practice of law on behalf of clients in matters involving a particular body of federal, nationally-uniform, foreign, or international law."[11] This leaves in limbo a large number of specialized practices that provide services on a multi-jurisdictional basis where the lawyer's expertise is not based on the bodies of law enumerated in the commentary. The amendment would make it clear that any specialized area of practice or any body of law may be the basis of the expertise out of which the lawyer's services arise or to which they are related.

With Regard to the ABA's Model Rule on Admission by Motion:

- The MJP Commission's recommendation requires that an applicant meet a number of requirements, including having received a passing score on the Multistate Professional Responsibility Exam. This requirement may be too restrictive because it discriminates against older lawyers admitted before the Multistate Exam existed.[12]

- Eliminate the "however" proviso in the fourth line of Paragraph 2 of the proposed Model Rule.

  The proposed requirements for admission on motion include being primarily engaged in the "active practice of law" for five of the last seven years. Paragraph 2 of the proposed Model Rule defines "active practice of law" to include in paragraph (e) "service as a judicial law clerk" and in paragraph (f) "service as corporate counsel," but adds the proviso that in no event shall these activities, if performed in advance of bar admission in the jurisdiction to which application for admission on motion is being made, be accepted towards the durational requirement. By eliminating the proviso, service as a judicial law clerk or as corporate counsel within the jurisdiction to which application for admission on motion is being made will count towards the durational requirement.

With Regard to the ABA's Model Rule on *Pro Hac Vice* Admission:

- Delete "and In-state Lawyer Duties Generally" from the heading of Paragraph I-B since Paragraph B does not relate to the duties of in-state lawyers.[13]

- Revise Paragraph I-C to read as follows:

  Association With In-State Lawyer. An out-of-state lawyer seeking to appear for a client in a proceeding pending in this state shall associate with an in-state lawyer. The in-state lawyer shall sponsor the application of the out-of-state lawyer and shall, at a minimum, appear of record in the action together with the out-of-state lawyer. Upon admission *pro hac vice* of the out-of-state lawyer, the in-state lawyer's continuing duties and responsibilities, if any, shall depend upon the requirements of the court and the understandings between the in-state lawyer and the client or out-of-state lawyer.

  The Model Rule as proposed would require the in-state lawyer to remain responsible to the client and for the conduct of the proceeding and would require the in-state lawyer to advise the client of his or her independent judgment on contemplated actions in the proceeding if that judgment differs from that of the out-of-state lawyer, provisions which would in effect require clients to pay for duplicative services.

- Eliminate from the application procedure described in Paragraph I-D the obligation to serve the *pro hac vice* application on the state's "lawyer regulatory authority" in addition to all

parties who have appeared in the proceeding and eliminate the subsequent provisions authorizing the lawyer regulatory authority to file an objection.

The requirement of serving the lawyer regulatory authority adds unnecessary complexity and uncertainty as well as potential delay to a process that should be as simple as possible. The proposed rule would authorize the regulatory authority to file an objection and would provide for the revocation of the *pro hac vice* admission even at a later stage in the proceeding after the lawyer admitted *pro hac vice* has participated in the representation.

- Substitute as the last sentence in Paragraph 9 of Appendix A "The bar member shall appear of record together with the out-of-state lawyer" for "The bar member will be the lawyer of record for the client(s) the applicant seeks to represent."
- Delete the seventh paragraph in the discussion of the Model Rule which seeks to describe the responsibilities of the in-state lawyer, or substitute a paragraph indicating that upon the admission *pro hac vice* of the out-of-state lawyer the in-state lawyer's duties and responsibilities will depend upon the requirements of the court and the agreements between the in-state lawyer and the client or out-of-state lawyer.

IV. New Jersey

In response to the ABA's July 2000 directive, the New Jersey Supreme Court appointed the Commission on the Rules of Professional Conduct in January 2001 to review ethical issues concerning multi-jurisdictional practice, multidisciplinary practice and the "appearance of impropriety" rules. In February 2001, the New Jersey Supreme Court also created the Ad Hoc Committee on Bar Admissions to make recommendations on multi-jurisdictional practice by attorneys. Both reports are complete[14] and the recommended changes reflect many, but not all, of the recent amendments to the ABA Model Rules. Both of the proposed versions would allow more cross-border practice, but would limit the amount of transactional practice by out-of-state attorneys. In addition, both proposals recommend that the bona fide in-state office be relaxed to require that lawyers have only a bona fide office somewhere.

A public hearing on the two reports was scheduled for April 23, 2003.

A. Commission on the Rules of Professional Conduct

The Commission on the Rules of Professional Conduct ("Professional Conduct Commission") found that, in general, New Jersey's rules work, although it agreed that they should conform to the mobile practice of law. The Professional Conduct Commission's recommendations indicate a general intention to permit out-of-state attorneys to practice in New Jersey as long as they conform to New Jersey's ethical standards.

Over the course of the discussions, it was concluded that the current legal practice "expands across state borders" and that it is difficult to defend standards that serve as barriers to practice by out-of-state attorneys.[15] Notwithstanding the trend, the Professional Conduct Commission's report stressed that New Jersey has a tradition of high legal ethical standards that it should not sacrifice to this trend. Its recommendations are based on the general intention to allow out-of-state attorneys to practice in New Jersey temporarily so long as they comply with New Jersey's ethical standards. The proposed changes to New Jersey's Rules of Professional Conduct (RPC) are as follows:

- Paragraph (a) of proposed RPC 5.5 prohibits a lawyer from practicing law in a jurisdiction when the lawyer is not authorized to do so or assist another in doing so.
- Paragraph (b) of proposed RPC 5.5 prohibits a lawyer who is not admitted to practice law from: (1) establishing an office or other systematic and continuous presence in this jurisdiction for the practice of law except as authorized by law or (2) holding out to the public that the lawyer is admitted to practice.
- Proposed paragraph (c) of RPC 5.5 broadly accommodates four sets of circumstances under which a lawyer who is not admitted in New Jersey, but is admitted and is in good standing in another state jurisdiction may provide legal services in New Jersey on a temporary basis. A lawyer may provide legal services on a temporary basis as long as the services are (i) provided on a temporary basis in association with a lawyer admitted to practice law in the jurisdiction, who actively participates in the representation, (ii) reasonably related to or ancillary to pending or prospective litigation or administrative agency proceedings in a state where the lawyer is admitted or expects to be admitted *pro hac vice* or is otherwise authorized to appear, (iii) reasonably related to the representation of clients in, or ancillary to, an alternative dispute resolution ("ADR") setting, such as arbitration or mediation and (iv) related to non-litigation work that arises out of or is reasonably related to the lawyer's practice in a jurisdiction in which the lawyer is admitted to practice, or, in the case of subparagraph (c) (4), on an occasional basis.

- Proposed RPC 5.5(c)(4) permits an out-of-state lawyer to provide legal services if the services arise out of or are reasonably related to the lawyer's practice in a jurisdiction in which the lawyer is admitted to practice and the practice in New Jersey is no more than occasional. The insertion of the word "occasional" in proposed rule RPC 5.5(c)(4) is a departure from the ABA Model Rules. The Professional Conduct Commission believes that the level of service permissible under this provision should be "significantly lower" than is permissible under the other provisions in proposed Rule 5.5(c). The rationale for this distinction is that it is easier to keep track of the ethical behavior under the other provisions.

The Professional Conduct Commission also suggests revising the bona fide office requirement to facilitate the changes to Rule 5.5. The Commission opposes an in-state bona fide office requirement for those other than a lawyer who holds a plenary license to practice in New Jersey and is otherwise qualified to practice in New Jersey. If the New Jersey Supreme Court adopts their recommendation for RPC 5.5, the Commission recommends that Rule 1:21-1 (bona fide office), be revised to reflect the changes.

The Professional Conduct Commission also recommends the adoption of RPC 8.5, which would extend disciplinary jurisdiction to lawyers not admitted in New Jersey who practice law or render or offer to render any legal services in New Jersey.

B. New Jersey Ad Hoc Committee on Bar Admissions

The Proposed Rule of the New Jersey Ad Hoc Committee on Bar Admissions (the "New Jersey Ad Hoc Committee") differs from the ABA Model Rule 5.5 and the Professional Conduct Commission's Proposed Rule in that the New Jersey Ad Hoc Committee's version restricts out-of-state attorneys to representations involving existing clients and transactions that originate in or are related to the out-of-state lawyer's jurisdiction. The New Jersey Ad Hoc Committee recommends that RPC 5.5, Unauthorized Practice of Law, be amended to read as follows:

Lawyers not admitted to the Bar of this state may engage in the lawful practice of law in New Jersey if:

- The lawyer is admitted to practice *pro hac vice* or is preparing for a proceeding in which the lawyer reasonably expects to be so admitted and is associated with a lawyer in this state;
- The lawyer practices as an in-house counsel and obtains a limited license for lawyers employed by a corporation, partnership, etc., in this state. With the limited license, and after satisfying other requirements, the lawyer is authorized to practice law for the designated employer;
- The lawyer engages in the negotiation of the terms of a transaction on behalf of an existing client in a jurisdiction in which the lawyer is admitted to practice and the transaction relates to that jurisdiction;
- The lawyer participates in an arbitration, mediation or other dispute resolution program on behalf of an existing client and the dispute relates to a jurisdiction in which the lawyer is admitted to practice;
- The lawyer investigates, engages in discovery, interviews witnesses, or deposes a witness in this jurisdiction in preparation for a proceeding pending or anticipated to be instituted in a jurisdiction in which the lawyer is admitted to practice; or
- The lawyer practices under any other circumstance where the matter arises directly out of the lawyer's representation on behalf of an existing client in a jurisdiction where the lawyer is admitted to practice, but the representation must be occasional and undertaken where the lawyer's disengagement would result in substantial inefficiency.

The New Jersey Ad Hoc Committee's report also suggests that the New Jersey Supreme Court clarify the circumstances under which out-of-state lawyers may be admitted to the New Jersey Bar. With respect to in-house counsel, the Committee recommends that out-of-state lawyers be granted a limited license to practice in New Jersey if the legal practice is exclusively for the benefit of the employer and the lawyer does not provide legal services to others, including the employer's other employees.

C. New Jersey State Bar Association

The New Jersey State Bar Association (NJSBA) also conducted a study in response to the national debate over the multi-jurisdictional practice of law.[16] The NJSBA proposes amendments to RPC 5.5 to expand the rule in its current form to include safe harbors for certain actions by out-of-state lawyers that will not be deemed the unauthorized practice of law. The NJSBA's recommendations are, however, much more detailed and limited in application than the Model Rules adopted by the ABA. The NJSBA also recommends that no MJP rule or policy be implemented unless a super-majority of the states (three-fourths) agree to the proposal. The proposed revisions are as follows:

- The NJSBA recognizes the need for a safe harbor not only for *pro hac vice* admission, but also for a lawyer who is preparing for a proceeding in which the lawyer reasonably expects to be authorized. The NJSBA goes further than the ABA's Model Rule by requiring lawyers engaged in pre-litigation activity to be associated with local counsel. Association with local counsel must be legitimate, and local counsel must play a real role in supervising the litigation.
- The NJSBA reports that its amendment to RPC 5.5(b)(2)(i) strengthens the rule proposed by the MJP Commission by making it clear that the lawyer/employee's entire law-related compensation must come from the employer and that the lawyer/employee cannot provide legal services to others.
- The NJSBA reports that the ABA's Model Rule on transactional matters is "too open ended, and would permit a lawyer unlimited opportunity to practice in another jurisdiction." The bar recommends a more detailed rule governing transactional practice as follows:

  1. Proposed RPC 5.5(b)(2)(ii) would permit transactional negotiation, but would require that it be in furtherance of a lawyer's representation of an existing client and that the transaction originate in or be related to the jurisdiction where the lawyer is admitted;
  2. Proposed RPC 5.5(b)(2)(iii) would create a safe harbor for the representation of clients in ADR and other forms of non-judicial dispute resolution. The representation would have to be of an existing client from the jurisdiction where the lawyer is licensed. Furthermore, the dispute would have to originate in or be related to the jurisdiction where the lawyer is admitted;
  3. Proposed Rule 5.5(b)(2)(iv) permits movement across jurisdictional lines with respect to investigation, interviewing and deposing of witnesses in furtherance of a proceeding in the jurisdiction where the lawyer is admitted;
  4. Proposed Rule 5.5(b)(2)(v) is intended as a catch-all safe harbor to cover circumstances that might arise apart from those covered in (i) through (iv). This rule would create a safe harbor for the representation of an existing client provided that the representation "is occasional and is undertaken only when the lawyer's disengagement would result in substantial inefficiency, impracticality or detriment to the client;" and
  5. Rule 5.5(b)(2)(vi) permits out-of-state counsel to associate with local counsel so long as the local counsel assumes overall responsibility for the representation.

The NJSBA also suggests that RPC 5.5 include additional provisions, as set forth in paragraph (c) of the proposed rule. These include that the lawyer (i) be in good standing and not subject to current or pending license suspension or disbarment in any jurisdiction, (ii) be subject to New Jersey's RPCs and disciplinary authority of the New Jersey Supreme Court, (iii) consent to the New Jersey Supreme Court Clerk as agent for service of process, (iv) not hold himself or herself out as being admitted to practice in this jurisdiction and (v) not assist another person in the unauthorized practice of law.

D. Opinion 38[17]

In June 2002, New Jersey's Committee on the Unauthorized Practice of Law issued *Opinion 38*, taking an extremely restrictive position for the trusts and estate bar. The Committee received an inquiry from a New Jersey attorney concerning the extent to which an out-of-state attorney may provide legal services to a New Jersey estate without engaging in the unauthorized practice of law. In relying on *Opinion 14 of the Committee on the Unauthorized Practice of Law*,[18] which states that out-of-state counsel may provide legal services to New Jersey residents when the use of a New Jersey licensed attorney would not be "in the public interest," the Committee held that there are only two narrow exceptions that permit the hiring of a non-New Jersey lawyer for estate work.

- The New Jersey and out-of-state issues must be so entangled and interwoven as to make use of New Jersey counsel impractical and inefficient; or
- There must be out-of-state issues and a long-standing lawyer-client relationship that is so close that using a New Jersey firm would be economically inefficient.[19]

The opinion further noted that in such cases, "responsibility must be divided so that the New Jersey firm handles matters of New Jersey law and practice, and the out-of-state firm handles matters pertinent to its jurisdiction and business matters with which it is intimately familiar due to the long term representation of the decedent."[20] The opinion concluded that "[i]n the absence of circumstances such as those outlined above, the provision of legal services to a New Jersey estate by an out-of-state attorney constitutes the unau-

thorized practice of law."[21] The weight of *Opinion 38* is not clear given the reports of the Professional Conduct Commission and the New Jersey Ad Hoc Committee.

V. Conclusion

It was reported that the testimony before the ABA's MJP Commission was unanimous in recognizing that lawyers today commonly engage in cross-border legal practice. Fortunately, most states do not enforce their unauthorized practice of law rules, except in the more egregious cases. They remain a threat, however, and violation of these rules can have serious consequences.

Given the dramatic rise in cross-border representation, modernization of the MJP rules across the country seems to be just a matter of time. In fact, some jurisdictions have already modernized their rules. Many jurisdictions, however, are reluctant to become pioneers in this area, and a wait-and-see approach is being adopted. How far each state will go continues to be the subject of debate and will most likely depend in large part on the philosophy of neighboring states. For a comprehensive and up-to-date status report on the revisions to state MJP rules across the country go to www.crossingthebar.com.

Endnotes

1. Throughout this article, the term "multi-jurisdictional practice of law" is used to indicate what is commonly referred to as the "unauthorized practice of law." The terms are often used interchangeably.
2. A list of the various state statutes and information on the unauthorized practice of law can be found at www .crossingthebar.com.
3. This was fueled in large part by the 1998 California Supreme Court decision, *Birbrower, Montalbano, Condon & Frank v. Superior Court*, 949 P.2d 1 (1998), which pointed out that the Internet makes it possible to argue that a lawyer is practicing in a jurisdiction without ever physically setting foot in the jurisdiction. In *Birbrower*, a New York law firm advised a California client regarding California law in connection with settlement negotiations and arbitration proceedings to be held in California without associating local California counsel. After the settlement, the California client sued the New York lawyers in California state court for legal malpractice. The New York firm counterclaimed for its fees, but the California court denied the fees on the grounds that the New York lawyers had been engaged in the unauthorized practice of law in violation of California Business and Professions Code § 6125, which states that "[n]o person shall practice law in California unless the person is an active member of the State Bar." This decision has been criticized by courts and commentators in and outside of California and does not reflect the state of the law in New York. In response to the *Birbrower* decision, the law in California was recently amended to specifically authorize out-of-state lawyers to represent clients in arbitrations as long as certain requirements are met. *See* Cal. Civ. Proc. Code § 1282.4.
4. The final report can be found at www.abanet.org/cpr/mjp/final_mjp_rpt_5-17.pdf.
5. The Model Rules are referred to herein as proposed because the NYSBA's report was printed prior to the adoption of the revised MJP rules by the ABA.
6. In general, the counterparts to Model Rules 5.5 and 8.5 under New York law are DR §§ 1-105 and 3-101, and 22 N.Y.C.R.R. §§ 1200.5, 1200.16.
7. The Special Committee report, which is reproduced in large part above, can be found at www.nysba.org under Attorney Resources, NYSBA Reports, 2002 Reports.
8. *See id*.
9. *See* Model Rules of Professional Conduct R. 5.5 cmt. 6 (2002).
10. *See* Model Rules of Professional Conduct R. 5.5 cmt. 14 (2002).
11. *See id*.
12. This requirement has been deleted from the final version of the Model Rule.
13. This language was deleted from the final version of the Model Rule.
14. Both reports can be found atwww.judiciary.state.nj.us/pressrel/pr021211.htm.
15. *See* Professional Conduct Commission Report, at 2.
16. The NJSBA's report can be found at www.judiciary.state.nj.us/notices/reports/njsba_mjp.pdf.
17. *Opinion 38* can be found at 169 N.J. L.J. 54 (July 1, 2002), or at www.crossingthebar.com.
18. *Opinion 14* can be found at 98 N.J. L.J. 399 (1975). The New Jersey Supreme Court in *In re Jackma*n, 165 N.J. 580 (2000), reaffirmed the principles in *Opinion 14*, holding that: "[t]he care with which the exceptions have been carved out underscores the Court's commitment to the rule requiring a New Jersey plenary license in order to engage in the practice of law. Indeed, even a cursory review of the rules governing Practice and Admission to Practice should put a reasonable person on notice that a license is required unless one is acting pursuant to a carefully delineated exception." *Id.* at 586.
19. *See Opinion 38, supra* note 17, at 54.
20. *Id*.
21. *Id*. *See also Opinion 33*, 733 A.2d 478 (N.J. 1999). In *Opinion 33*, the New Jersey State Bar Association initiated an advisory opinion request with the New Jersey Supreme Court's Unauthorized Practice of Law Committee due to the use of out-of-state bond counsel by New Jersey public entities. The Court concluded that except in certain limited circumstances, lawyers who are not admitted to the practice of law in New Jersey were engaged in the unauthorized practice of law when they advised New Jersey governmental entities on the issuance of state and municipal bonds. The Committee noted that New Jersey bond transactions involved New Jersey bonds and facts and that New Jersey lawyers are as skilled as out-of-state lawyers in federal tax matters such that there is no reason (except in limited circumstances) not to hire New Jersey counsel. The court held that "[w]e anticipate that as a result of this decision, state, county and municipal bond issuers ordinarily will retain as bond counsel only law firms with bona fide New Jersey law offices and that the required legal services will be performed primarily by lawyers licensed to practice in this State." *Id*. at 489.

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Special Issues Regarding Life Insurance, Annuities and Retirement Benefits

By David A. Pratt

A. General Estate Planning Issues

1. Survivor Annuity Requirements[1]

Qualified plans protect the rights of spouses by requiring that pension plans (defined benefit, money purchase or target benefit plans) provide

(a) a qualified joint and survivor annuity (QJSA) as the required form of benefit, unless the participant, with the informed written consent of the spouse, elects otherwise; and

(b) a qualified pre-retirement annuity (QPSA) for the surviving spouse in the event of the death of a vested participant prior to the start of receipt of payments, unless the spouse elects otherwise.[2]

A waiver of the QJSA must take place between 30 and 90 days prior to the date payments will begin, although the 30-day minimum notice period may be waived.[3] Accordingly, a spousal waiver included in a pre-nuptial agreement is ineffective.[4]

Tax-sheltered annuity arrangements described in I.R.C. § 403(b) are not subject to the Code rules, but are (if they are subject to ERISA) subject to the corresponding ERISA rules.[5]

Even plans that are not automatically subject to the annuity rules (such as 401(k) plans, profit-sharing plans and ESOPs) will be required to comply unless they provide that, on the death of a married participant, the entire account balance will be paid to the surviving spouse, unless properly waived by such spouse.

Thus, in a planning engagement that involves the designation of beneficiaries of qualified plan balances, it must be recognized that the consent of the spouse will be required (1) for a non-spouse beneficiary designation of death benefits and (2) in the case of a pension plan, for retirement distributions in a form other than a QJSA.

A consent to a beneficiary designation (as to the form of the benefit and/or the beneficiary) may be made specific as to the chosen designation or may be a blanket consent (in which case it would allow subsequent changes in the beneficiary designation).[6] The designation of a trust which benefits the surviving spouse requires the waiver and consent procedures to be followed.

None of these rules applies to IRAs. Thus, regular IRAs, simplified employee pension plans (SEPs), SIMPLE IRAs and Roth IRAs are all exempt from these requirements.

Also, the rules do not apply to (1) governmental plans,[7] (2) church plans,[8] or (3) most nonqualified deferred compensation arrangements.[9]

Comment: A spouse who waives the right to a survivor annuity is giving up potentially valuable rights. If the spouse signs a waiver without legal advice, can the validity of the waiver be challenged? In addition, an attorney who represents both husband and wife must be sensitive to the ethical considerations.

The spouse's consent to waive his or her right to a QJSA or QPSA must (1) acknowledge the effect of the election and (2) be witnessed by a plan representative or a notary public.[10] In one recent case, a consent without a witness' signature was held to be invalid.[11]

2. When Can Distributions Be Made?

If a qualified plan makes a distribution at a time when no distribution is permitted, this is potentially a disqualifying defect. Different rules apply to different types of plan, and any after-tax employee contributions can generally be withdrawn at any time, if the plan so provides.

2.1 Pension Plans

Under a pension plan (defined benefit or defined contribution), distributions can be made only upon the occurrence of one of the following events:[12] death of the participant; disability of the participant; retirement; severance from employment;[13] termination of the plan; or attainment of normal retirement age without terminating employment, if the plan so provides. Also, payments can be made to an alternate payee under a qualified domestic relations order (QDRO), even if none of the above events has occurred, if the QDRO and the plan so provide.[14]

There are also special limits on the amount that can be distributed to certain highly compensated employees from a defined benefit plan.[15]

2.2 Profit-Sharing, 401(k) and Stock Bonus Plans

Under a profit-sharing, 401(k) or stock bonus plan, benefits (other than those attributable to elec-

tive deferrals) can be distributed upon the occurrence of any of the above events, and also upon the occurrence of any of the following:[16] attainment of a stated age; occurrence of a stated event such as hardship, layoff, partial plan termination or illness; or accumulation of funds for a fixed number of years.

2.3 Elective Deferrals

Amounts attributable to (i) elective deferrals under a 401(k) plan, and (ii) other contributions that are subjected to the same distribution restrictions (QMACs, QNECs, safe harbor 401(k) contributions) may only be distributed upon the occurrence of one of the following events:[17] death of the participant; disability of the participant; retirement; severance from employment; termination of the plan without establishment or maintenance by the employer of another defined contribution plan (other than an ESOP or SEP); attainment of age 59½, in the case of a profit-sharing or stock bonus plan; or hardship, in the case of elective contributions to a profit-sharing or stock bonus plan (see 2.4 below).[18] This is not permitted under a safe harbor 401(k) plan.

Also, payments can be made to an alternate payee under a QDRO, even if none of the above events has occurred, if the QDRO and the plan so provide.[19]

3. Minimum Distribution Requirements

3.1 Introduction

On April 17, 2002, the IRS issued final regulations.[20] The regulations provide guidance on the minimum distribution requirements for qualified plans, IRAs, 403(b) arrangements and section 457 eligible deferred compensation plans.

In addition, new proposed and temporary regulations change the rules for defined benefit plans and annuity contracts.

This outline discusses the major changes made by the new regulations, which apply in determining RMDs for calendar years beginning on or after January 1, 2003.[21]

3.2 The Uniform Lifetime Table

The new final regulations retain the minimum distribution rules for individual accounts under the 2001 proposed regulations, including the calculation of the RMD during the employee's lifetime using a uniform table. (In this article, "employee" includes an IRA owner). For years after the year of the employee's death, the distribution period is generally the remaining life expectancy of the designated beneficiary. If there is no designated beneficiary, the distribution period is the employee's life expectancy, determined immediately before his or her death. The uniform lifetime table in the final regulations was adjusted to reflect new mortality tables.[22] Thus, for example, the distribution period allowed during the employee's lifetime by the final regulations has increased from 26.2 years to 27.4 years at age 70 and from 17.6 years to 18.7 years at age 80.

3.3 Determination of the Designated Beneficiary

The 2001 proposed regulations provided that, generally, the designated beneficiary is determined as of the end of the calendar year following the year of the employee's death. Thus, any beneficiary eliminated (by distribution of the beneficiary's benefit or through disclaimer), during the period between the employee's death and the end of the following year, is disregarded in determining the employee's designated beneficiary for purposes of calculating RMDs. Under the final regulations, the date for determining the designated beneficiary has been changed to September 30 of the year following the year of the employee's death.[23]

The final regulations clarify that the designated beneficiaries are determined as of the date of death. After that date, beneficiaries can be eliminated, but not added:

> In order to be a designated beneficiary, an individual must be a beneficiary as of the date of death . . . the employee's designated beneficiary will be determined based on the beneficiaries designated as of the date of death who remain beneficiaries as of September 30 of the calendar year following the calendar year of the employee's death.[24]

If a designated beneficiary dies between the employee's date of death and September 30 of the year following the year of the employee's death, the individual continues to be treated as the designated beneficiary, for purposes of determining the distribution period, rather than the successor beneficiary.[25]

If, as of the end of the year following the year of the employee's death, the employee has more than one designated beneficiary, and the account or benefit has not been divided into separate accounts or shares for each beneficiary, the beneficiary with the shortest life expectancy is the designated beneficiary. Further, if a person other than an individual (or a qualifying trust) is a beneficiary as of that date, the employee is treated as not having a beneficiary.

The final regulations clarify that, in order for a beneficiary to effectively disclaim a benefit for pur-

poses of section 401(a)(9), the disclaimer must satisfy Code section 2518.[26] Thus, (1) the disclaimer must be an irrevocable and unqualified refusal of the benefit, and must be made before the beneficiary accepts any part of the benefit; (2) the benefit must pass to another beneficiary without any direction by the person disclaiming; (3) the disclaimer must be written and be signed by the person disclaiming; (4) the disclaimer must be delivered to the plan administrator or IRA trustee within nine months after the later of the beneficiary's 21st birthday or the date of death of the plan participant (or IRA owner); and (5) the disclaimer must meet all applicable requirements of state law.[27]

3.4 Beneficiaries of Participants or IRA Owners Who Are Already Dead

The final regulations clarify that the rules under the final regulations will apply whenever account balances are still held for the benefit of a beneficiary, even if the participant or IRA owner died before their effective date.[28] Although the new rules are generally beneficial, in some circumstances they will require faster distributions than did the 1987 proposed regulations, because of the change in the date on which the designated beneficiaries are determined.

Under the 1987 regulations, the designated beneficiaries were determined as of the earlier of the RBD or the date of death of the plan participant or IRA owner. Under the new final regulations, the determination date is generally September 30 of the calendar year following the year of death. This change can have an adverse effect.[29]

3.5 Trust as Beneficiary

As under the proposed regulations, a beneficiary of a trust may be a designated beneficiary for purposes of determining RMDs when the trust is named as the beneficiary, provided that certain requirements are met. One requirement is that documentation of the beneficiaries of the trust be provided to the plan administrator or IRA trustee.[30]

In the case of individual accounts, unless the lifetime distribution period for an employee is measured by the joint life expectancy of the employee and the employee's spouse, the deadline under the regulations for providing the beneficiary documentation is October 31 of the year following the year of the employee's death, rather than the end of the year following the year of the employee's death, as under the 2001 proposed regulations.[31] This deadline is coordinated with the deadline for determining the employee's designated beneficiary. The regulations also provide that, if the date for providing this documentation is before October 31, 2003, the documentation may be provided to the plan administrator (or IRA trustee) until October 31, 2003.[32]

Trust beneficiaries cannot use the separate accounts rule for the trust's interest in the benefits.[33] Thus, the beneficiary designation should establish separate accounts at the IRA level. It is not clear whether this can be corrected after the employee's death.

Finally, the preamble states that the IRS and Treasury intend that a revocable trust will not fail to be a trust for purposes of section 401(a)(9) merely because the trust elects to be treated as an estate under Code section 645, as long as the trust continues to be a trust under state law.[34]

Some commentators requested that final regulations provide that, if the employee's estate is named as the beneficiary, or becomes the beneficiary by operation of law, the beneficiary of the estate, or the beneficiary named under the employee's will, could replace the estate as beneficiary by September 30 of the year following the year of death:

> This change is not being adopted in these final regulations. The period between death and the beneficiary determination date is a period during which beneficiaries can be eliminated but not replaced with a beneficiary not designated under the plan as of the date of death. In order for an individual to be a designated beneficiary, any beneficiary must be designated under the plan or named by the employee as of the date of death.[35]

3.6 Who Is a Beneficiary of a Trust?

The final regulations provide that a beneficiary can be disregarded (for purposes of determining who is the oldest beneficiary, and whether all beneficiaries are individuals) if the beneficiary is merely the successor to the interest of another beneficiary. The beneficiary cannot be disregarded if he or she has an interest in the trust that is not merely as successor to another beneficiary.[36] This is an improvement over the 2001 proposed regulations, but is still not entirely clear. Unfortunately, the final regulations do not include any examples on this issue.

3.7 Separate Accounts

The final regulations provide that separate accounts with different beneficiaries can be established "at any time," either before or after the RBD. However, the final regulations also provide that the separate accounts are recognized, for purposes of

determining RMDs, only after the later of (1) the year of the employee's death (whether before or after the RBD) or (2) the year the separate accounts are established.[37]

In addition, the final regulations clarify that

a. For purposes of determining who is the designated beneficiary, the separate account must be established by September 30 of the year following the year of the employee's death;

b. In order to determine the distribution period for the separate account by disregarding the beneficiaries of the other separate account(s), the separate account must be established by the end of the year following the year of the employee's death;[38] and

c. In order to establish a separate account payable solely to the spouse, for purposes of the special rules for the surviving spouse of an employee who dies before the RBD, the separate account must be established by the end of the year following the year of the employee's death.

In order for separate accounts to be recognized for any of these purposes, the beneficiaries must have separate interests as of the date of the employee's death. Also, the separate accounting must allocate all post-death investment gains and losses for the period prior to the establishment of the separate accounts, on a pro rata basis and in a reasonable and consistent manner, among the separate accounts for the different beneficiaries. The separate accounting must also allocate any post-death distribution to the separate account of the beneficiary receiving that distribution.[39] Thus, a pecuniary bequest will not qualify as a separate account unless it shares in post-mortem gains and losses.

Once the separate accounts are established, the final regulations permit separate investments for each account.[40]

3.8 New Rules for Defined Benefit Plans

In order to allow comment, the section of the regulations governing defined benefit plans and annuities was issued as temporary and proposed regulations rather than final regulations.

Under the 1987 and 2001 proposed regulations, if the distributions from a defined benefit plan are not in the form of an annuity, the employee's benefit will be treated as an individual account for purposes of determining required minimum distributions. This rule has not been retained in the temporary regulations except for use in determining the amount that is eligible for rollover when a defined benefit plan pays an employee's entire vested accrued benefit in a lump sum.[41] The prior rule is very widely used, particularly by small plans. The only bright spot is that the old rule can still be used, until the regulations are finalized.

3.9 Additional Temporary Rules for Defined Benefit Plans and Annuity Contracts

The new temporary regulations change the annuity rules in the 2001 proposed regulations.[42]

3.10 Default Rule for Post-Death Distributions

The final regulations, like the 2001 proposed regulations, provide that, if an employee dies before the employee's required beginning date (RBD), and the employee has a designated beneficiary, then the life expectancy rule (rather than the 5-year rule) is the default distribution rule. Thus, absent a plan provision or election of the 5-year rule, the life expectancy rule applies in all cases in which the employee has a designated beneficiary, and the 5-year rule applies if the employee does not have a designated beneficiary.[43]

This was a change from the 1987 proposed regulations, under which the 5-year rule was the default unless the spouse was the sole beneficiary. Commentators pointed out that, as a result of the default rule under the 1987 regulations, some beneficiaries did not commence distributions under the life expectancy rules. In response, the final regulations provide a transition rule that permits beneficiaries subject to the 5-year rule under the 1987 proposed regulations to switch to the life expectancy rule, if the plan permits this, provided that all amounts that would have been required to be distributed under the life expectancy rule are distributed by the earlier of December 31, 2003, or the end of the 5-year period following the year of the employee's death.[44]

3.11 Incidental Benefit Requirement

The new regulations provide rules relating to the interaction of the section 401(a)(9) requirements and the incidental benefit requirement of Reg. § 1.401-1(b)(1)(i). Generally, if distributions satisfy the minimum distribution incidental benefit (MDIB) requirement under the regulations, the distribution will satisfy the incidental benefit requirements.

3.12 Election of Surviving Spouse to Treat an Inherited IRA as Spouse's Own IRA

The final regulations generally retain the rules in the 2001 proposed regulations regarding how and when a surviving spouse of a deceased IRA owner can elect to treat the IRA as the spouse's own IRA.[45] The final regulations provide that the election can be made at any time after the IRA owner's death, and

clarify that the RMD for the year of the IRA owner's death is determined by assuming the IRA owner lived throughout the year. The regulations also clarify that the surviving spouse is required to receive a minimum distribution for the year of the IRA owner's death only to the extent that the amount required was not distributed to the owner before death.

3.13 Simplification of Calculations

Several simplifying changes are included in the final regulations:

1. For lifetime distributions, the marital status of the employee is determined on January 1 each year. Divorce or death after that date is disregarded until the next year.[46]
2. A change in beneficiary due to the spouse's death is not recognized until the following year.[47]
3. Contributions and distributions made after December 31 of a calendar year may be disregarded for purposes of determining the minimum distribution for the following year.[48]
4. An employee's account balance for the valuation calendar year that is also the employee's first distribution calendar year is no longer reduced for a distribution on or before April 1 to satisfy the minimum distribution requirement for the first distribution calendar year.
5. Contributions made after the calendar year, that are allocated as of a date in the prior calendar year, are no longer required to be added back. The only exceptions are rollover amounts, and recharacterized conversion contributions, that are not in any account on December 31 of a year.
6. Under the 2001 proposed regulations, the method of calculating the remaining life expectancy of a deceased employee was different from the method of calculating the remaining life expectancy of a deceased spouse. They are now the same.
7. If the employee dies after the RBD, the applicable distribution period will be the longer of (1) the remaining life expectancy of the employee or (2) the remaining life expectancy of the designated beneficiary.[49] This is helpful if the beneficiary is older than the employee.

These changes are made to the qualified plan rules as well as to the IRA rules, to maintain the parity between the rules.

3.14 Section 403(b) Contracts

Section 1852(a) of TRA '86 applied section 401(a)(9) to section 403(b) contracts effective for benefits accruing after December 31, 1986. The final regulations clarify that a contract will not lose the grandfather for a pre-'87 account balance merely because the account balance is transferred from one section 403(b) contract to another, provided that the issuer of the transferee contract satisfies the record keeping requirements for the pre-'87 account balance. However, a distribution and rollover (including a direct rollover) of an amount from the pre-'87 account will cause that amount to lose the grandfather treatment.[50]

3.15 Other Rules for IRAs

The final regulations retain the general rule that the rules applying section 401(a)(9) to qualified plans apply also to IRAs, unless otherwise provided. The final regulations provide a special rule for trustee-to-trustee transfers between IRAs, to coordinate with the rule that allows aggregation of IRA distributions. Although the IRA-to-IRA transfer is not treated as a distribution for purposes of section 401(a)(9), in light of the fact that the RMD with respect to the transferor IRA can be taken from any IRA, the transferor IRA will be able to transfer the entire balance and will not be required to retain the amount of the RMD for the year.

3.16 IRA Reporting of Required Minimum Distributions

The 2001 proposed regulations required the trustee of an IRA to report to the IRS the amount of the RMD from the IRA, at the time and in the manner to be provided by IRS guidance and applicable IRS forms and instructions. Many commentators objected to this requirement. The final regulations continue to provide authority to the Service to require IRA reporting.[51]

In conjunction with the final regulations, the IRS published Notice 2002-27, specifying the reporting requirements that will apply.

Although the regulations permit reporting with respect to RMDs to beneficiaries, no reporting is required with respect to beneficiaries at this time. However, if the surviving spouse elects to treat an inherited IRA as the spouse's own IRA by redesignating the IRA as an account in the name of the spouse, the reporting requirements do apply to the redesignated IRA.

The regulations retain the rule in the 1987 and 2001 proposed regulations that a section 403(b) contract is treated as an IRA for purposes of satisfying

the RMD rules.[52] Consequently, the authority to require reporting with respect to IRAs also applies to section 403(b) contracts. However, no reporting is required at this time with respect to RMDs from section 403(b) contracts.

The reporting provisions are intended to assist taxpayers in complying with the minimum distribution requirement. "However, the Treasury and the IRS continue to have concerns about the overall level of compliance in this area and intend to monitor the effect of the new reporting regime on compliance to determine whether it would be appropriate to modify the regime in the future."[53]

The reporting requirements do not apply to Roth IRAs.

3.17 Amendment of Qualified Plans

Revenue Procedure 2002-29 requires qualified plans to be amended to reflect the final and temporary regulations under I.R.C. § 401(a)(9) by the last day of the plan year beginning in 2003.

3.18 Amendment of IRAs

Rev. Proc. 2002-10, 2002-4 I.R.B. 401, provides guidance on when IRA documents must be updated for the final regulations and for changes made by EGTRRA.

3.19 Conclusion

The final regulations are, in most respects, a welcome improvement over the 1987 proposed regulations with which we have grappled for so long. However, the rules are still unnecessarily complex: why should naming an estate as beneficiary produce dramatically different results from naming a revocable trust that becomes irrevocable at death? Why should having named an estate or charity along with family members result in no designated beneficiary, even for the funds passing to the family members, whose life expectancies are readily calculated?

Unfortunately, the rules will continue to trap the unwary and those who do not have access to expert advice, and should thus be regarded as only a work in progress. Congress should seriously consider exempting smaller retirement accounts from the rules. In addition, now that reporting by IRA trustees to the IRS will be mandatory, there is no longer any justification for the savage 50% excise tax penalty for failure to take the RMD from one or more IRAs,[54] and it should be reduced to 10% at the most.

4. Planning for Lifetime Distributions

1. Protect any grandfathered estate tax exclusion. If the participant separated from service before 1985, the estate tax exclusion previously available under section 2039(c) may still apply (see section 10.3 below).[55] While other considerations will often apply, preservation of the estate tax exclusion may make any change inadvisable.
2. As a general rule, schedule distributions to maximize the available income tax deferral by minimizing distributions.
3. If the participant's spouse is named as beneficiary, permit the spouse to elect a complete withdrawal after the participant's death, so that the spouse can roll the distribution into his or her own IRA. A common goal for married participants is to provide minimum distributions during their lifetimes, name the children as beneficiaries, and provide maximum income tax deferral during the lifetime of the children.

5. Income Taxation of Distributions[56]

5.1 General Rules

An individual is taxed only on the actual receipt of benefits from a qualified plan or IRA: the constructive receipt doctrine does not apply. Special rules apply to Roth IRAs: see below.

In the case of a distribution which is not a Lump-Sum Distribution

1. The full amount of each payment will be taxable unless the employee has basis. Generally, the individual will have basis only if (1) after-tax employee contributions were made or (2) the plan provided life insurance protection. Deductible contributions made by the individual (to an IRA, 401(k) plan or 403(b) plan) do not result in basis.
2. There is now a simplified method of calculating the nontaxable portion of each annuity payment where the individual has basis.[57]

IRAs (including SEPs and SIMPLE IRAs) are subject to a similar basis recovery rule, but its effect in practice is distorted by the requirement that all IRAs be aggregated to calculate the nontaxable portion.[58]

The basis recovery rules are applied separately to Roth IRAs and other IRAs,[59] and if any Roth IRA distribution is taxable (because it is not a qualified distribution), the taxpayer may recover his or her entire basis (i.e. the total nondeductible, rollover or conversion contributions made to the Roth IRA) before receiving any portion of the taxable income earned

by the account.[60] Clearly, this is a significantly more favorable basis recovery rule than applies to regular IRAs or qualified plans.

If the death benefit under a qualified plan consists of, or includes, life insurance proceeds, then the at-risk amount is not subject to income tax.[61] The balance of the insurance proceeds (the cash surrender value immediately prior to death), minus the total insurance costs previously taxed to the participant, is a taxable distribution.[62]

5.2 Taxation of Lump-Sum Distribution (LSD)

Special averaging has been repealed, but transition rules are still in effect if the participant was born before 1936.[63]

5.3 Net Unrealized Appreciation

If a distribution consists of or includes employer securities attributable to after-tax employee contributions, the "net unrealized appreciation" (NUA) on such securities is not currently taxable. The NUA on employer securities attributable to employer contributions is also excludable from income, but only if the securities are part of a lump sum distribution.[64] In order for the NUA rules to apply, the employee must actually receive a distribution of employer securities and not, for instance, a cash distribution equal in value to employer securities previously held in his or her account under the plan.

Unless the employee elects otherwise, the NUA is not taxable until the securities are sold by the employee. The NUA is long-term capital gain. Any appreciation after the date of the distribution will be a long-term or short-term capital gain, depending on the length of the employee's holding period, commencing with the date of distribution.

The basis of the securities to the trust (generally, their value when contributed to the plan) is includible in income upon distribution. The regulations provide four different methods of calculating the trust's basis.[65]

If the employee rolls over the employer securities to an IRA, there will be no immediate taxation, but on distribution from the IRA the entire amount will be taxable as ordinary income.

An employee who receives employer securities as part of an LSD, and rolls over to an IRA the balance of the LSD, can still defer tax on the NUA.[66]

If the employee still owns the employer securities at the time of his or her death, the securities do not receive a step up in basis, as NUA is a right to receive income in respect of a decedent.[67]

5.4 The Premature Distribution Penalty

I.R.C. § 72(t) imposes a penalty tax on most distributions made before the date on which the employee or account owner attains age 59½, from any qualified plan, 403(b) arrangement or IRA. The tax is equal to 10% of the amount includible in income, so does not apply to the portion of any distribution that is not taxable, for instance because it is rolled over or represents a return of basis. Recent legislation has added yet more exceptions to the tax, so there are now 15 separate exceptions.[68]

From a planning viewpoint, the most important exception is for a distribution that is part of a series of substantially equal periodic payments, made not less frequently than annually, for the life or life expectancy of the employee, or for the lives or life expectancies of the employee and a designated beneficiary.[69] Unless the distribution is made from an IRA, the series of payments must begin after separation from service.[70]

If the series of payments is modified, other than by reason of death or disability, before the employee attains age 59½, or before the close of the 5-year period beginning on the date of the first payment, then generally the tax (plus interest) will apply to all payments previously shielded by the exception.[71] However, the IRS has now provided an important exception to this rule: see Rev. Rul. 2002-62, issued on October 3, 2002.

5.5 Rollovers

An individual (including an alternate payee who is the spouse or former spouse of the participant)[72] who receives an "eligible rollover distribution" from a qualified plan may defer income tax thereon, to the extent that the distribution is transferred to an IRA or another "eligible retirement plan."[73] If a surviving spouse receives an eligible rollover distribution after the employee's death, the spouse may also effect a rollover.[74]

If the individual does not elect a direct rollover,[75] the transfer must be made within 60 days after receipt of the distribution[76] and, in the case of a distribution of property, the property itself (or the proceeds of sale of the property)[77] must be transferred.[78]

Generally, all distributions are eligible rollover distributions, with the exception of the following:

1. Substantially equal annuity payments,[79]
2. Substantially equal installment payments made over a period of 10 years or more,[80]
3. Distributions required under the minimum distribution rules,[81]

4. Any portion (other than net unrealized appreciation) of the distribution that is not includible in gross income,

5. Elective deferrals (and income) that are returned to correct an excess annual addition,

6. Corrective distributions of excess deferrals, excess contributions and excess aggregate contributions (and income),

7. Loans and loan defaults that are treated as deemed distributions under section 72(p). By contrast, a plan loan offset amount generally is an eligible rollover distribution,[82]

8. Dividends paid to employees on employer securities held by an ESOP, and

9. The taxable cost of current life insurance protection (the PS 58 costs).[83]

In addition, for distributions made after 1998, hardship distributions of elective deferrals under a 401(k) plan or 403(b) plan are not eligible rollover distributions.[84] For distributions made after 2001, no portion of a hardship distribution may be rolled over.

Eligible rollover distributions from a 403(b) or a governmental 457 plan may also be rolled over.[85] An IRA distribution (other than a required minimum distribution) may be rolled over to another IRA, qualified plan or 403(b) plan.[86]

6. Stock Options

In recent years, many companies have amended their stock option plans to allow an executive to transfer nonqualified stock options[87] to family members or to a trust for family members. Such a transfer can save a substantial amount of transfer taxes.

In Rev. Rul. 98-21, 1998-18 IRB 15, the IRS ruled that a gift of a nonqualified option is not complete, for gift tax purposes, until the later of

1. the date of the transfer, or

2. the date on which the donee's right to exercise the option becomes vested.

Rev. Proc. 98-34[88] provides guidance for the valuation of compensatory stock options for estate, gift and generation skipping transfer tax purposes. Although the Revenue Procedure applies, by its terms, only to options on publicly traded stock, there does not seem to be any reason why its principles should not be applied to options on non-traded stock.

An ISO which is unexercised at the holder's death must be exercised within three months after death,[89] and many plans have similar time limits for nonqualified options. These unexercised options may have substantial value, and the estate plan must address where the necessary funds are to be found. The plan should also specifically authorize the fiduciary to exercise options, to borrow money in order to do so, and to pledge the shares so acquired.

7. Marital Deduction Trust as Beneficiary

1. There may be valid non-tax reasons for using a trust, as opposed to an outright designation to the surviving spouse, such as the participant's desire to control the ultimate disposition of the plan proceeds, the need to protect the assets from creditors of the surviving spouse, and the desire to provide professional investment advice. If the beneficiary is a trust, rather than the IRA owner's spouse, and the disposition is intended to qualify for the marital deduction, the same language that would be included in a marital deduction trust, to ensure qualification for the marital deduction, should be included in the beneficiary designation form (BDF), e.g., allowing the surviving spouse to direct investments or requiring the trustee to obtain investments which produce a reasonable current income.[90]

2. If payments are deferred over the life expectancy of the surviving spouse, it may be necessary to make a specific designation of the marital trust, as opposed to having the qualified plan assets pass through the estate or through an allocation in the hands of the trustees. If the marital deduction trust is a pre-residuary, pecuniary trust or non-pro rata fractional share trust, the "assignment" of the IRD item will cause acceleration of the income tax on the deferred payments.[91]

3. Installment payments to an estate-type marital trust will permit greater income tax deferral, because the income distribution requirement of power of appointment and QTIP marital trusts will not be a factor. Installment payments must also satisfy the minimum distribution rules under section 401(a)(9).

4. The requirements that must be met, in order for the beneficiaries of a trust to be designated beneficiaries, are described above.

5. The basic position of the IRS is now set forth in Rev. Rul. 2000-2. The facts described in the ruling were as follows. The IRA owner (A) died at the age of 55, survived by his or her spouse (B), who was 50 years old. A named the trustee of a testamentary trust as the beneficiary of the IRA. A copy of the trust and a

list of the trust beneficiaries were provided to the custodian of A's IRA within nine months after A's death. As of the date of A's death, the testamentary trust was irrevocable and was a valid trust under the laws of the state of A's domicile.

Under the terms of the testamentary trust, all trust income is payable annually to B, and no one has the power to appoint trust principal to any person other than B. A's children, who are all younger than B, are the sole remainder beneficiaries of the trust. No other person has a beneficial interest in the trust. Under the trust, B has the power, exercisable annually, to compel the trustee to withdraw from the IRA an amount equal to the income earned on the assets held by the IRA during the year, and to distribute that amount through the trust to B.

The trustee of the testamentary trust elects to receive annual minimum required distributions over B's life expectancy. On B's death, any undistributed balance of the IRA will be distributed to the testamentary trust over the remaining distribution period.

The IRS noted that the IRA is payable to a trust, the terms of which entitle B to receive all trust income, payable annually. In addition, no one has a power to appoint any part of the property in the trust or the IRA to any person other than B. Therefore, the IRS said, whether A's executor can elect to treat the trust and the IRA as QTIP depends on whether B is entitled to all the income for life from the IRA, payable at least annually.

Under the terms of the testamentary trust, B is given the power, exercisable annually, to compel the trustee to withdraw from the IRA an amount equal to all the income earned on the assets held in the IRA and to pay that amount to B.

The IRS ruled that B's power meets the standard set forth in Reg. § 20.2056(b)-5(f)(8) for the surviving spouse to be entitled to all the income for life payable annually. Thus, B has a qualifying income interest for life within the meaning of section 2056(b)(7) in both the IRA and the testamentary trust. Because the trust is a conduit for payments from the IRA to B, A's executor needs to make the QTIP election under section 2056(b)(7) for both the IRA and the testamentary trust.

In order to take advantage of Rev. Rul. 2000-2, it is necessary to be able to determine the amount of income of the IRA or plan for the year in question.[92] The best approach would be to define "income" in the document, rather than leaving this to the vagaries of state law.[93] It is also advantageous to be able to claim that amounts withdrawn are income rather than principal. Michael Jones suggests: "Consider providing that all withdrawals from the IRA, including withdrawals made under the minimum distribution rules, will be paid first from current and accumulated income of the IRA, then from IRA principal."[94]

6. Another issue that has surfaced in Private Letter Rulings relates to how the plan beneficiary designation is made.

    a. In theory, the designation could be set forth in the plan document, the participant's beneficiary designation, the beneficiary's distribution election, or in the marital trust documents (trust agreement or will).

    b. Private Letter Rulings indicate that either of the first two options is acceptable, but that the beneficiary's distribution election is insufficient.[95]

If the surviving spouse is not a U.S. citizen, the requirements of Code § 2056A(a) must be incorporated in an IRA agreement. The IRS has ruled that a marital deduction was available for a deceased U.S. citizen's two IRAs payable to his non-citizen spouse, provided that (1) The spouse would create a qualified domestic trust; (2) the trust is subject to the spouse's general power of appointment exercisable during life and at death; and (3) the qualified domestic trust is irrevocably designated the beneficiary upon the spouse's death.[96]

8. Payment of Estate Taxes

Generally, the personal representative of the decedent's estate pays the tax while the beneficiary receives the benefits free of all estate taxes. Absent any direction for apportionment under the will or state law, the personal representative of the estate cannot recover the tax from the retirement benefits payable to a specific beneficiary.[97]

Good estate planning may suggest, in a particular case, that a tax clause should be included in the BDF. However, this may cause problems under the current IRS interpretation of the minimum distribution rules. Until this issue is resolved, it appears to be safer not to address the issue in the BDF.

Some commentators take the position that, if a trust is named as beneficiary of a plan or IRA, the

trust should affirmatively provide that benefits cannot be used to pay estate taxes, debts or expenses of estate administration or the IRS will assert that the estate is a beneficiary under the trust and thus there is no designated beneficiary.[98]

According to Virginia Coleman,

> The latest word we have is that if estate taxes are imposed on a plan or IRA under applicable law (e.g., a state apportionment statute), the estate will not on account of this be treated as a beneficiary. If, however, the instrument says anything about paying death taxes, even if it simply tracks what the law would otherwise provide, the estate will be treated as a beneficiary of the plan or IRA except if the plan or IRA cannot be used for this purpose by the terms of the instrument.[99]

Any tax clause should be both in the will and in the BDF. If the source of funds to pay the tax will or may be the plan or IRA, the BDF should authorize distribution of the amount of taxes attributable to the benefits, as determined by the executor. The tax clause should also allow the beneficiaries to pay their share of the tax from their own funds, to preserve the tax deferral potential of the plan or IRA.

9. Nonqualified Plans[180]

Section 2039 does not distinguish between qualified and nonqualified plans in determining includibility in the gross estate. However, there are some practical differences which should be noted:

1. Nonqualified plans, unlike qualified plans, are subject to the constructive receipt principle.[101] Accordingly, many nonqualified plans either do not give the participant a choice as to the method of payment, or require the choice to be made at the time of initial participation, which is usually many years before benefits become payable. If the spouse is the beneficiary, the form of payment must be analyzed to determine whether it qualifies for the marital deduction.

2. No tax-free rollovers can be made from a nonqualified plan (other than a governmental 457 plan) to an IRA. For a valid rollover, the plan must be qualified when the funds are distributed from that plan.

3. A death-benefit-only plan, under which the decedent neither received nor had the right to receive payments before death, is not includible under section 2039. However, the regulations[102] provide for aggregation of a DBO plan with other plans, and this aggregation may result in the value of the DBO plan being included.

10. Roth IRAs

10.1 Income Taxation

There is a 5-year minimum holding period for a nontaxable "qualified distribution" from a Roth IRA.[103]

In addition to satisfying the 5-year rule, a qualified distribution must be (i) made after the IRA owner attains age 59½, or (ii) made to the beneficiary, or to the IRA owner's estate, following the IRA owner's death, or (iii) attributable to the IRA owner's being disabled (as defined in Code § 72(m)(7)), or (iv) a qualified first-time home buyer distribution.[104]

If the distribution is *not* a qualified distribution, the taxpayer can recover, tax-free, the full amount contributed to the Roth IRA (including rollover contributions) before any (taxable) earnings are received.[105] This essentially removes the teeth from the 10% early distribution penalty, as the penalty tax applies only to amounts that are taxable.

Comment: This basis recovery rule is significantly more favorable to the taxpayer than the general basis recovery rules for qualified plans and IRAs to which nondeductible contributions have been made. Under the general rule, each distribution is deemed to include a portion of the earnings on the contributions.

10.2 Conversion of a Regular IRA to a Roth IRA

If a taxpayer converts a regular IRA to a Roth IRA after 1998, the amount converted (excluding any basis) is includible in income in the year of conversion.[106] A taxpayer over age 70½ may convert to a Roth IRA, but no required minimum distribution from a non-Roth IRA may be converted. The minimum distribution must be distributed before any conversion is effected.[107]

10.3 The Minimum Distribution Rules

The minimum distribution rules do not apply to a Roth IRA before the account holder's death.[108] On the death of the Roth IRA owner, the rules of Reg. 1.408-8 apply as though the owner died before the required beginning date.[109] The minimum distribution rules apply separately to (1) Roth IRAs and other retirement plans, and (2) Roth IRAs inherited by a beneficiary from one decedent, and any other Roth IRAs of which the beneficiary is either the owner or the beneficiary of another decedent.[110]

If the owner's surviving spouse is the sole beneficiary, then the spouse may (1) delay distributions until the decedent would have attained age 70½, or (2) treat the Roth IRA as her own.[111] This presumably means that no distributions will be required during the spouse's lifetime.

If, on the date of death, the spouse is not the sole beneficiary, the entire remaining interest will, at the election of the owner (or, if the owner has not elected, at the election of the beneficiaries) either (a) be distributed by December 31 of the year containing the fifth anniversary of the owner's death, or (b) be distributed over the life expectancy of the designated beneficiary.[112] Unless distributions actually begin by December 31 of the year following the year of death, method (a) must be used.

10.4 Creditor Protection

Before converting a regular IRA to a Roth IRA, the laws of the relevant jurisdiction(s) should be checked to determine whether Roth IRAs enjoy as much protection as regular IRAs against claims of creditors. New York law has been amended to exempt Roth IRAs, so they now enjoy the same protection as regular IRAs.[113] The Investment Company Institute has made available on its Web site[114] a chart showing the extent to which each type of IRA is protected from creditors' claims under the laws of each state.

11. Charitable Planning

For an individual who has charitable inclinations, using retirement plans and accounts to fund charitable bequests can be very cost-effective because this saves both estate taxes and income taxes. See section 3 above for minimum distribution concerns that can arise from charitable dispositions of plan assets.

B. Beneficiary Designations for IRAs[115]

12. Introduction

The premise of this section of the outline is that, for any IRA of any size, the terms of the IRA document, and the terms of the owner's BDF governing the distribution of the IRA assets, are as important as the owner's other estate planning documents, and should be prepared with as much care as the owner's will or revocable trust. This will generally require that individualized additional provisions be drafted and agreed with the IRA sponsor.

This report discusses BDFs for traditional IRAs, including rollover IRAs and accounts under a SEP or SIMPLE IRA. Although most of the issues discussed are also applicable to qualified plans, 403(b) plans and Roth IRAs, the report does not address the additional considerations that apply to such programs.

13. Threshold Issues

13.1 Choice of IRA Sponsor

13.2 Trust or Custodial Account?

14. The Minimum Distribution Rules

Current IRA documents reflect the superseded 1987 regulations, so do not deal adequately with minimum distribution issues.

If the IRA owner dies before the RBD, article IV.4(b) of Form 5305 provides that the beneficiary will elect the method of distribution, unless the owner has elected otherwise. If the owner does not wish the beneficiaries to have control over the distribution method, the election should be made by the owner and, again, the BDF appears to be the ideal place to do so.

15. Designation of a Trust as Beneficiary

See sections 3.5, 3.6 and 7 above, for minimum distribution and marital deduction issues.

New York Estates, Powers and Trusts Law 13-3.3 (EPTL) deals with the designation of a trustee to receive certain proceeds, including savings and retirement plan benefits, life insurance and annuity contracts, and requires that the trust so designated must either (i) be in existence on the date of the designation or (ii) be a testamentary trust. This section does not specifically refer to IRAs. The Committee recommended that the law be amended to provide specifically that it does apply to IRAs.

16. Additional Planning Issues During the Owner's Lifetime

16.1 Disability or Incompetence of the IRA Owner

Increased longevity carries with it an increased risk that an IRA owner may become incapable of making decisions with respect to the account, temporarily or permanently. Accordingly, in the case of any client with a substantial IRA balance, the appointment of an agent to make necessary decisions (such as changes of investments, transfer of the IRA to a new sponsor, electing a distribution method or changing the beneficiaries) should be considered. It may be appropriate to appoint different people to make different decisions.

There are at least two ways of appointing an agent. If the agent is to have limited, easily defined responsibilities, such as making investment decisions, then the easiest approach is probably to make the appointment in the BDF.

If the agent's authority is to be more wide-ranging, then it would be preferable to use a durable power of attorney (DPA) that complies with the requirements of section 5-1501 of the General Obligations Law (GOL). The DPA should be a separate document from the BDF, as the DPA may need to be shown to parties who have no business knowing the dispositive provisions of the BDF.[116]

The statutory short form DPA lists, among the categories of transactions that the agent may be authorized to perform, "Retirement benefit transactions" and "Tax matters." The scope of each of these categories is further defined in the statute. The statutory definition will often not coincide with the scope of the authority that the owner wishes to confer, so the DPA should be modified as necessary. It is important to coordinate the BDF and the DPA, to ensure that there are no inconsistencies in the client's plan.

16.2 Separate Accounts[117]

Separate accounts are a response to two difficult rules under the proposed minimum distribution regulations: first, the rule that if there is more than one designated beneficiary, the beneficiary with the shortest life expectancy (i.e., the oldest one) is used to determine the maximum payout period; and second, the rule that if any beneficiary is not an individual, there will be no designated beneficiary.

One response to these rules is to establish totally separate IRAs. However, it may be more efficient and cost-effective to establish separate accounts under a single IRA. Trust beneficiaries cannot use the separate accounts rule for the trust's interest in the benefits.[118] Thus, the beneficiary designation should establish separate accounts at the IRA level. It is not clear whether this can be corrected after the employee's death.

17. Planning for Events After the IRA Owner's Death

The following are some issues that can be problematic after the death of the IRA owner, and that are not addressed, or are not addressed satisfactorily, in the typical IRA document. The IRA owner should at least consider addressing these issues in the BDF.

17.1 Method of Payment of Death Benefits

17.2 Death of the Primary Beneficiary

The choice of primary and contingent beneficiaries, and the possibility of different contingent beneficiaries in different situations, requires the same degree of care as the corresponding provisions in a will or trust.

17.3 Transfer of the IRA

17.4 Simultaneous Death

As with a will or trust, the order of deaths can directly affect the distribution of benefits from the IRA. Accordingly, the BDF should specify the presumptions that are to apply in the event of simultaneous death.

17.5 Governing Law

17.6 Execution of the IRA Documents

Particularly if the IRA documents establish a custodial account rather than a trust, it may be necessary (and is probably prudent) to execute the BDF with the same formalities as would be required for a valid will.

EPTL 13-3.2 deals with the rights of named beneficiaries of annuity or insurance policies and pension, retirement, death benefit, stock bonus and profit-sharing plans. The statute provides that ". . . the rights of persons so entitled or designated and the ownership of money, securities or other property thereby received shall not be impaired or defeated by any statute or rule of law governing the transfer of property by will, gift, or inheritance."[119] A designation that is to take effect on death (of the person making the designation or another) must be written, signed[120] and (1) in the case of insurance, agreed to by the insurer or (2) in the case of a plan, agreed to by the employer or made in accordance with the plan's rules.[121]

Most IRA documents provide for a default beneficiary (e.g., the surviving spouse, if any, followed by surviving issue or, if none, the IRA owner's estate) if the IRA owner dies without a valid beneficiary designation. Clearly, the default designation is not signed by the IRA owner, and the statute should be amended to clarify that the default designation is valid despite the lack of a signature.[122]

EPTL 13-3.2 does not specifically state that IRAs are subject to its provisions, though cases have so held.[123] The statute should be amended to clarify that this is so. In addition, the statute does not specify how to revoke such a designation, or whether the designation can be revoked by will.[124] The statute should be amended to clarify these issues.

New York State law also does not specify how an IRA beneficiary may designate his or her own beneficiary of an inherited IRA under state law. EPTL 13-3.2 should be amended to address this issue.

17.7 Disclaimers

As with any other dispositive document, provision for a disclaimer can provide increased flexibility and allow for post-mortem planning. The IRA owner should consider including in the BDF a specific provision for disclaimer of all or part of the benefit, particularly if the primary beneficiary is the surviving spouse. The BDF should also state specifically who is to be the beneficiary of any benefit that is disclaimed.

17.8 Minor Beneficiaries

17.9 Tax Clause

Good estate planning may suggest, in a particular case, that a tax clause should be included in the BDF. However, this may cause problems under the current IRS interpretation of the minimum distribution rules. See section 8 above. Until this issue is resolved, it appears to be safer not to address the issue in the BDF.

18. Additional Legal Issues

18.1 Compliance with IRA Sponsor's Procedural Requirements

IRA documents, like insurance policies and retirement plans, typically require a beneficiary designation to be delivered to the appropriate person (here, the IRA sponsor) in order for it to be effective. In several cases, New York courts have held that the institution can waive compliance with its procedural requirements so that, in some of the cases, benefits passed under the decedent's will rather than under the beneficiary designation.[125]

The test applied by the courts is a facts and circumstances test, so this introduces uncertainty and increases the risk of litigation. Consideration should be given to including in the BDF a statement as to whether the IRA owner reserves the right to alter the beneficiaries by a later will and, if so, an agreement by the sponsor to waive its procedural requirements in that case. If, as one assumes would normally be the case, the IRA owner does not reserve that right, the BDF could require the IRA sponsor not to waive the procedural requirements so that a designation by will would be ineffective unless the will is delivered to the IRA sponsor.

18.2 Spousal Rights

IRAs are not subject to the QJSA and QPSA rules that apply to qualified plans under ERISA and the Code. The EPTL includes "thrift, savings, retirement, pension, deferred compensation, death benefit, stock bonus or profit-sharing" plans and accounts as testamentary substitutes that are subject to the spouse's right of election.[126] The statute does not specifically refer to IRAs, and should be amended to clarify whether it does so. From a policy viewpoint, there is no reason to exclude IRAs.

A retirement benefit will not be classified as a testamentary substitute if the decedent designated the beneficiary on or before September 1, 1992, and has not changed the beneficiary thereafter.[127]

18.3 Effect of Divorce

A participant in an employer-sponsored plan, or owner of an insurance policy, designates his or her spouse as beneficiary; the parties are later divorced, but the beneficiary designation is never changed. Who receives the proceeds?[128] One way to address this issue is to specify in the property settlement agreement who is to receive any IRA proceeds, identifying each account individually. Another, and probably better, way is to specify in the BDF whether any designation of a spouse as beneficiary is to survive a divorce or separation.

C. Spousal Rights in Retirement Benefits

19. Federal Rules Protecting a Surviving Spouse

(a) In General

Under a qualified pension plan (defined benefit, money purchase or target benefit) that is subject either to Code section 401(a)(11) or to ERISA section 205, the normal form of benefit for a married participant is required to be a QJSA.[129] Under a QJSA, benefits are paid to the participant for life and then a survivor benefit, equal to between 50% and 100% of the amount payable to the participant during his or her life, continues to be paid to the surviving spouse (if he or she survives the participant) for the surviving spouse's lifetime.[130] Payment in any other manner requires the consent of both the participant and the spouse. For an unmarried participant, the normal form of benefit is a life annuity unless the participant elects to receive a different form of distribution.

Any plan that is required to offer the QJSA and QPSA is also required to give the participant a written explanation of the annuity option, including the terms and conditions of the annuity, the participant's right to make, and the effect of, an election to waive the annuity, the spousal consent rules, and the participant's right to make, and the effect of, a revocation of an election to waive the annuity.[131]

Many defined benefit plans, particularly large plans and collectively bargained plans, offer only annuity options (and lump sum cash-outs of benefits whose present value is $5,000 or less).

A qualified profit-sharing plan, 401(k) plan or ESOP is not required to provide the QJSA or QPSA, provided that

(1) the participant's accrued benefit is payable in full, on the death of the participant, to the participant's surviving spouse (or, if there is no surviving spouse, or the surviving spouse consents in accordance with section 417(a)(2), to a designated beneficiary),

(2) the participant does not elect payment of benefits in the form of a life annuity, and

(3) with respect to that participant, the plan is not a direct or indirect transferee of a plan that is required to provide the QJSA and QPSA.[132]

(b) Which Plans Are Subject to the QJSA and QPSA Requirements?

In addition to the exception for profit-sharing plans, 401(k) plans and ESOPs, the following retirement plans are NOT required to provide the QJSA and QPSA:

1. A plan to which Code § 411 does not apply, without regard to section 411(e)(2).[133] This exempts governmental plans[134] and non-electing church plans.[135]
2. The Code § 401(a) requirements generally apply only to qualified plans. Section 403(b) plans are specifically required to comply with certain provisions of section 401(a),[136] but they are not made subject to the requirements of section 401(a)(11). A 403(b) plan will, however, be subject to the parallel annuity rules of ERISA § 205 unless
   A. The plan is a governmental plan or a non-electing church plan;[137] or
   B. The plan is funded solely by employee contributions and employer involvement is limited;[138] or
   C. The plan is classified as a profit-sharing plan and the requirements described in (a) above are satisfied.
3. A plan described in Code section 457.
4. A non-qualified deferred compensation plan that is exempt from ERISA.
5. Any type of IRA, including an employer-sponsored IRA (a SEP or a SIMPLE IRA) and a rollover IRA that holds funds transferred from a plan that IS subject to the annuity rules.

20. The Right of Election Under New York Law

(a) In General

EPTL 5-1.1-A generally grants a right of election to the surviving spouse[139] of a decedent who dies, domiciled in New York State,[140] after August 31, 1992.[141] The amount of the elective share to which the surviving spouse is entitled is generally equal to the greater of $50,000 or 1/3 of the "net estate."[142] The net estate includes, in addition to the probate estate, "testamentary substitutes" described in section 5-1.1-A(b)(1).

If the decedent created testamentary substitutes during his or her life, the right of election is the right to receive money from the beneficiaries who received them, not a share of the assets themselves.[143]

Generally, the election must be made within six months from the date of issuance of letters testamentary or of administration, but in no event later than two years after the date of death. However, the time may be extended by order of the surrogate's court which issued the letters.[144]

What if the beneficiary is not the spouse, and demands immediate distribution before the end of the period in which an election can be made by the surviving spouse? These provisions do not prevent a person from paying or transferring any funds or property to a person otherwise entitled thereto, unless there has been served personally upon the payer a certified copy of an order enjoining such payment or transfer, made by the surrogate's court having jurisdiction of the decedent's estate or by another court of competent jurisdiction. Otherwise, a person so paying or transferring funds or property will be held harmless and free from any liability for making the payment or transfer.[145]

The spouse or surviving spouse cannot seek a QDRO. A QDRO must be issued under a state "domestic relations" law:[146] section 5-1.1A of the EPTL is a succession law, not a domestic relations law.

The EPTL specifically says that the spouse is not a creditor with respect to the elective share. Accordingly, it appears that the creditor protection statutes under federal and state law would not protect assets in a qualified plan or IRA from the right of election.

(b) Retirement Benefits as Testamentary Substitutes

These testamentary substitutes include any "money, securities or other property" payable under a "thrift, savings, retirement, pension, deferred com-

pensation, death benefit, stock bonus or profit-sharing plan, account, arrangement, system or trust."[147] However, with respect to

1. A plan to which section 401(a)(11) of the Internal Revenue Code (the Code) applies, or
2. A defined contribution plan to which that subsection does not apply pursuant to section 401(a)(11)(B)(iii) (i.e., a profit-sharing plan, 401(k) plan or ESOP described in 19(a) above)

only 50% (rather than 100%) of the "capital value" of the benefit is a testamentary substitute.[148]

A spouse who receives retirement plan benefits as a result of exercising the right of election will apparently not be a designated beneficiary for purposes of the minimum distribution rules: "The fact that an employee's interest under the plan passes to a certain individual under applicable state law does not make that individual a designated beneficiary unless the individual is designated as a beneficiary under the plan."[149]

According to the preamble to the final minimum distribution regulations, under "Explanation of Provisions":

> The period between death and the beneficiary determination date is a period during which beneficiaries can be eliminated but not replaced with a beneficiary not designated under the plan as of the date of death. In order for an individual to be a designated beneficiary, any beneficiary must be designated under the plan or named by the employee as of the date of death.[150]

(i) Which Plans Are Subject to the 50% Rule?

As indicated above, Code § 401(a)(11) applies only to qualified plans, and the exception under section 401(a)(11)(B)(iii) also applies only to qualified plans. Section 403(b) plans may be subject to the annuity requirements under section 205 of ERISA, but they are NOT subject to section 401(a)(11).

In *Estate of Cohen*, [151] Surrogate Preminger applied a "purposive interpretation" of the right of election statute, which led her to "the conclusion that any plan (whether or not a "qualified plan" for federal tax purposes) required to comply with the section 401(a)(11) requirements, directly or indirectly, is subject to the special 2 rule." Surrogate Preminger acknowledged that 403(b) plans "are not directly subject to section 401(a)(11)" but cited the Treasury regulations, which provide:

> The requirements set forth in section 401(a)(11) apply to other employee benefit plans that are covered by applicable provisions under Title I of [ERISA]. For purposes of applying the regulations under sections 401(a)(11) and 417, plans subject to ERISA section 205 *are treated as if they were described in section 401(a).* For example, to the extent that section 205 covers section 403(b) contracts and custodial accounts they are treated as section 401(a) plans. Individual retirement plans (IRAs), including IRAs to which contributions are made under simplified employee pensions described in section 408(k) and IRAs that are treated as plans subject to Title I, are not subject to these requirements (emphasis supplied).[152]

Accordingly, she concluded, as the EPTL "does not differentiate between plans directly or indirectly subject to" section 401(a)(11), then a 403(b) plan that is subject to ERISA is subject to section 401(a)(11) for purposes of the right of election.

I believe that the result is correct from a policy viewpoint. However, the fact remains that, no matter what the Treasury regulations suggest, 403(b) plans are *not* subject to Code § 401(a)(11). There is, I suggest, no policy reason to differentiate between (1) retirement plans which are subject to Code § 401(a)(11), and (2) retirement plans (including many 403(b) plans) which are NOT subject to Code § 401(a)(11), but are subject to the parallel requirements of ERISA § 205. Accordingly, I recommend that the right of election statute should be modified to apply the 50% rule to any retirement plan that is subject to either Code § 401(a)(11) or ERISA § 205.

The 50% rule raises another policy issue. Assume that the deceased spouse leaves nothing to his or her surviving spouse and has, in each case, only one asset subject to the right of election, and that the value of that asset is $300,000.

1. If the asset is corporate stock, then the surviving spouse is entitled to receive $100,000 if she exercises her right of election.
2. If the asset is an account balance under a qualified governmental retirement plan, then the surviving spouse is again entitled to receive $100,000 if she exercises her right of election.

3. If the asset is an account balance under a qualified corporate retirement plan, then the surviving spouse is entitled to receive only $50,000 if she exercises her right of election.

4. If the asset is an account balance under an individual retirement account, which was funded solely by a rollover from a qualified corporate plan, then the surviving spouse is entitled to receive the full $100,000 if she exercises her right of election.

The difference in treatment can only be explained as an attempt to comply with ERISA preemption, which is discussed below.

(ii) Life Insurance and Annuity Contracts

The statute does not specifically include either life insurance or annuity contracts. The prior version of the statute, applicable to decedents who died before September 1, 1992, did specifically exclude life insurance.[153] At least two cases have held that life insurance is not a testamentary substitute unless payable to the estate.[154] Some retirement plans provide an insured death benefit; as the life insurance proceeds are part of the retirement plan benefit, it seems that they should be included as testamentary substitutes rather than excluded as life insurance.[155]

(iii) Transition Rule: No Change of Beneficiary After August 31, 1992

A transaction described above will not constitute a testamentary substitute if the decedent designated the beneficiary or beneficiaries of the plan benefits on or before September 1, 1992, and did not change the beneficiary designation thereafter.[156] In one case, the decedent married after September 1, 1992. This had the effect of making his new spouse the beneficiary of his profit-sharing plan. The court held that he was deemed to have changed his beneficiary after September 1, 1992, so the plan was a testamentary substitute.[157]

In *Estate of Alent*,[158] before 1992 the decedent named her two daughters as her beneficiaries. After September 1, 1992, she selected the method of payment, and again named her children as beneficiaries. After her death, her husband sought a declaration that her retirement benefits were testamentary substitutes. The court held against him: "Inasmuch as no new beneficiary was designated after the original designation of decedent's children in 1964, the exception to the requirement that a retirement plan be treated as a testamentary substitute . . . applies."

(c) Waiver of Right of Election

A testamentary substitute is not included to the extent that the surviving spouse has executed a valid waiver or release pursuant to section 5-1.1A(e) with respect thereto.[159]

The spouse may, during the lifetime of the other spouse, waive or release the right of election against a particular will, or against any will, or a testamentary substitute. The waiver or release must be in writing, signed and acknowledged in the manner required for recording a conveyance of real property. However, in *Saperstein*,[160] a waiver was held valid even though it was not acknowledged.

The waiver or release is effective even if it is executed before the marriage, or without consideration.[161] The language must clearly indicate that the election right in particular is being waived.[162]

A waiver may be withdrawn if it was obtained by fraud, concealment or overreaching.[163]

If, at the time of the decedent's death, there is in effect a waiver, or a consent to the decedent's waiver, with respect to any survivor benefit, or right to such a benefit, under Code § 401(a)(11) or section 417, then that waiver is deemed to be a waiver against that testamentary substitute.[164] The preamble to the final, temporary and proposed regulations under sections 401(a)(11) and 417 states that section 417 "provides explicit safeguards to ensure informed consent of the participant and the participant's spouse."[165]

The IRS has issued sample language to waive the QJSA or QPSA.[166] Each form contains an extensive explanation of the nature of the rights being given up and the effect of the consent.[167]

The likelihood of an ERISA waiver being a truly informed waiver appears remote. Also, what if plan assets for which an ERISA waiver was obtained are commingled in a single IRA with other assets?

21. ERISA Preemption

(a) In General

ERISA includes a broad preemption provision[168] which generally preempts any state law or cause of action which "relates to" an employee benefit plan that is subject to ERISA.[169] In *Hisquierdo*, a non-ERISA case,[170] the U.S. Supreme Court said "mere conflict in words is not sufficient. State family and family-property law must do 'major damage' to 'clear and substantial' federal interests before the Supremacy Clause will demand that state law be overridden."

The EPTL provides that if any part of section 5-1.1A is preempted by federal law with respect to a payment or an item of property included in the net estate, a person who, not for value, received that payment or item of property is obligated to return to

the surviving spouse that payment or item of property or is personally liable to the surviving spouse for the amount of that payment or the value of that item of property, to the extent required under the section.[171]

(b) *Boggs v. Boggs*[172]

Isaac Boggs' first wife died in 1979. He remarried in 1980, retired in 1985 and died in 1989. He participated in (1) a qualified savings plan, which he rolled over to an IRA before his death, (2) a qualified ESOP, from which he received a distribution of employer stock before his death, and (3) a qualified defined benefit plan. After he retired, he received annuity payments from the defined benefit plan and, after his death, these payments continued to his second wife.

His first wife bequeathed a remainder interest in two-thirds of her estate to their sons. Absent preemption, Louisiana community property law would control, and her will would effectively dispose of her community property interest in the plans. The lower courts held that ERISA did not preempt state law. The Supreme Court reversed in a 5-4 decision.

For the majority, Justice Kennedy said that

> We can begin, and in this case end, the analysis by simply asking if state law conflicts with the provisions of ERISA or operates to frustrate its objectives. We hold that there is a conflict, which suffices to resolve the case. . . .
>
> ERISA's solicitude for the economic security of surviving spouses would be undermined by allowing a predeceasing spouse's heirs and legatees to have a community property interest in the survivor's annuity. . . .
>
> Beyond seeking a portion of the survivor's annuity, respondents claim a percentage of: the monthly annuity payments made to Isaac Boggs during his retirement; the IRA; and the ESOP shares of AT&T stock. . . .
>
> The surviving spouse annuity and QDRO provisions, which acknowledge and protect specific pension plan community property interests, give rise to the *strong implication* that other community property claims *are not consistent with the statutory scheme*. ERISA's silence with respect to the right of a nonparticipant spouse to control pension plan benefits by testamentary transfer provides *powerful support for the conclusion that the right does not exist*. . . .
>
> As was true with survivors' annuities, it would be inimical to ERISA's purposes to permit testamentary recipients to acquire a competing interest in undistributed pension benefits, which are intended to provide a stream of income to participants and their beneficiaries. . . .
>
> It does not matter that respondents have sought to enforce their rights only after the retirement benefits have been distributed since their asserted rights are based on the theory that they had an interest in the undistributed pension plan benefits. Their state-law claims are pre-empted (emphasis supplied).

In his dissent, Justice Breyer pointed out that

> . . . the state law in question involves family, property, and probate—all areas of traditional, and important, state concern. . . .
>
> The lawsuit before us concerns benefits that the fund has already distributed; it asks not the fund, but others, for a subsequent accounting. . . .
>
> The anti-alienation provision is designed to prevent plan beneficiaries from prematurely divesting themselves of the funds they will need for retirement, not to prevent application of the property laws that define the legal interest in those funds. One cannot find frustration of an "anti-alienation" purpose simply in the state law's definition of property. . . .

He also pointed out that protection of Isaac, the plan participant,

> . . . is beside the point . . . for the state law action here seeks an accounting that will take place after the deaths of both Dorothy and Isaac. . . .
>
> [I] agree with the majority that Louisiana cannot give Dorothy's children a share of the pension annuity that Sandra is receiving without

> frustrating the purpose of [ERISA section 205].
>
> This inconsistency does not end the matter, however, for Dorothy's children here sought different relief. Although the children apparently requested a portion of Sandra's monthly annuity payments in their state court pleading, they stipulated at oral argument that they are seeking only an accounting. . . .
>
> . . . it is possible that Louisiana law would permit Dorothy (or her heirs) to collect not the pension benefits themselves, but other nonpension community assets of equivalent value. . . .

The Court's decision is somewhat surprising. First, there is a strong presumption (to which the Court paid lip service) against preemption of state law in traditional areas of state concern, such as succession law. Second, since its *Travelers* decision,[173] the Court has applied ERISA preemption much less sparingly than it did before and could have sidestepped the preemption issue in *Boggs*, with respect to two of the plans (the savings plan and the ESOP), as the benefits were no longer held by the employer plans at the time of Isaac's death.[174] Third, as Justice Breyer indicated in his dissent, there is no apparent policy reason why the drafters of ERISA would have wished (had they thought about it, which they clearly did not) to preempt state community property law.

(c) The Uniform Probate Code

The Uniform Probate Code (1990) (UPC) provides[175] that, if any provision thereof is preempted by federal law, the person receiving funds to which he or she would not be entitled under the UPC is personally liable for that amount to the person who would be entitled under the UPC. According to the Comment,

> This provision respects ERISA's concern that federal law govern the administration of the plan, while still preventing unjust enrichment that would result if an unintended beneficiary were to receive the pension benefits. Federal law has no interest in working a broader disruption of state probate and nonprobate transfer law than is required in the interest of smooth administration of pension and employee benefit plans.

This statement is echoed by Justice Breyer in his dissent:

> I cannot understand why Congress would want to pre-empt Louisiana law if (or insofar as) that law provides for an accounting and collection from other property-—i.e., property other than the annuity that section 1055 requires the BellSouth plans to pay to Sandra. The survivor annuity provision assures Sandra that she will receive an annuity for the rest of her life. Louisiana law (on my assumption) would not take from her either that annuity or any other asset that belongs to her. The most one could say is that Sandra will not receive certain other assets—assets which belonged to the Dorothy-Isaac community and which Isaac had no right to give to anyone in the first place.

Example

Assume that a New York decedent has a probate estate of $700,000 and a $1,000,000 account balance under a qualified plan that is subject to Code § 401(a)(11). In 1997, the decedent named his children as the sole beneficiaries of his estate and also of the plan. The surviving spouse has not waived her annuity rights, so she is entitled to a $500,000 QPSA, 50% of the account balance. For purposes of the elective share statute, the net estate is $1,200,000 ($700,000 plus 50% of $1 million), and the elective share is $400,000. As the spouse has already received $500,000, more than her elective share, under Justice Breyer's approach she would receive no other assets.

This approach appears eminently reasonable. However, as Langbein & Wolk point out:[176]

> the rejection of Part II-B-3 of Breyer's dissent by seven justices has implications beyond community property issues. . . . the Uniform Probate Code directs the state probate court to set off a surviving spouse's pension benefits derived from the decedent against the surviving spouse's forced-share entitlement. Does *Boggs* signal that the UPC system will be pre-empted?

Also, the Breyer approach was rejected by Surrogate Preminger in *Cohen*:[177]

> The apparent purpose of the 50 percent exclusion of certain retirement benefits was to ensure that the right of the surviving spouse to control disposition of 50 percent of the plan benefit conferred by federal law would not be diluted by the surviving spouse's right of election with respect to non-pension assets . . . the total value of the plan assets received by [the husband] from the two plans that are fully includible in the elective share base are proper offsets to the net amount of the elective share while the amount received from the 50 percent plan is not a proper offset. *Accord, Matter of Farlow*, 174 Misc. 2d 629.

Accordingly, on the facts of the above Example, the surviving spouse would receive her entire elective share of $400,000 in addition to the $500,000 QPSA.

(d) Preemption and Divorce

Most states have laws providing that divorce revokes the provisions of a will in favor of the divorced spouse, but do not extend this to non-testamentary transfers.[178] The UPC would revoke any revocable "disposition or appointment of property" in favor of the ex-spouse.[179]

In *Egelhoff*,[180] H designated W as his beneficiary under two ERISA plans, a pension plan and a life insurance plan. They were later divorced, and H died intestate two months later. H had not changed the beneficiary designation. Under state law, his heirs in intestacy were his children from a prior marriage. Washington state law provided that a divorce revoked the designation in favor of the ex-wife. The Washington Supreme Court held that the state law was not preempted. The U.S. Supreme Court reversed 7-2. The Court held that the Washington statute was expressly preempted by ERISA because it governed the payment of benefits, "a central matter of plan administration" and would impose a burden on plan administrators, exacerbated by choice-of-law problems. Also, the statute "interfered with nationally uniform plan administration."

According to Justice Thomas, writing for the majority,

> The statute binds ERISA plan administrators to a particular choice of rules for determining beneficiary status. The administrators must pay benefits to the beneficiaries chosen by state law, rather than to those identified in the plan documents. The statute thus implicates an area of core ERISA concern. . . .
>
> Plan administrators cannot make payments simply by identifying the beneficiary specified by the plan documents. Instead they must familiarize themselves with state statutes so that they can determine whether the named beneficiary's status has been "revoked" by operation of law. And in this context the burden is exacerbated by the choice-of-law problems that may confront an administrator. . . .
>
> There is . . . a presumption against pre-emption in areas of traditional state regulation such as family law []. But that presumption can be overcome where, as here, Congress has made clear its desire for pre-emption. Accordingly, we have not hesitated to find state family law pre-empted when it conflicts with ERISA or relates to ERISA plans [citing *Boggs*].

In dissent, Justice Breyer said:

> [I]f one looks beyond administrative burden, one finds that Washington's statute poses no obstacle, but furthers ERISA's ultimate objective—developing a fair system for protecting employee benefits. The Washington statute transfers an employee's pension assets at death to those individuals whom the worker would likely have wanted to receive them. As many jurisdictions have concluded, divorced workers more often prefer that a child, rather than a divorced spouse, receive those assets. Of course, an employee can secure this result by changing a beneficiary form; but doing so requires awareness, understanding, and time. That is why Washington and many other jurisdictions have created a statutory assumption that divorce works a revocation of a designation in favor of an ex-spouse. That assumption is embodied in the Uniform Probate Code; it is consistent with human experience; and those

with expertise in the matter have concluded that it "more often" serves the cause of "[j]ustice." Langbein, The Nonprobate Revolution and the Future of the Law of Succession, 97 Harv. L. Rev. 1108, 1135 (1984).

In forbidding Washington to apply that assumption here, the Court permits a divorced wife, who already acquired, during the divorce proceeding, her fair share of the couple's community property, to receive in addition the benefits that the divorce court awarded to her former husband. To be more specific, Donna Egelhoff already received a business, an IRA account, and stock; David received, among other things, 100% of his pension benefits. David did not change the beneficiary designation in the pension plan or life insurance plan during the 6-month period between his divorce and his death. As a result, Donna will now receive a windfall of approximately $80,000 at the expense of David's children. The State of Washington enacted a statute to prevent precisely this kind of unfair result. But the Court, relying on an inconsequential administrative burden, concludes that Congress required it.

D. Pension Reform Proposals

22. Introduction

In January, 2003, the Bush Administration announced its federal budget proposals for the 2004 fiscal year.[181] These proposals include radical changes to the federal pension laws, arguably the most significant changes since the enactment of ERISA in 1974.

First, the Administration proposes that shareholders would generally not be taxable on corporate dividends paid out of income that has already been taxed at the corporate level.

Second, the proposal creates two new types of savings account, Lifetime Savings Accounts (LSAs) and Retirement Savings Accounts (RSAs) to which everyone could contribute, with no limitations based on age or income.

Third, the proposal creates Employer Retirement Savings Accounts (ERSAs), which would "promote and vastly simplify employer sponsored retirement plans by consolidating 401(k), SIMPLE 401(k), 403(b), and 457 employer-based defined contribution accounts into a single type of plan that can be more easily established by any employer."[182]

The Treasury Department described these as "two bold new expanded savings proposals covering all Americans."[183]

Finally, the proposal would simplify the coverage and nondiscrimination rules applicable to defined contribution plans.

At this stage, it is impossible to predict which, if any, of the pension proposals will be enacted this year. The proposals were greeted with considerable criticism, and received a lukewarm response even from normally staunch supporters of the President: "The White House has abandoned the idea as a legislative priority. . . . In large part, the backpedaling reflects hostile reactions from Republicans who were not consulted in advance and were taken aback by the sweep of the Bush administration's proposals."[184]

More recently, however, Administration officials have stressed their continuing support for the proposals: "Our first priority, administration-wide, is the jobs and growth package. It has been our first priority since before the president introduced his budget. Once it is passed, we're going to focus on other budget items—and LSAs and RSAs are important; they're huge!"[185]

Even if the proposals are not enacted this year, they offer an important insight into the ways in which the current Administration would like to revise the current rules, and changes that are not enacted this year may well be proposed again in the future.

23. Lifetime Savings Accounts[186]

Under the budget proposal, LSAs could be used for any type of saving. Any individual (even one with no earned income) could contribute up to $7,500 per year (indexed for inflation in future years) in cash, and could make tax-free withdrawals at any time, with no penalty and no minimum holding period. Contributions would not be deductible. The saver's tax credit[187] would be available for LSA contributions made before 2007, but withdrawals from any of the new accounts, including an LSA, could disqualify the individual from the saver's credit for the current and two subsequent tax years.[188]

Investment earnings of an LSA would not be taxed, and all distributions would be tax-free.

In addition, taxpayers would be allowed to convert balances in an Archer Medical Savings Account (MSA), Coverdell Education Savings Account (ESA) or Qualified State Tuition Plan (QSTP) to LSAs. Conversion of a QSTP or ESA would not result in taxable income. Conversion of an MSA to an LSA would result in taxation of the total amount converted, in the year of conversion. Any such conversion must occur before January 1, 2004.[189]

The current rules governing who can be trustee of an IRA will apply to LSAs.

An individual may make LSA contributions for another person, provided that the total contributions made on behalf of that person do not exceed the applicable limitation ($7,500 for 2003). LSA balances can be rolled over to an LSA for a family member. An account in a child's name would become the child's property at age 18.[190]

Catch-up contributions, for people aged 50 or older, will not be available for LSAs.

Under the proposal, LSAs would be effective in 2003.

24. Retirement Savings Accounts[191]

LSAs can be used for any purpose: RSAs are intended for retirement saving. According to the Treasury Department, the new RSA will improve and simplify savings opportunities for all Americans by consolidating traditional IRAs, nondeductible IRAs and Roth IRAs, each of which has a confusing and different set of rules regarding eligibility and tax treatment, into one streamlined type of account with rules similar to current-law Roth IRAs.[192]

Each year, an individual may contribute up to $7,500 (indexed for inflation, and in addition to amounts contributed to an LSA) in cash to an RSA. There are no maximum income limitations, but contributions to an RSA may not exceed the amount of compensation includible in gross income. An individual (regardless of the level of his or her income) may contribute to an RSA even if he or she participates in an employer-sponsored plan.

In the case of a married couple filing jointly, RSA contributions of up to $7,500 can be made for each spouse (including a spouse with no compensation income) if the total contribution for both spouses does not exceed the combined compensation income of both spouses. Catch-up contributions, for those aged 50 or older, will not be available for RSAs.

Contributions are not deductible. The saver's tax credit will be available for RSA contributions made before 2007, but withdrawals from any of the new accounts, including an RSA, could disqualify the individual from the saver's credit for the current and two subsequent tax years.[193]

An individual may make RSA contributions for another person, provided that the total contributions made on behalf of that person do not exceed the applicable limitation.

Investment earnings will generally never be taxed, as distributions after age 58, death or disability will be tax-free. Other ("nonqualified") distributions from an RSA, in excess of contributions, would be taxable and subject to a 10% excise tax. As with a Roth IRA, (1) distributions would be deemed to come first from contributions, and (2) individuals will not be required to take minimum distributions from the RSA during their lifetime.[194]

Existing Roth IRAs will automatically become RSAs, but otherwise are not affected. Deemed IRAs under employer plans would become deemed RSAs and be subject to the RSA rules. Other existing IRAs can be converted into RSAs at any time. There would be no income limit on conversions of IRAs to RSAs. The amount converted would be taxable, except to the extent that the taxpayer has basis. If the conversion occurs before 2004, the tax can be spread over four years. If the conversion occurs after 2003, the total taxable amount will be included in gross income for the year of the conversion. Distributions from employer plans could be rolled over to an RSA by including the rollover amount (excluding basis) in income in the year of conversion.[195]

IRAs that are not converted may not accept new contributions, other than rollover contributions. New traditional IRAs could be created to accommodate rollovers from employer plans, but they could not accept any new individual contributions. No one would be required to convert.

The current rules governing who can be trustee of an IRA will apply to RSAs.

The proposal would also permit tax-free withdrawals from IRAs for charitable contributions. Individuals would be allowed to exclude from gross income distributions made after age 65 from a traditional or Roth IRA directly to a charity. The proposal would not apply to indirect gifts made through a split interest entity such as a charitable remainder trust. The exclusion would be available without regard to the percentage of AGI limitations that apply to deductible contributions. The amount transferred directly would count as a distribution for purposes of the minimum distribution rules. This proposal would be effective for distributions made after 2002.[196]

Under the proposal, RSAs would be effective in 2003.

25. Employer Retirement Savings Accounts[197]

25.1 The Proposal

Under current law, there are several different types of tax-preferred, employer-based retirement savings arrangements, including 401(k) plans, thrift plans, 403(b) arrangements, governmental 457 plans, SARSEPs and SIMPLE IRAs. All of these plans have similar goals but are subject to confusingly different rules regarding employee eligibility, employer eligibility, contribution limits, tax treatment, and withdrawal restrictions. The budget proposal would consolidate all of them into a single type of plan, an employer retirement savings account (ERSA), a "streamlined and simpler account . . . which can be sponsored by any employer."[198] The ERSA would replace all of the different types of funded plans which allow pre-tax employee contributions, but would not replace non-governmental 457 plans. An ERSA may also provide for matching contributions and nonelective contributions.

ERSAs generally follow the existing rules for 401(k) plans, but the rules would be simplified, as described below.

The ERSA deferral limit will be the same as the current limit for 401(k) plans ($13,000 for 2004), including catch-up contributions for those over age 50. ERSAs can be pre-tax or after-tax. A pre-tax ERSA would exclude the employee contribution from income but would fully tax distributions. Employee contributions to an after-tax (Roth) ERSA would not be deductible and distributions would generally not be taxed.[199] As under current law, employer contributions to either type of ERSA would be deductible.

For individuals who can afford to make after-tax (Roth) deferrals under an ERSA—which will typically be those with higher incomes—a $13,000 after-tax deferral is a significantly higher limit than a $13,000 pre-tax deferral. For an individual whose marginal income tax bracket (state and federal) is 35%, a $13,000 annual after-tax contribution is really equivalent to a $20,000 pre-tax contribution to an ERSA.

Beginning in 2004, all 401(k) plans will become ERSAs, and could continue to operate. Current 403(b) plans and governmental 457 plans could be operated as ERSAs or operated separately. If not converted to ERSAs, they could not accept new contributions after 2004. SIMPLEs and SARSEPs may continue in existence indefinitely, but may not accept any future contributions after 2004.

Finally, the proposal would allow up to $500 of unused amounts in an employee's health flexible spending account to be distributed to the employee or contributed to a 401(k) plan, 403(b) plan, governmental 457 plan, SARSEP, SIMPLE IRA or medical savings account, subject to the normal tax rules applicable to such plans.

ERSAs would be effective for years beginning after 2003.

25.2 Other Rules

The lifetime minimum distribution rules would not change. These rules would, however, be amended significantly by the proposed bill introduced by Representatives Portman and Cardin.[200] The bill would increase the age for required minimum distributions from 70½ to 75 and reduce the rate of the excise tax from 50% to 20%.

Finally, the pension provisions of EGTRRA that are currently scheduled to sunset on December 31, 2010, would be permanently extended.[201]

26. The Pension Preservation and Savings Act

On April 10, 2003, Reps. Portman and Cardin announced that they had completed work on a pension simplification bill.[202] The following are included in the bill:

> The bill includes a correction mechanism to allow IRA owners to return funds to their accounts when distributions have been made in error.
>
> The bill changes the minimum required distribution rules by raising the starting age from 70½ to 72 in 2004 and then gradually to 75 in 2010. In addition, the excise tax for failing to take distributions will be reduced from 50% to 20%. The bill also establishes a reasonable, good-faith compliance standard for governmental plans.
>
> The bill encourages annuitization by allowing individuals to exclude from gross income 10% (5% for 2004 through 2007) of annual retirement plan annuity income. The maximum exclusion is 5% (2.5% for 2004 through 2007) of the dollar limit on annual additions under Code § 415(c) (currently $40,000). The exclusion is phased out for higher income taxpayers, and is subject to a recapture rule.
>
> The bill allows direct rollovers from an employer plan to a Roth IRA.

The bill allows individuals a distribution into an IRA (for example, at job change or retirement) to direct some or all of the distribution to the IRA of their spouse.

The bill would allow non-spouse beneficiaries to roll over plan benefits to an IRA and take the money out over a period of years, consistent with the minimum distribution rules.

27. Retirement Planning

Effective for years beginning after 2001, retirement planning advice and information provided by an employer to an employee or spouse are excludible from income and wages.[203]

The exclusion will not apply to a highly compensated employee unless the advice and information are available on substantially the same terms to every other member of the group of employees normally provided education and information regarding the employer's plans.[204] However, according to the legislative history, the employer can limit certain advice to individuals nearing retirement age under the plan.[205]

The retirement advice may relate to 403(b) and governmental 457(b) plans as well as qualified plans.[206]

The Portman-Cardin bill requires employers to provide new investment education notices and notices of blackout periods to participants and beneficiaries. In addition, the bill allows employees to pay for retirement planning services on a pre-tax basis and will once again provide tax-favored treatment for qualified group legal services.

Endnotes

1. See also section 19 below.
2. Internal Revenue Code §§ 401(a)(11) and 417 (I.R.C.); ERISA § 205, 29 U.S.C. § 1055.
3. I.R.C. § 417(a)(6), (7); ERISA § 205(c)(6), 29 U.S.C. § 1055(c)(6).
4. Treas. Reg. 1.401(a)-20, Q & A 28; *Hurwitz v. Sher,* 982 F.2d 778 (2d Cir. 1992); *see*, however, *Callahan v. Hutsell*, 1993 U.S. App. Lexis 34005 (6th Cir. 1993).
5. ERISA § 205, 29 U.S.C. § 1055.
6. IRS Notice 97-10 contains sample spousal consent language.
7. I.R.C. §§ 401(a)(final sentence), 411(e)(1)(A); ERISA § 4(b)(1), 29 U.S.C. § 1003(b)(1).
8. I.R.C. §§ 401(a)(final sentence), 411(e)(1)(B); ERISA § 4(b)(2), 29 U.S.C. § 1003(b)(2).
9. A nonqualified plan, by definition, is one which does not attempt to satisfy the requirements of I.R.C. § 401(a). Any excess benefit plan (as defined in ERISA § 3(36), 29 U.S.C. § 1002(36)) and an unfunded plan maintained primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees are exempt from the requirements of section 205 of ERISA [ERISA § 201(2), (7), 29 U.S.C. § 1051(2), (7)].
10. I.R.C. § 417(a)(2)(A).
11. *Lasche v. George W. Lasche Basic Profit Sharing Plan*, 21 E.B.C. 1001 (11th Cir. 1997).
12. Treas. Reg. § 1.401-1(b)(1)(i).
13. *See* Rev. Ruls., 56-693, 1956-2 C.B. 282 and 74-417, 1974-2 C.B.131.
14. I.R.C. § 414(p)(10).
15. Treas. Reg. § 1.401(a)(4)-5(b); Rev. Rul. 92-76.
16. Treas. Reg. § 1.401-1(b)(1)(ii), (iii).
17. I.R.C. § 401(k)(2)(B)(i); Treas. Reg. § 1.401(k)-1(d).
18. I.R.C. § 401(k)(2)(B).
19. I.R.C. § 414(p)(10).
20. 67 Fed. Reg. 18988.
21. In determining RMDs for calendar year 2002, taxpayers could rely on the final regulations, the 2001 proposed regulations, or the 1987 proposed regulations [67 Fed. Reg. at 18994].
22. 67 Fed. Reg. at 18989.
23. Reg. 1.401(a)(9)-4, Q & A 4(a).
24. Reg. 1.401(a)(9)-4, Q & A 4(a).
25. Reg. 1.401(a)(9)-4, Q & A 4(c).
26. Reg. 1.401(a)(9)-4, Q & A 4(a).
27. Code § 2518; GCM 39858 (1991).
28. Reg. 1.401(a)(9)-1, Q & A 2(b)(1).
29. See the example given by Barry Picker, "New Minimum Distribution Regulations Bad News for Some Beneficiaries," www.BPickerCPA.com.
30. In this outline, the term "IRA trustee" includes an IRA custodian or issuer.
31. Reg. 1.401(a)(9)-4, Q & A 6(b).
32. Reg. 1.401(a)(9)-1, Q & A 2(c).
33. Reg. 1.401(a)(9)-4, Q & A 5(c).
34. 67 Fed. Reg. at 18992.
35. Preamble, 67 Fed. Reg. at 18990; *see also* Reg. 1.401(a)(9)-8, Q & A 11.
36. Reg. 1.401(a)(9)-5, Q & A 7(c).
37. Reg. 1.401(a)(9)-8, Q & A 2(a)(2).
38. Reg. 1.401(a)(9)-8, Q & A 2(a)(2).
39. Reg. 1.401(a)(9)-8, Q & A 3.
40. Reg. 1.401(a)(9)-8, Q & A 3.
41. Preamble, 67 Fed. Reg. at 18991; see also Temp. Reg. 1.401(a)(9)-6T, Q & A 1(d).
42. Temp. Reg. 1.401(a)(9)-6T, Q & A 2(d).
43. Reg. 1.401(a)(9)-3, Q & A 4(a).
44. Reg. 1.401(a)(9)-1, Q & A 2(b)(2).
45. Reg. 1.408-8, Q & A 5.
46. Reg. 1.401(a)(9)-5, Q & A 4(b)(2).
47. Reg. 1.401(a)(9)-5, Q & A 4(b)(2).
48. Reg. 1.401(a)(9)-5, Q & A 3(b).
49. Reg. 1.401(a)(9)-5, Q & A 5(a)(1).

50. Reg. 1.403(b)-3, Q & A 2(d).
51. Reg. 1.408-8, Q & A 10.
52. Reg. 1.403(b)-3, Q & A 1(b).
53. 67 Fed. Reg. at 18993.
54. Code § 4974.
55. DEFRA § 525(b), as amended by section 1852(e)(3) of TRA 86; TEFRA § 245; s*ee also* Rev. Rul. 92-22, PLR 9144046.
56. I.R.C. §§ 72 and 402.
57. I.R.C. § 72(d)(1).
58. I.R.C. § 408(d)(2).
59. I.R.C. § 408A(d)(4)(A).
60. I.R.C. § 408A(d)(4)(B).
61. I.R.C. § 101(a).
62. I.R.C. § 72(m)(3)(C); Reg. 1.72-16(b), (c). Special rules apply to owner-employees.
63. SBJPA §§ 1401(a)(2), 1401(c)(2); *see also* Ann. 87-2, 1987-12 IRB 38, Q & A C4.
64. Code § 402(e)(4). The term "lump sum distribution" is defined in section 402(e)(4)(D).
65. Reg. § 1.402(a)-1(b)(2)(ii).
66. *See*, for instance, PLR 199939048, 199928034, 199919039 and 9721036.
67. I.R.C. §§ 691, 1014; Rev. Rul. 75-125, 75-1 CB 254.
68. In addition, the tax does not apply to the taxable cost of current life insurance protection (the PS 58 cost). Notice 89-25, 1989-1 CB 662, Q & A 11.
69. I.R.C. § 72(t)(2)(A)(iv).
70. I.R.C. § 72(t)(3)(B). Notice 89-25 provides guidance on this exception, and the IRS has also issued numerous private rulings. In PLR 200027062, IRS took the position that any interest rate not exceeding 120% of the federal mid-term rate is reasonable for calculating substantially equal payments.
71. I.R.C. § 72(t)(4). In PLR 199943050, the taxpayer wanted to add a 4% annual COLA to the amount of the withdrawals from his IRA. The IRS ruled that this would be an impermissible modification that would subject the withdrawals to the 10% tax. By contrast, in PLR 9536031, the COLA was part of the distribution method from the outset, and thus did not trigger the tax. In PLR 200027060, the IRS ruled that, following the division of an IRA in connection with a divorce, the IRA owner's spouse need not continue to receive her proportionate share of substantially equal periodic payments that began to the IRA owner before the divorce. In PLR 9818055, the IRS ruled that the section 72(t) penalty tax applied when the IRA owner, after receiving periodic distributions, returned to work and transferred the IRA balances to her employer's 401(k) plan.
72. I.R.C. § 402(e)(1)(B).
73. I.R.C. § 402(c)(1), (8)(B).
74. I.R.C. § 402(c)(9).
75. I.R.C. § 401(a)(31).
76. Special rules apply to certain frozen deposits in a financial institution. I.R.C. § 402(c)(7).
77. I.R.C. § 402(c)(6). No gain or loss is recognized on the sale, to the extent that the proceeds are rolled over. I.R.C. § 402(c)(6)(D).
78. I.R.C. § 402(c)(1), (3).
79. *See* Treas. Reg. § 1.402(c)-2, Q & A 5, 6.
80. *See* Treas. Reg. § 1.402(c)-2, Q & A 5, 6.
81. *See* Treas. Reg. § 1.402(c)-2, Q & A 7, 8.
82. Treas. Reg. § 1.402(c)-2, Q & A 9.
83. I.R.C. § 402(c)(4); Treas. Reg. § 1.402(c)-2, Q & A 3, 4.
84. I.R.C. § 402(c)(4)(C); *see* section 2.4 *supra*.
85. I.R.C. § 403(b)(8).
86. I.R.C. § 408(d)(3). A special rule applies to distributions from a SIMPLE IRA (I.R.C. § 408(d)(3)(G)), and no distribution from an inherited IRA may be rolled over (I.R.C. § 408(d)(3)(C)).
87. In this outline, the term "nonqualified stock option" means any stock option that is not an incentive stock option (ISO). An ISO may not be transferred during the optionee's life [I.R.C. § 422(b)(5)].
88. 1998-18 IRB 15.
89. I.R.C. § 422(a)(2).
90. *See* Reg. 20.2056(b)-5(f)(4).
91. I.R.C. § 691(a)(2); Treas. Reg. § 1.661(a)-2(f)(1).
92. *See* Jones, *Guidance on QTIP Elections and IRAs Offers Slim Benefits*, Tax Notes, May 15, 2000, 961, at 966.
93. *See*, for instance, section 409 of the 1997 Uniform Principal and Income Act, which provides default rules.
94. Jones, note 90 *supra*. *See also* Doyle, *IRA Distributions to a Trust After the Death of the IRA Owner—Income or Principal?*, 139 Trusts & Estates 60 (Sept. 2000).
95. *See* Ltr. Rul. 9220007 and 9232036.
96. Ltr. Ruls. 9151043, 9623063, 9729040.
97. Code § 2205. *See also* Temp. Reg. 54.4981A-1T, Q & A d-8A (dealing with the now-repealed excess accumulations tax].
98. *See*, for instance, Coleman, *Preserving the "Designated Beneficiary" If a Trust is Named as Beneficiary of a Qualified Plan or IRA*, 25 ACTEC Notes 137 (1999), at 142 (hereinafter "Coleman"). *See also* PLR 199912041.
99. Coleman, note 187, at 143. *See also Ice, Hot Topics and Recent Developments in the IRA/ Qualified Plan Distribution Area: From the Sublime to the Ridiculous*, 25 ACTEC Notes 226 (1999), at 241.
100. *See* Edelstein & Baird, *Nonqualified Plans Are Important for Estate Planning*, 139 Trusts & Estates 49 (Sept. 2000).
101. I.R.C. §§ 402, 451.
102. Reg. § 20.2039-1(b).
103. I.R.C. § 408A(d)(2)(B); Reg. 1.408A-6, Q & A 2, 7.
104. I.R.C. § 408A(d)(2)(A).
105. I.R.C. § 408A(d)(4)(B)(i).
106. I.R.C. § 408A(d)(3)(A).
107. Reg. 1.408A-4, Q & A 6.
108. I.R.C. § 408A(c)(5).
109. Reg. 1.408A-6, Q & A 14.
110. Reg. 1-408A-6, Q & A 15.
111. Reg. § 1.408A-6, Q & A 14(b).
112. Reg. § 1.408A-6, Q & A 14(b).
113. EPTL 7-3.1, CPLR § 5205.
114. www.ici.org.
115. This section is an abbreviated version of a report by the Life Insurance and Employee Benefits Committee. The full report was published in the Winter 2001 issue of the *Trusts and Estates Law Section Newsletter* (p. 16).

116. For a sample power of attorney for retirement benefits, *see* Natalie B. Choate, Life and Death Planning for Retirement Benefits, Ataxplan Publications.

117. *See also* section 3.7 *supra*.

118. Reg. 1.401(a)(9)-4, Q & A 5(c).

119. EPTL 13-3.2(a). *See In re Clotworthy*, 294 A.D.2d 720 (3d Dep't 2002), in which a claimant against the estate sought unsuccessfully to reach an annuity which provided that any balance at the decedent's death would be payable to her heirs.

120. *See Androvette v. Treadwell*, 73 N.Y.2d 746 (1988), holding that an unsigned change of beneficiary was void.

121. EPTL 13-3.2(e). The requirement that the beneficiary designation be in writing was held to be preempted by ERISA with respect to an employer plan [*O'Shea v. First Manhattan Co. Thrift Plan & Trust*, 55 F.3d 109 (2nd Cir., 1995)].

122. *In re Trigoboff*, 175 Misc. 2d 370, 669 N.Y.S.2d 185 (1998) (court did not suggest that the default designation in the IRA was invalid, but held that a testamentary disposition was better evidence of the decedent's intent).

123. *See*, for instance, *In re Morse*, 150 Misc. 2d 415, 568 N.Y.S. 2d 689 (1991) (holding that a testamentary disposition of an IRA superseded a prior designation); *In re Trigoboff*, 175 Misc. 2d 370 (holding that a specific testamentary disposition of an IRA in a will pre-dating decedent's marriage superseded the IRA's generic default designation in favor of the surviving spouse).

124. In *Freedman v. Freedman*, 116 F. Supp. 3d 379 (E.D.N.Y. 2001), the decedent named his wife as beneficiary of his IRA. They separated, and she commenced divorce proceedings. He executed a new will, excluding his wife, but did not change the BDF for the IRA. They were not yet divorced when he died. His residuary beneficiaries sought a holding that his will effectively changed the BDF. The court rejected the claim, as the will did not make an unambiguous disposition of the IRA, as required by earlier cases.

125. *See*, for instance, *McCarthy v. Aetna Life Ins. Co.*, 92 N.Y.2d 436 (1998); *Freedman*, 116 F. Supp. 3d 379. *See also Silber v. Silber*, 2003 N.Y. LEXIS 159 (N.Y. 2003) (holding that QDRO agreement effectuated a sufficiently specific waiver of former wife's right to death benefits).

126. EPTL 5-1.1-A(b)(1)(G).

127. EPTL 5-1.1-A(b)(1)(G).

128. For instance, in *McCarthy*, 92 N.Y.2d 436, the decedent had named his ex-wife as beneficiary of an insurance policy. A later will left all "insurance proceeds" to his father, but the beneficiary designation was never changed. The court held that the ex-wife was entitled to the proceeds because there was insufficient evidence of an intent to change the beneficiary. In the context of an ERISA-covered pension or welfare plan, the situation is complicated by the anti-alienation and QDRO rules and the general preemption of state law.

129. Code § 401(a)(11); ERISA § 205(a), 29 U.S.C. § 1055(a). However, the plan may, without participant consent, cash out benefits whose present value is $5,000 or less, in lieu of providing an annuity. Code § 417(e)(1), ERISA § 205(g)(1), 29 U.S.C. § 1055(g)(1). Also, the plan may require the participant and the spouse to have been married throughout the one-year period ending on the earlier of the participant's death or the participant's annuity starting date. Code § 401(a)(11)(D); ERISA § 205(b)(4), (f), 29 U.S.C. § 1055(b)(4), (f).

130. Code § 417(b); ERISA § 205(d), 29 U.S.C. § 1055(d).

131. Code § 417(a)(3), ERISA § 205(c)(3), 29 U.S.C. § 1055(c)(3).

132. Code § 401(a)(11)(B)(iii); ERISA § 205(b), 29 U.S.C. § 1055(b).

133. Code § 401(a), flush language.

134. The term "governmental plan" is defined in Code § 414(d) and ERISA § 3(32), 29 U.S.C. § 1002(32.

135. The term "church plan" is defined in Code § 414(e) and ERISA § 3(33), 29 U.S.C. § 1002(33). A church employer may elect that its retirement plans be subject to the Code's participation, vesting, funding, etc. rules [Code § 410(d)]. The term "non-electing church plan" describes a plan for which the election has not been made. Few churches have so elected.

136. *See* Code §§ 403(b)(1)(E), 403(b)(10), 403(b)(12)(A)(i).

137. ERISA §§ 4(b)(1), (2), 29 U.S.C. §§ 1003(b)(1), (2).

138. 29 C.F.R. § 2510.3-2(f).

139. For disqualification as surviving spouse, see EPTL 5-1.2.

140. In *Estate of Rhoades*, 607 N.Y.S.2d 893 (Sup. Ct. 1994), the court held that a New York resident could disinherit a spouse by moving out of state. In *In re Schwarzenberger*, 626 N.Y.S.2d 229 (App. Div. 1995), the court held that there was no New York right of election because the decedent was domiciled in Florida.

141. The right of election is not available to the spouse of a decedent who was not domiciled in the state at the time of death, unless the decedent has elected, under EPTL 3-5.1(h), to have the disposition of his or her property situated in New York governed by New York law [EPTL 5-1.1-A(c)(6)].

142. "In order to discharge his fiduciary duty to treat the estate's beneficiaries impartially, the executor of the decedent's estate should typically fund the surviving spouse's elective share with assets that are representative of the assets of the estate." Preminger *et al.*, Trusts and Estates Practice in New York (West) at para. 6:75. By contrast, under the Uniform Probate Code, the amount of the elective share depends upon the length of the marriage. U.P.C. § 2-202 (1990).

143. *Matter of Daniello*, N.Y.L.J., Nov. 28, 2000, at 27 (Sur. Ct., Bronx Co.). *See also* EPTL 5-1.1-A(c)(2) ("Except as otherwise expressly provided in the will or other instrument making a testamentary provision, ratable contribution to the share to which the surviving spouse is entitled shall be made by the beneficiaries and distributees (including the recipients of any such testamentary provision), other than the surviving spouse, under the decedent's will, by intestacy and other instruments making testamentary provisions, which contribution may be made in cash or in the specific property received from the decedent by the person required to make such contribution or partly in cash and partly in such property as such person in his or her discretion shall determine.")

144. EPTL 5-1.1-A(d).

145. EPTL 5-1.1-A(b)(4).

146. Code § 414(p)(1)(B)(ii); ERISA § 206(d)(3)(B)(ii), 29 U.S.C. § 1056(d)(3)(B)(ii).

147. EPTL 5-1.1-A(b)(1)(G).

148. EPTL 5-1.1-A(b)(1)(G).

149. Treas. Reg. 1.401(a)(9)-4, Q & A 1.

150. 67 FR 18990 (Apr. 17, 2002). It is not clear what the result would be if the plan (unusually) provided specifically for a beneficiary designation to be made in the participant's will.

151. *Estate of Cohen*, N.Y.L.J. Jan. 22, 2001, at 21 (Sur. Ct., N.Y. Co.).

152. Treas. Reg. 1.401(a)-20, TD 8219, 8/19/88, Q & A 3(d).

153. EPTL 5-1.1(e)(2).

154. *Will of Boyd*, 613 N.Y.S.2d 330 (Sur. Ct., Nassau Co. 1994); *In re Callaghan*, N.Y.L.J., Sept. 23, 1994, p. 21, col. 6 (Sur. Ct., Dutchess Co. 1994).

155. Under the Uniform Probate Code, life insurance proceeds are included in the augmented estate, as are annuity contracts purchased during marriage. UPC § 2-205 (1990) and Comment, Example 13.

156. EPTL 5-1.1-A(b)(1)(G).

157. *In re Farlow*, 174 Misc. 2d 629, 666 N.Y.S.2d 388 (Sur. Ct., Monroe Co. 1997).

158. *Estate of Alent*, 709 N.Y.S.2d 902 (4th Dep't 2000).

159. EPTL 5-1.1-A(b)(1).

160. *Estate of Saperstein*, 678 N.Y.S.2d 618 (1st Dep't 1998).

161. EPTL 5-1.1-A(e).

162. *In re Le Roy*, 461 N.Y.S.2d 161 (Sur. Ct., Onondaga Co. 1983).

163. *In re Sunshine*, 369 N.Y.S.2d 304 (N.Y. Co. 1975), *rev'd*, 381 N.Y.S.2d 260 (1st Dep't 1976), *aff'd*, 389 N.Y.S.2d 344 (1976).

164. EPTL 5-1.1-A(e)(4).

165. T.D. 8620, 1995-41 IRB 25. *See also* "Private Pensions: Spousal Consent Forms Hard to Read and Lack Important Information," GAO/HRD-90-20, Dec. 27, 1989.

166. Notice 97-10, 1997-2 IRB 1.

167. For additional rules relating to waivers under the Code and ERISA, see Treas. Reg. 1.401(a)-20, Q & A 27 (circumstances when consent is not required), 28 (consent in a prenuptial agreement does not satisfy the rules) and 29 (consent by a spouse does not bind a later spouse).

168. ERISA § 514, 29 U.S.C. § 1144.

169. The term "employee benefit plan" includes employee pension benefit plans and employee welfare benefit plans. ERISA §§ 3(1), (2), (3), 29 U.S.C. §§ 1002(1), (2), (3). Certain categories of plans, including governmental plans and church plans, are exempt from ERISA. ERISA § 4(b), 29 U.S.C. § 1003(b).

170. *Hisquierdo v. Hisquierdo*, 439 U.S. 572 (1979).

171. EPTL 5-1.1-A(b)(7).

172. 520 U.S. 833 (1997). For discussions of *Boggs*, see Tony Vecino, Note: Boggs v. Boggs: *State Community Property and Succession Rights Wallow in ERISA's Mire*, 28 Golden Gate U. L. Rev. 571 (1998); Alvin J. Golden, *A Preliminary Analysis of* Boggs v. Boggs—*and the Problems It Does Not Answer*, 23 ACTEC Notes 139 (1997); Boggs v. Boggs *Holds That a Predeceasing Nonparticipant Spouse Has No Property Interest in an ERISA Pension Plan*, 6 no. 3 ERISA Lit. Rptr. 4 (Aug. 1997); Philip H. Wile, Boggs v. Boggs: *The Good News and the Bad News*, 76 no. 5 Tax Notes 679 (1997).

173. *New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 514 U.S. 645 (1995).

174. In *Guidry v. Sheet Metal Workers' Int'l Assn., Local No. 9*, 10 F.3d 700 (1993), *aff'd en banc*, 39 F.3d 1078 (1994), the 10th Circuit held that the ERISA anti-alienation rule protects plan benefits against claims of creditors only as long as the benefits are held in an ERISA plan. *Accord, Trucking Employees of New Jersey Welfare Fund, Inc. v. Colville*, 16 F.3d 52 (3d Cir. 1994).

175. UPC § 2-804(h)(2).

176. John H. Langbein & Bruce A. Wolk, Pension and Employee Benefit Law, Foundation Press, 3d ed., 2000, at 617.

177. *Estate of Cohen*, N.Y.L.J., Jan. 22, 2001, at 21 (Sur. Ct., N.Y. Co.).

178. *See, e.g.*, EPTL 5-1.4.

179. UPC § 2-804(b).

180. *Egelhoff v. Egelhoff*, 532 U.S. 141 (2001). *See also Melton v. Melton*, No. 02-2984 (7th Cir., Apr. 8, 2003); *Hansmann v. Fidelity Invs. Institutional Servs. Co.*, No. 01-1499/1866 (6th Cir., Apr. 10, 2003); Egelhoff v. Egelhoff: *the Supreme Court More or Less Stands Pat on Preemption*, 9 no. 1 ERISA Lit. Rptr. 3 (Apr. 2001).

181. *See* Department of the Treasury, General Explanations of the Administration's Fiscal Year 2004 Revenue Proposals, Feb. 3, 2003 ("General Explanations"), *reprinted in* Tax Notes Today, Feb. 4, 2003, 2003 TNT 23-11; Joint Committee on Taxation, "Description of Revenue Provisions Contained in the President's Fiscal Year 2004 Budget Proposal" (JCS-7-03), March 2003, *reprinted in* Tax Notes Today, Mar. 7, 2003, 2003 TNT 45-16 ("JCT Description").

182. "President's Budget Proposes Bold Tax-Free Savings and Retirement Security Opportunities for All Americans," Department of the Treasury, Office of Public Affairs, Jan. 31, 2003 ("Office of Public Affairs Statement").

183. *Id.*

184. Edmund L. Andrew, *Bush's Plan for Pensions is Now Given Low Priority*, N.Y. Times, Feb. 26, 2003.

185. Treasury spokeswoman Tara Bradshaw, as quoted in Amy Hamilton, *House Panel Approves Post-Enron Pension Reform Bill*, Tax Notes, Mar. 10, 2003, at 1501; *see also Olson Promotes Bush's Tax-Free Savings Plans*, Tax Notes Today, Mar. 11, 2003, 2003 TNT 47-4.

186. *See* General Explanations, note 179 *supra*, at paras. 414 *et seq.*

187. Code § 25B.

188. Code § 25B(d)(2).

189. General Explanations, note 179 *supra*, at para. 419. The proposal would not affect the ability to contribute to a MSA, ESA or QSTP.

190. General Explanations, note 179 *supra*, at para. 416.

191. General Explanations, note 179 *supra*, at paras. 417 *et seq. See also* Patrick J. Purcell, "Retirement Savings Accounts: President's Budget Proposal for FY 2004," CRS Report for Congress, Mar. 2003; *Treasury's Sweetnam Explains Plans to Simplify Retirement Savings*, Tax Notes Today, Mar. 11, 2003, 2003 TNT 47-6.

192. Office of Public Affairs Statement, *supra* note 182.

193. Code § 25B(d)(2).

194. General Explanations, note 179 *supra*, at para. 418.

195. General Explanations, note 179 *supra*, at para. 420.

196. General Explanations, note 179 *supra*, at paras. 117, 118.

197. General Explanations, note 179 *supra*, at paras. 442 *et seq.*

198. Office of Public Affairs Statement, *supra* note 182.

199. The effective date for Roth contributions to ERSAs would be moved up to 2004 from 2006. General Explanations, note 179 *supra*, at para. 450.

200. *See* section 26 of text *infra*.

201. General Explanations, note 179 *supra*, at para. 458.

202. *Portman and Cardin Rolling Out Savings Simplification Bill*, Tax Notes Today, Apr. 11, 2003, 2003 TNT 70-3.

203. Code §§ 132(a)(7), (m).

204. Code § 132(m)(2).

205. EGTRRA Conference Report at page 189.

206. Code § 132(m)(3), referring to section 219(g)(5).

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Posthumous Conception and Inheritance Rights

By Gail Goldfarb

"As science races ahead, it leaves in its trail mind-numbing ethical and legal questions. The law, whether statutory or decisional, has been evolving more slowly and cautiously."[1] Over the last several decades, scientific advances have made it possible for a living person to parent a child using a deceased partner's frozen sperm, eggs or a previously fertilized and subsequently frozen embryo or pre-embryo.[2] The scarce case law as well as the statutory law in the several states of this country are ill-equipped to deal with the myriad issues this new technology presents. Such issues include, but certainly are not limited to: first, whether this genetic material is susceptible to bequest or gift to a loved one for use at a later date to parent a child; second, what the status of such afterborn child is; and third, what rights of inheritance from their biological parents these children have. Intertwined with a posthumously conceived child's right to inherit is the child's right to Social Security survivor benefits, worker's compensation awards, and wrongful death awards under various state and federal statutes. This article will examine these issues in general, and then specifically evaluate statutory and case law in New York, in light of Supreme Court precedent and pertinent judicial decisions in other states, in an attempt to determine whether or not a posthumously conceived child may inherit in intestacy in New York under current law.

"'As science races ahead, it leaves in its trail mind-numbing ethical and legal questions. The law, whether statutory or decisional, has been evolving more slowly and cautiously.'"

Two technologies that enable a surviving spouse or partner to posthumously conceive a child are artificial insemination and in vitro fertilization (IVF). Artificial insemination, the oldest and most common form of reproductive technology, involves collection of the male donor's sperm, which may be cryopreserved ("frozen") for ten years or longer.[3] This frozen sperm may then be thawed and inserted in the mother's uterus while she is ovulating, thereby allowing a surviving spouse or partner to parent a child with her loved one many years after his death.[4] IVF, a newer and somewhat less common technology, involves removal of a female's eggs during a normal menstrual cycle or after hormonal stimulation. These eggs are then combined with the male donor's sperm in a culture dish and incubated until a zygote or pre-embryo of between two and eight cells (a blastomere) develops, which can then either be implanted in the female's uterus or cryogenically preserved for use hundreds of years later.[5] Unlike artificial insemination, IVF will allow a surviving spouse or partner of either sex to parent a biological child of the couple many years after the death of one spouse or partner. IVF, however, involves additional issues such as the rights of the gestational mother and the validity of surrogacy contracts which will not be addressed in this article.

Prior to addressing the status of children born of these reproductive technologies and their respective rights of inheritance, it is necessary to determine the rights individuals have in their genetic material. In order for a surviving spouse or partner to be able to use the deceased partner's genetic material or jointly owned pre-embryos to parent a child posthumously, the deceased partner must be able to pass this material to the survivor for such use. While states lack statutory law in this area, several innovative judicial decisions have attempted to fill the void.[6] Additionally, although courts historically have been reluctant to recognize a property interest in a person's body, body parts or tissue, certain courts have recognized a "quasi-property" interest in an individual's gametes.[7] The first case to decide the issue of an individual's property interest in his or her gametes arose in France. In 1984, the French Tribunal de Grand Instance decided *Parpalaix v. CECOS*, wherein a just-married surviving spouse requested her deceased husband's sperm from Centre d'Etude et de Conservation du Sperm (CECOS), where it had been deposited by him.[8] Because the deceased husband/sperm donor had failed to leave any instructions for the disposition of his sperm, which had been deposited with CECOS before he and his surviving spouse were married, Corrine (the surviving spouse) and her in-laws based their legal argument for return of the sperm on article 1939 of the French Civil Code, which provided that on the death of the bailor, the heirs were entitled to have the bailment property returned to them.[9] The French court, although ultimately resolving the issue in favor of Corrine and her in-laws, declined to rule that the sperm was movable property subject to inheritance.[10] The court, describing sperm as "the seed of life . . . tied to the fundamental liberty of a human being to conceive or

not to conceive," decided that the disposition of the sperm must turn on the intent of the sperm donor and that the deceased spouse had intended that Corrine bear his child.[11]

Similarly, in 1992, the Tennessee Supreme Court, in a divorce custody battle, was required to decide the disposition of cryopreserved pre-embryos stored in a Knoxville fertility clinic which had been created from a husband's and wife's gametes during an earlier and happier stage of their marriage.[12] The court decided that the pre-embryos were neither property nor human life, but that they occupied an interim category of potential life deserving of special respect.[13] After assigning this "quasi-property" label to the pre-embryos, the court held that the couple, as progenitors, had an interest in the ownership of the pre-embryos to the extent that they had decision-making authority concerning their disposition.[14] In dictum, the *Davis* court stated that the intent of the couple should govern disposition of these gametes. But because, in this instance, there had been no dispositional agreement from which to discern the intent of the couple, the court was forced to weigh the procreative rights of each party, deciding that the father's right not to procreate would override the wife's desire to donate the pre-embryos to a childless couple.[15]

Thereafter, in 1993, for the first time in the United States, the Court of Appeal of California, Second Appellate District, Division Seven, was forced to address the issue of the rights of a female to the sperm of a decedent.[16] The petitioner, Deborah Hecht, girlfriend of decedent William Kane, sought a writ of prohibition to vacate a Superior Court order directing destruction of the decedent's sperm, which was being cryogenically stored at and which was under the control of California Cryobank, Inc.[17] The decedent, William Kane, before taking his own life, had deposited his sperm with the sperm bank, authorizing its release to Hecht, her physician and the executor of his estate.[18] Additionally, Kane had also executed a will, bequeathing the stored sperm to Hecht, and indicating his wish that Hecht become impregnated with his sperm.[19] The sperm bank refused to release the sperm to Hecht, and Kane's grown children tried to prevent release of the sperm to Hecht, arguing that it should be destroyed.[20] Citing *Davis*, the court similarly ruled that the sperm occupied an interim category of property, entitling it to special respect, and that the decedent had an interest in the nature of ownership to the extent that he had decision-making authority over the sperm.[21] Relying on the *Davis* and *CECOS* cases, the court looked to the decedent's intent to posthumously father a child with Hecht as the deciding factor.[22] Having decided that Kane had indeed manifested his intent to posthumously father a child with Hecht and that there was, therefore, no need to weigh each party's procreative rights, the court reversed the lower court's order to destroy the sperm, remanding the case for determination of the will's validity and hence the right of Hecht to the sperm.[23] Because there was a signed a global settlement governing the disposition of all estate assets between Hecht and Kane's children, a probate judge decided that the sperm was included in this settlement entitling Hecht to twenty percent of all assets, and awarded her three of the fifteen sperm vials.[24] However, Hecht was unable to conceive and returned to the California Appeals Court to request the balance of the sperm. In this later proceeding, the court ordered the distribution of the remaining vials of Kane's sperm to Hecht, finding that Kane's right to procreate could not be defeated by a settlement contract that Hecht and Kane's children had signed.[25]

Then, in 1998, the New York Court of Appeals, during the pendency of a divorce proceeding, had the opportunity to decide the disposition of pre-embryos created by a couple during marriage and cryogenically stored.[26] The Court, affirming an appellate division ruling and adopting its reasoning, held that the couple was bound by their prior joint unequivocal intent to donate the pre-embryos to the IVF program for research in the event of unforeseen circumstances, as manifested by the consent agreements they had both signed with the IVF facility.[27] Relying to some degree on the *Davis* decision, the Court held the parties' intent regarding the disposition of the pre-embryos to be the controlling factor, and that because there had been manifestation of such intent in this case, it was therefore unnecessary to weigh the wife's fundamental right to procreate against the husband's fundamental right not to procreate.[28]

Contrary to sparse prior precedent, in 2000, the Massachusetts Supreme Judicial Court, in a decision incident to a divorce proceeding, refused to enforce a prior consent agreement signed by the couple while married, to return the frozen pre-embryos to the wife for implantation.[29] However, unlike the New York case, each time eggs were removed from the wife, the husband would sign a blank consent form which the wife would then complete and sign.[30] Reasoning that the consent form did not represent the true intent of both partners, and noting the husband's current opposition to implantation of the pre-embryos in his former wife, the court held that it would not enforce an agreement that would compel one donor to become a parent against his will.[31] Like the *Hecht*, *Davis*, and *CECOS* cases, the court based its decision

on the intent to become a parent, finding the fundamental right not to procreate outweighed the fundamental right to procreate. Similarly, in 2001, the New Jersey Supreme Court, in a proceeding subsequent to a couple's divorce, refused to allow unused pre-embryos to be donated to a childless couple, holding that it would not force the wife to become a biological parent against her will.[32] The New Jersey court, in dictum, however, stated that it would enforce agreements entered into at the time of IVF, subject to the right of either party to change their mind until the pre-embryos were either destroyed or used.[33] Neither this court nor the Massachusetts court discussed the issue of classification of pre-embryos as property or "quasi-property."

". . . since apparently the road to posthumous parenthood has been or will be, at least, technologically and judicially opened, it is necessary to determine what the status of these posthumously conceived children will be."

To date, it appears that the courts which have addressed the issue of the right to dispose of gametes have uniformly held that this genetic material is "quasi-property," subject to the owner's decisional authority. Since these gametes are "quasi-property," they may be left by their owner or owners by will or other testamentary substitute or transferred by gift to an individual of the owner's choice to enable the devisee or donee to parent the biological child of the deceased gamete owner. It is equally clear, however, that the courts will require that the gamete donor(s) have evinced a clear and unambiguous intent to posthumously parent a child. This requirement is seen as necessary because the decision to procreate or not is classified as a fundamental right, and courts are reluctant to force individuals to become biological parents against their will. The legislatures of the various states must address this issue and provide statutory law to enable the smooth and orderly devise or gift of such genetic material to avoid the necessity of case-by-case decisions by the courts. Additionally, a form containing a substantively complete consent to posthumous parenthood with a specific individual must be agreed upon in order to alleviate any question of the intent of the deceased gamete owner.

In the meantime, since apparently the road to posthumous parenthood has been or will be, at least, technologically and judicially opened, it is necessary to determine what the status of these posthumously conceived children will be. Historically, a distinction has been drawn between children born of a lawful marriage and children born outside the marital relationship, denying to nonmarital children the same benefits and protections afforded marital children.[34] Because, in addition to unmarried partners taking advantage of this new technology, the death of one spouse terminates the marital relationship, posthumously conceived children are necessarily always classified as nonmarital children.[35] The common law of England, from which our law stems, denied any rights to nonmarital children, describing them as *filius nullis*, nobody's child, kin to no one. They were not even considered the lawful children of their mother and were unable to inherit even from her.[36]

The rights accorded nonmarital children over the years have been vastly broadened as a result of various federal and state statutory enactments and decisions of the United States Supreme Court which have increasingly minimized the common law's discriminatory treatment of nonmarital children. The various Supreme Court decisions have held that nonmarital children are not "nonpersons," that they should not be denied rights solely because of their birth out of wedlock, and that they are persons entitled to the protection of the Due Process and Equal Protection Clauses of the Fourteenth Amendment.[37] Further, understanding that throughout the ages, the status of illegitimacy has expressed society's condemnation of liaisons outside the marital relationship, the Court has strongly reiterated the growing societal belief and public policy that visiting this condemnation on these innocent children and thereby penalizing them is unjust and unfair because these children are in no way responsible for their birth.[38] Additionally, the Court has consistently held that any statutory classification singling out nonmarital children must bear a reasonable relation to the purpose of the applicable statute.[39] The Supreme Court has even suggested that the test of equal protection for nonmarital children should be the biological relationship, rather than the legal relationship.[40] Among the various rights and benefits accorded nonmarital children by the Court, along the way to attaining parity with marital children, are: inclusion in wrongful death awards;[41] inclusion in receipt of worker's compensation benefits;[42] inclusion in receipt of assistance to families of the working poor;[43] and the ability under certain statutorily controlled circumstances to inherit from their father.[44]

Additionally, various state court decisions have reflected a growing trend in public and social policy to protect nonmarital children and to allow them the

same benefits and rights as children born of lawful marriages. For example, a New York appellate court, opining that a rigid adherence to precedent would produce a result not warranted by facts, rejected the longstanding rule that the unqualified word "issue" in a will would be construed to mean only lawful descendants and held that it would, henceforth, be interpreted to include both marital and nonmarital descendants.[45] Another New York court, while noting the evolving trend of the law to extend equality to all children and that the relationship of a biological father to his child arose from the law of nature and not from statute, held that a newly amended intestacy statute retroactively applied to proceedings pending at its effective date in order to give the child an opportunity to prove the paternity of his deceased father.[46]

Moreover, in Massachusetts, as far back as 1907, the Supreme Judicial Court discussed the evolving legislative enactments designed to recognize the rights of innocent nonmarital children who have no control over the circumstances leading to their birth.[47] This evolution was moving nonmarital children closer to equality with children born of lawful marriages and bringing the law "into harmony with the humane spirit of the civil law and of modern times and freed from the policy of the early common law. . . . "[48] Further, in 1987, a Massachusetts appellate court finding that United States Supreme Court precedent regarding discriminatory treatment of nonmarital children, would result in a then-applicable Massachusetts statute allowing support orders for parents of marital children until age 21 under certain conditions, but cutting off support for nonmarital children at 18 would result in an unconstitutional denial of equal protection of the laws to nonmarital children.[49] Additionally, the Massachusetts Supreme Judicial Court later held that the protection of minor children, who may be stigmatized by their nonmarital status, required a ruling that the responsibility of the father to support such a child, who he had disinherited, did not abate upon his death, and that the claim for the child's support was in the nature of a preferred creditor's claim and must be satisfied prior to any testamentary dispositions.[50] Likewise and in concert with a public and social policy to protect nonmarital children, a New Jersey appellate court, abiding by that state's policy of construing legitimization statutes liberally in order to spare innocent children from being burdened with the stigma of illegitimacy, construed a state statute to allow a void and bigamous common law marriage to legitimize the child born to the partners.[51] These cases represent only a small sampling of the growing trend of the judiciary, mindful of public policy, to both protect nonmarital children and to attempt to accord them equality with marital children. Additionally, the common law notion that nonmarital children are a legal nonentity is increasingly being replaced with statutes according them rights and benefits equal to or on a par with marital children. Although these trends will ease the way to acceptance of and integration into society and our legal system of posthumously conceived children, there are still major hurdles they must overcome.

One such hurdle to according these increased rights and benefits to nonmarital children is necessarily a determination that the decedent is the biological parent of the posthumously conceived child and that he or she intended to be legally responsible for the support of such child. Because the common law accorded no rights to nonmarital children, and because of the inherent possibility of fraudulent claims, any declaration or adjudication of paternity and the consequent rights and benefits inherent in such a finding, can be made possible only by statutes enacted by the several states. Posthumously conceived children will necessarily always have to prove the paternity of their biological father and will have more limited means by which to do so than nonmarital children whose fathers are still living. In addition to being influenced by the liberalizing effects of modern social and public policy, these various state paternity statutes are bound by United States Supreme Court equal protection jurisprudence.[52] For instance, the Court, striking down a six-year statute of limitations for paternity actions incident to support orders in Pennsylvania, held that it was not substantially related to Pennsylvania's interest in avoiding the litigation of stale or fraudulent claims because in a number of other circumstances Pennsylvania allowed the issue of paternity to be litigated more than six years after the birth of the nonmarital child.[53] Additionally, the Court, after discussing shorter statutes of limitation it had held unconstitutional, stated that six years did not necessarily provide a reasonable opportunity for a mother to assert a claim on behalf of a nonmarital child.[54] Posthumously conceived children, because of the circumstances of their birth, will benefit from mandated longer statutes of limitations to bring paternity actions for support and for the purpose of intestate inheritance.

Furthermore, the common law rule that proceedings, including paternity proceedings, abate on the death of the father must be addressed by the state statutes in order to allow findings of paternity after the death of the putative father, which will necessarily always be the case with posthumously conceived children.[55] New York enacted such a statute in 1987, allowing continuation after death of a paternity action that a putative father had initiated, or if the

putative father had acknowledged paternity of the child in open court, or if a genetic marker or DNA test had been administered to the putative father prior to his death, or if the putative father had openly and notoriously acknowledged the child as his own.[56] In New York, as the statute stands, an individual who intends to posthumously parent a child must, therefore, have the results of a DNA or genetic marker test on file, in order to have a posthumous order of filiation issued in Family Court. Accordingly, in 1979, prior to New York's statute authorizing paternity actions after the death of the father, the New York Family Court, Queens County, although sympathetic to the plight of the child in question, dismissed such a paternity proceeding, rather than engage in judicial legislating.[57] Several other New York courts, however, in keeping with the judiciary's inclination to protect nonmarital children and prior to amendment of the Family Court Act, exhibited some innovative and progressive reasoning to enable them to enter orders of filiation after the death of the putative father—for example, facilitating standing to inherit intestate or the ability to collect Social Security dependent child benefits.[58]

"In concert with . . . [the] growing social policy of equality for nonmarital children and the advent of innovative reproductive technology, New York courts have used creative and progressive reasoning to accord every possible benefit to these children, sometimes regardless of current statutory law."

Similarly, a New Jersey appellate court, after construing a section of the Uniform Parentage Act the state had enacted, which made no specific provision for continuation of a paternity support action after the father's death, concluded that the "liberal construction which should be afforded the statute to reach its beneficial ends permitted support orders for minors who survive the parent."[59] The Uniform Parentage Act was originally drafted and has been amended several times by the National Conference of Commissioners of Uniform State Laws, because much of the then-current state law on the subject of nonmarital children had been declared unconstitutional by the United States Supreme Court because of its discriminatory treatment of nonmarital children.[60] The Act strives to ensure, regardless of the marital status of the parents, that children and parents have equal rights with respect to each other and with regard to most areas of substantive law.[61] The Act is one more example of the evolving movement to implement a social and public policy of equality between marital and nonmarital children by completely removing the stigma that the status of nonmarital child once carried.

In concert with this growing social policy of equality for nonmarital children and the advent of innovative reproductive technology, New York courts have used creative and progressive reasoning to accord every possible benefit to these children, sometimes regardless of current statutory law. For instance, a Monroe County Family Court used the theory of equitable estoppel to prevent a transvestite domestic partner from abrogating support obligations to a child conceived by artificial insemination agreed to by both partners and who they both agreed to support.[62] In another Family Court case, the court allowed posthumous DNA tests on the frozen blood of a murdered security guard to prove his paternity after the death of a child he had fathered outside of his marriage.[63] Although the court thought posthumous DNA tests were admissible and urged the legislature to amend Family Court Act § 519 to allow them as proof of paternity, it based its holding on the fact that the father had openly and notoriously acknowledged his paternity.[64] Similarly, a Nassau County Family Court allowed blood test results taken three years earlier for a different paternity proceeding to be admitted in a posthumous paternity proceeding where none of the other four subdivisions of Family Court Act § 519 applied, finding no precedent or evidence to support the widow's motion to dismiss.[65] This trend and these innovative precedents pave the way to enabling posthumous orders of filiation to be issued and facilitate entitlement to other rights and benefits for posthumously conceived children.

Notwithstanding this developing social and public policy endeavoring to equalize marital and nonmarital children, and the Supreme Court's equal protection jurisprudence on behalf of nonmarital children, the several states' rights to regulate the disposition of property upon death has been fiercely guarded. Every state has statutory law which governs the disposition of property when an individual dies intestate. These statutes outline who may inherit from an individual who dies intestate, in what order and in what proportion they may inherit. These statutes also distinguish between marital and nonmarital children, most allowing nonmarital children to inherit from their mothers in all circumstances and allowing nonmarital children to inherit from their putative fathers after proving paternity under varying statutorily enumerated conditions. Some states

have separate sets of statutes for paternity determinations for purposes of child support as opposed to adjudications of paternity for the purposes of intestate succession. Posthumously conceived children, being deemed nonmarital children, will, therefore, necessarily have to prove the paternity of their deceased fathers under the applicable statutory schemes in order to be able to inherit from a predeceased father.

The United States Supreme Court has addressed this issue three times within a span of seven years with no apparent consistency in its rulings. The first time was in 1971, when the constitutionality of Louisiana's intestate succession statute in regard to nonmarital children was before the Court.[66] Louisiana's law provided that a nonmarital child could only be legitimated if the parents, at the time of conception of the child, could have contracted marriage.[67] A legitimated child could then inherit by will, but could not inherit in intestacy unless no ascendant or descendant of the parent existed, and a child who could not be legitimated could not inherit at all, either by will or in intestacy.[68] The Court, although not endorsing Louisiana's statutory solution, upheld its constitutionality, stating that only the legislature of a particular state had the power to make rules to establish, protect and strengthen family life and regulate the disposition of property upon death, and concluded that this particular statutory scheme did not present an insurmountable barrier to inheritance for the nonmarital child.[69]

The second time that the Court addressed the issue was in 1977, this time declaring the Illinois intestacy statute unconstitutional.[70] The Court held that this state's interest in providing for stability in land titles and determination of valid ownership of property upon death could not make constitutionally acceptable a statute which allowed a nonmarital child to inherit from his or her mother, but only allowed inheritance from the father if the parents intermarried and the father subsequently acknowledged the child.[71] In discussing the Illinois Supreme Court's assertion that the distinction in its intestacy statute was rationally related to the increased difficulty in proving paternity and the associated assertion of spurious claims, the Court opined that a more demanding standard for allowing nonmarital children to inherit from their father as opposed to from their mother or as opposed to marital children inheriting from either parent would be understandable and acceptable.[72] The problem with the Illinois statute, according to the Court, was that it was too extreme, foreclosing an entire group of nonmarital children from inheriting, even though they could possibly inherit from their fathers without jeopardizing the state's proper objectives of assuring accuracy and efficiency in the disposition of property at death.[73] The apparent inconsistency in the Court's finding the Louisiana statute constitutional, although it appears more preclusive than the Illinois statute subsequently found unconstitutional, is difficult to rationalize and could lead to confusion among the states as to where the line between constitutionally permissible and impermissible discrimination towards nonmarital children could be located.

Last of the trio to be decided by the Court was the issue of the constitutionality of New York's EPTL 4-1.2, which delineates the conditions under which a nonmarital child may inherit.[74] At the time of the decision, New York's statute provided that a nonmarital child could inherit from his or her mother at all times, and from his or her father, if an order of filiation declaring paternity had been made during the lifetime of the father.[75] Discussing New York's considerable interest in the just and orderly disposition of property at death, the inherent difficulty of proving paternity, and the careful consideration the statute was given before its enactment by the Bennett Commission, the Court upheld the constitutionality of EPTL 4-1.2.[76] The New York statute has since been amended and liberalized to add certain other conditions under which nonmarital children can inherit from their fathers.[77] This holding further blurs the point beyond which discrimination against nonmarital children will be deemed unconstitutional; however, what is clear is that states will be afforded considerable deference to their intestacy statutory schemes, thereby precluding nonmarital children from achieving equality with marital children in this area and preventing them from realizing all of the rights and benefits they have been accorded in other areas of the law. Additionally, it is also clear that intestate inheritance by posthumously conceived children will necessarily be a state-specific issue, leaving it up to the judiciary and legislatures of each state to formulate policy and law regarding such inheritance.

The newly amended Uniform Parentage Act attempts to provide some guidance for state courts and a model for state legislatures regarding the issue of posthumously conceived children, even though an earlier version has been enacted by only a minority of states.[78] For example, section 509 of the Act specifically provides for posthumous genetic testing, indicating that this section is intended to give a state court authority to order disinterment of a deceased individual to establish paternity.[79] Section 707 of the Act, however, is the only section to directly address the issue of posthumous conception, something which state intestacy statutes do not even contemplate. This section provides that the death of a spouse whose genetic material, i.e., eggs, sperm, or embryo, is subsequently used or implanted, effec-

tively ends the potential parenthood of the decedent, unless the decedent had specifically consented in a record to parent the posthumously conceived child.[80] Further, the comment to the section states that it was designed to avoid the problems of intestate succession which could occur if the deceased were determined to be a parent of the posthumously conceived child, adding that the deceased spouse could explicitly provide for such children in his or her will. Section 707 appears to allow for posthumous adjudications of paternity provided that the deceased parent leaves a clear indication of his or her intention to parent a child posthumously, while foreclosing such an adjudication absent a record of the deceased parent's intent. As in the case law addressing ownership and descent of genetic materials, intent appears to be an important factor. Whether states will allow such a posthumous adjudication of paternity and subsequent intestate inheritance by these posthumously conceived children is a matter of state-specific statutory law and judicial interpretations of that law, keeping in mind the considerable deference afforded state intestacy statutes by the Supreme Court.

To date, there have been only two state court cases which have adjudicated the issue of the heirship of posthumously conceived children, one in New Jersey and one in Massachusetts. In both cases the declaration of the posthumously conceived children's heirship was necessary for their entitlement to Social Security survivor benefits. In order for children to receive Social Security survivor benefits, they must prove paternity and dependency on the deceased wage earner. For marital children paternity and dependency are presumed, while for nonmarital children, paternity and dependency can be proved by meeting one of the formal methods outlined, including a formal adjudication of paternity or a live putative father's acknowledgment by certain enumerated methods, or can be presumed if the applicant is entitled to inherit under state intestacy laws.[81] The Supreme Court has upheld the constitutionality of the classifications and presumptions under the Social Security Act and their discriminatory effect on nonmarital children.[82]

The first, a decision handed down by the Probate Part of the New Jersey Superior Court, involved a young married couple who had harvested the husband's sperm and deposited it with a New Jersey sperm bank after he was diagnosed with leukemia.[83] The husband subsequently died, and the surviving spouse authorized release of his sperm almost a year after his death so that an IVF procedure could be performed with her eggs which had been withdrawn.[84] The procedure was successful and resulted in the birth of twin girls eighteen months after the husband's death. Social Security survivor benefits had been applied for on behalf of the twin girls, preliminarily denied and were in the appeals process.[85] The surviving spouse, in the instant case, was seeking a declaration from the court that her posthumously conceived children could be the intestate heirs of the deceased husband under New Jersey law, so that the girls would be eligible for the Social Security survivor benefits.[86] Although urged not to adjudicate the case by the state, the court felt compelled to determine what New Jersey law was, rather than leave it to a federal tribunal to determine.[87] The court, after discussing the traditional rule that heirs were determined as of the decedent's date of death and the New Jersey statute dealing with afterborn heirs which provides that relatives conceived before the decedent's death, but born after, inherit as if they had been born in the lifetime of the decedent, reasoned that although it was necessary to promptly identify persons qualified to inherit and thereafter to deliver their property, there were statutory instances where determination of heirs had to await the birth of a child *en ventre sa mere*.[88] Further, the court reasoned that when the legislature had enacted the afterborn statute they were not giving any thought to posthumously conceived children and therefore, it looked to the general intent the legislature had manifested that the children of a decedent should be amply provided for, subsequently deciding that this general intent should prevail over a literal, restrictive reading of the statute.[89] The court also discussed the necessity of a legislature imposing time limitations on the length of time after a decedent's death a posthumously conceived child could claim as an heir, so as not to unfairly deprive living individuals of the property they were entitled to.[90] The court ultimately ruled that because the decedent by his intentional conduct had created the possibility of having posthumously conceived children and because the decedent was unequivocally proven to be their father, it would recognize the twin girls as the intestate heirs of the decedent.[91] This decision, although not overruled to date, is only a trial court decision and, therefore, of limited precedential value. Additionally, the fact that it was not truly an adversarial decision, coupled with not being an interpretation of New Jersey's law by its highest court, makes its authoritative value in a federal judicial proceeding questionable.

The second case and the only one to date decided by a state's highest court was a result of a question certified to it by a United States District Court, and was an advisory opinion interpreting the state's intestacy statutes.[92] The question certified to the court was whether a posthumously conceived child could inherit from the deceased father under Massachusetts intestacy law.[93] This case also involved a young, childless, married couple. The husband was

diagnosed with leukemia and he and his spouse arranged for his sperm to be withdrawn and stored at a sperm bank. Artificial insemination of the surviving spouse subsequent to the husband's death resulted in the birth of twin girls two years after his death.[94] A previously entered judgment of paternity by a probate court, which was based on a stipulation signed by the surviving spouse as administrator of her husband's estate, was found not to be probative of the issue of the deceased husband's paternity by the Massachusetts Supreme Court.[95] The children and surviving spouse, having already been denied Social Security survivor benefits through the administrative appeals process, were now seeking a declaratory judgment from the district court reversing that decision. The Massachusetts Supreme Court, after reviewing the state's intestacy statutes, including its provisions for posthumous children which provides that "posthumous children shall be considered as living at the death of their parent," found nothing limiting the class of posthumous children to those in utero at the time of death.[96] The court also noted that the Massachusetts intestacy statutes do not contain a definition of "posthumous children," and that the two girls were nonmarital children of the decedent. After stressing that the devolution of property in intestacy was neither a natural nor constitutional right, but a privilege conferred by statute, the court set out to determine if these nonmarital children were issue who could inherit under the state intestacy statute.[97] The state intestacy laws provide that although a nonmarital child is presumed to be the child of his or her mother, in order to inherit from the putative father, nonmarital children, in the absence of the father's acknowledgment of paternity or a subsequent marriage to the mother, would have to obtain a judicial determination of paternity.[98] Weighing the three powerful state interests it found implicated—the best interests and protection of children; the state's interest in the orderly administration of estates, which the court found protected by a statute of limitations for claims against an estate; and the reproductive rights of the genetic parent which had been affirmatively supported by the legislature—the court found that it could not, as a matter of law, dictate that all posthumously conceived children were barred from inheriting in intestacy.[99] Finding an overriding purpose of the legislature to protect the welfare of all children, the court answered the question certified to it by the district court in the affirmative in certain limited circumstances, stating that a biological relationship must be established between child and decedent, and the decedent's consent to both posthumous parenthood and support of the resulting child must be established.[100] The court was also concerned that a statute of limitations be enforced to prevent unfair delay of devolution of property to identified takers, although that was not at issue in this case.

Contrary to these two state court decisions, a very recent decision by the United States District Court for the District of Arizona, interpreting Arizona's intestacy laws for the first time as they relate to posthumously conceived children, held that these laws do not enable such a child to inherit in intestacy.[101] This decision, also predicated on an administrative denial of Social Security survivor benefits to twin girls born via IVF, eighteen months after the death from cancer of their biological father, granted summary judgment to the Commissioner of Social Security.[102] The court, after distinguishing and summarily dismissing both the *Kolacy* and *Woodward* state court decisions, interpreted, without any substantive analysis, the requirement in Arizona's intestacy laws that an heir survive the decedent to mean that the heir must be in existence at the date of death of the decedent, necessarily eliminating posthumously conceived children from the class of those who can inherit.[103] Further, the court held that Arizona's afterborn heir provision, which provides that a child in gestation is treated as living at decedent's death if it lives at least 120 hours after its birth foreclosed intestate inheritance by posthumously conceived children.[104] The court also summarily dismissed Arizona's statute treating all children as legitimate, which would allow these two girls the presumption of dependency under the Social Security Act and consequent entitlement to benefits, claiming that it was irrelevant to the case at bar.[105] Although this court's interpretation may ultimately be proven correct, the decision is poorly reasoned and unsubstantiated, and, therefore, unpersuasive. Additionally, this decision is totally devoid of any consideration of the evolving public and judicial policy of according equal rights and benefits to nonmarital children. The District Court should rightfully, as the district court did in the *Woodward* case, have certified the question of the interpretation of Arizona's intestacy laws in this novel situation to the state's highest court, which is in a better position to examine and evaluate state judicial precedent and legislative intent in enactment of its intestacy laws.

What can be gleaned from both state court decisions is an overriding social and public policy to protect and benefit children and to accord nonmarital children parity with marital children, which is consistent with the social and public policy regarding nonmarital children evidenced in other areas of the law. Additionally, these courts endeavored to preserve the fundamental right of reproductive freedom, which is likewise implicated in the *CECOS, Hecht, Davis* line of cases with their requirement that the intent of the decedent to posthumously parent a

child be unequivocally apparent. These policies must be balanced against the state's considerable interest in preventing false and spurious claims of paternity, which are enhanced when the putative father is deceased, and its subsequent entitlement to inherit in intestacy, and the orderly administration of estates so as not to deprive living heirs of timely receipt of property that they are entitled to. The traditional notion that a decedent's heirs are determined upon his or her death must also enter into this equation, although state statutes do provide that estates be held open to accommodate traditional afterborn heirs. The general benevolence toward children and the evolving attempts to equalize the benefits and rights accorded nonmarital children and remove any stigma associated with their birth are an overriding and recurrent theme and may ease the harshness of current statutory law. Additionally, the concerns traditionally exhibited regarding false and spurious claims of paternity are a continuing concern whenever a posthumously conceived child seeks either support from a deceased parent's estate or the right to inherit from that estate in intestacy. A particular state's statutory scheme will either enable intestate inheritance by posthumously conceived children by allowing posthumous declarations of paternity, or bar such inheritance by not allowing posthumous declarations of paternity. Liberal judicial interpretations of these statutes can assist in according posthumously conceived children those rights and benefits accorded marital children. Additionally, a particular state intestacy law's definition of a posthumous child will necessarily impact such a child's inheritance rights. A further concern in inheritance situations is a particular state's interest in the orderly administration of estates and the timely devolution of property to those entitled to such property. State statutes of limitation may be able to effectively resolve this concern by, for instance, limiting the length of time after death during which a posthumously conceived child can claim. Additionally, since a clear showing of an individual's intent to parent posthumously seems to be a consistent requirement, an individual could leave a trust fund for such child, thereby satisfying both the intent requirement and solving the timely estate administration concern.

To date, no New York court has decided the issue of whether posthumously conceived children may inherit from their putative father. Examination of New York's intestacy statutes and the cases interpreting such, coupled with the trend in social and public policy regarding the status of nonmarital children, can reasonably anticipate the outcome of such a court case. New York's statute governing intestate distribution of property provides that a decedent's distributees, conceived before his or her death and born alive thereafter, inherit as if they were born in the decedent's lifetime.[106] The Massachusetts Supreme Court, in its *Woodward* decision, did not have to confront this problem, because the Massachusetts intestacy statute did not explicitly define posthumous children and therefore, did not preclude posthumously conceived children from inheriting. The New Jersey court, however, disregarded their intestacy statute's requirement of conception before death in its definition of a posthumous child, which is similar to New York's definition, preferring instead to liberally construe the statute because of the state's protective attitude toward children who have lost a parent.

"To date, no New York court has decided the issue of whether posthumously conceived children may inherit from their putative father."

New York courts, however, have fairly consistently held that the date of a decedent's death is the date on which the statutory rights of individuals to inherit from or through that decedent are fixed.[107] Further, although there have not been any decisions in New York addressing this requirement of conception before death of the parent, a recent Suffolk County Supreme Court case reiterated that the status of nonmarital children as distributees was measured by their conception prior to the death of the decedent and their live birth thereafter.[108] This section of the intestate distribution statute, however, was added by the Laws of 1966, reenacting the previous Decedent's Estate Law § 83 without any substantive change, which indicates that the legislature could not have contemplated the current reproductive technology which allows posthumous conception of children.[109] Additionally, many lower court decisions have liberally construed intestacy statutes to effectuate the stated legislative purpose of granting equal benefits and rights to nonmarital children while at the same time safeguarding estates from fraudulent claims of heirship.[110] For instance, in a 1970 decision, the Supreme Court, Special Term, New York County, opining that "the better and more modern view is to abolish the unchosen birthgiven shackles of illegitimacy and to confer filial equality wherever possible,"disregarded the then-statutory requirement that an order of filiation be entered in the putative father's lifetime and allowed a nonmarital child to inherit where there were unrefuted formal acknowledgments of paternity.[111] Another New York court appointed a nonmarital child, who had been acknowledged, but not in the manner required by the then-applicable statute, as a co-administrator of her putative father's estate,

although forbidden by statute, in order to prosecute a wrongful death action.[112] Additionally, one court retroactively applied a Puerto Rican legitimization statute to a nonmarital child born to his putative father in Puerto Rico to allow him to inherit from this putative father,[113] while yet another court allowed a German court's finding that the decedent was the son's father for child support purposes to enable the nonmarital child to inherit in New York from his putative father.[114] Finally, in 1994, the New York County Surrogate's Court allowed a decedent's parents to rebut a nonmarital child's attempt to establish paternity after the death of his putative father by ordering DNA tests on the decedent's parents, the nonmarital child and his mother, finding nothing in the EPTL or its legislative history prohibiting this novel approach.[115] Although these innovative decisions confirm the state's protective and benevolent attitude toward nonmarital children, similar to the asserted priorities of New Jersey, it is questionable whether New York's highest court would disregard the statutory requirement of predeath conception before a posthumous child could inherit in intestacy, especially in light of its and the United States Supreme Court's fierce defense of New York's right to regulate the disposition of property in intestacy.[116] Unless the legislature amends the statute, this requirement might very well serve to preclude a child posthumously conceived by artificial insemination and posthumous IVF from inheriting from his or her father.

A posthumous child born as the result of IVF, from a pre-embryo or zygote cryogenically preserved prior to the biological father's death but implanted in the mother after the death of the biological father, may, however, fall within the statutory requirement of predeath conception enabling intestate inheritance from his or her biological parent. This possibility exists because conception is defined as "the onset of pregnancy, the implantation of the blastocyst; the formation of a viable zygote."[117] A zygote results from the union of a male and female gamete that begins to undergo segmentation into blastomeres, prior to implantation in the female's uterus.[118] This is exactly the stage at which a pre-embryo or zygote is cryogenically preserved for later implantation in the female, so that this cryogenically preserved pre-embryo, if created prior to the death and eventually born alive, would literally conform to the intestacy statute's requirement of predeath conception and would, therefore qualify as an intestate distributee of the deceased parent. Additionally, there is no time limitation as far as when the child will be born alive in the statute, although the legislature could not possibly have foreseen such a construction of the intestacy statute.

Finally, although New York's intestacy statute qualifying nonmarital children for inheritance contains several provisions for establishing paternity which require that they be performed during the lifetime of the putative father, such as that an order of filiation be entered during the putative father's lifetime and that a blood genetic marker test be administered to the father,[119] the statute's subdivision (a)(2)(C), which requires that paternity be established by clear and convincing evidence and that the father of the child openly and notoriously acknowledge the child as his own, has been liberally construed by recent case law to allow post-death declarations of paternity. Moreover, one New York Surrogate's Court, after ordering comparison of blood genetic marker tests of a mother and her nonmarital child with DNA tests performed on blood samples taken from the deceased putative father after he had been murdered, ruled that they would, if a 95 percent probability of paternity was indicated, be sufficient to satisfy the clear and convincing evidence required in the statute.[120] Further, in 2002 , the New York County Surrogate, in a post-death paternity proceeding, ordered petitioned-for DNA tests performed on blood samples, collected after the decedent's death and retained by the Medical Examiner, to decide the issue of paternity under the clear and convincing prong of the statute.[121] The Surrogate, finding "no basis in law or logic" to exclude the results of these posthumously conducted DNA tests from the category of clear and convincing evidence, held them admissible under subdivision (a)(2)(C) of the statute.[122] Additionally, although the blood tests established conclusively that the decedent was not the father of the nonmarital child, he alleged that the decedent openly and notoriously acknowledged him as his child. The Surrogate ruled that in order to inherit in intestacy, the nonmarital child must prove both prongs of subdivision (a)(2)(C) of the statute.[123]

Moreover, an appellate court, although it refused to allow disinterment of the putative father's body for DNA testing as evidence of paternity under the clear and convincing prong of the statute, held, after a hearing, that the proffered evidence satisfied the clear and convincing requirement under the statute.[124] The proffered evidence consisted of the nonmarital child's (now an adult) mother's testimony, photographs of the adult and the decedent taken throughout the adult's childhood, testimony of family friends, a real estate agent, and a notary public, and a document in connection with the purchase of the nonmarital adult's home wherein the decedent certified that he was her father.[125] The court did not address the open and notorious acknowledgment requirement, as the lower court had found it satisfied, and that issue was not appealed.[126] Such con-

struction of the clear and convincing prong of the statute certainly leaves open the possibility of a posthumously conceived child proving the paternity of his or her deceased biological father and thereby qualifying as an intestate distributee of that father. Additionally, it is possible that a decedent's consent in a record to posthumously parent a child, as contemplated by the Uniform Parentage Act, could qualify as the open and notorious acknowledgment also required under that subdivision of the statute, thereby enabling a posthumously conceived child to prove paternity under New York's intestacy statute.

Further, the Niagara County Surrogate's Court allowed the use of a pre-existing blood marker test performed on the decedent before his death to posthumously establish paternity under the subdivision of the intestacy statute requiring that a DNA test be performed during the lifetime of the putative father.[127] And a New York County Surrogate's Court, allowing a paternity proceeding after the death of the putative father, concluded that a nonmarital child born after the execution of his father's will qualified to receive his father's estate as a traditional after-born child.[128]

As with the New York Family Court's liberal construction of applicable statutes allowing post-death adjudications of paternity and subsequent issuance of orders of filiation, the New York Surrogate's Courts, seemingly also motivated by the pervasive public policy of protecting and equalizing nonmarital children, should be able to innovatively and liberally interpret the state's intestacy statutes to accommodate posthumously conceived children. Individuals who intend to posthumously parent a child must, however, leave a clear and unambiguous record of this intent and should leave DNA results to facilitate an adjudication of paternity. The biggest barrier to inheritance by posthumously conceived children in New York is the intestacy statute's requirement of conception before the death of a parent, although a child born from IVF performed before the parent's death may fall within this literal requirement. Perhaps, in view of the many innovative judicial decisions benefitting children, there may be a way around that requirement for posthumously conceived children born from artificial insemination and posthumous IVF.

Although the statutory law lags behind science in the field of reproductive technology, the diminution of the common law stigma attached to nonmarital children, hence posthumously conceived children, and the recurrent and overriding public policy of protecting and according rights and benefits to these children, can mostly fill the void left by this lack of statutory law. The courts have begun to resolve some of the difficult legal issues this new reproductive technology has produced by liberally and innovatively construing existing statutory law to enable children born of these technologies to enjoy many of the rights and benefits accorded children born of traditional marriages. Moreover, the Supreme Court has aided this evolution with its jurisprudence extending the protection of the Due Process and Equal Protection Clauses of the Fourteenth Amendment to nonmarital children. Necessarily, individuals who leave gametes to their loved ones for later use must also leave an unambiguous record of their intent to posthumously parent and leave blood genetic marker test results to facilitate both the disposition of the genetic material and later adjudications of paternity. The devolution of estates, however, seems to be a protected area of state regulation, leaving it to each state's legislature and courts to accommodate children born of this new technology within the boundaries of Supreme Court precedent. The law will eventually provide for these children, but by then science will have leaped ahead to a new era, only to await the law once again.

Endnotes

1. *Kass v. Kass*, 91 N.Y.2d 554, 562, 563; 696 N.E.2d 174, 178; 673 N.Y.S.2d 350, 354 (1998). Internal citations have been omitted.
2. Stacey Sutton, Note: *The Real Sexual Revolution: Posthumously Conceived Children*, 73 St. John's L. Rev. 857 (Summer 1999).
3. *Supra* note 2.
4. *Supra* note 2.
5. *Supra* note 2.
6. Charles M. Jordan, Jr. & Casey J. Price, *First Moore, Then Hecht: Isn't It Time We Recognize A Property Interest In Tissues, Cells, And Gametes?*, 37 Real Prop., Prob. & Tr. J. 151 (Spring 2002).
7. *Supra* note 6.
8. Kathryn Venturatos Lorio, *From Cradle To Tomb: Estate Planning Considerations Of The New Procreation*, 57 La. L. Rev. 27 (Fall 1996). *Paraplaix v. CECOS* is apparently an unreported case.
9. *Supra* note 8.
10. *Supra* note 8.
11. Christopher A. Scharman, Note: *Not Without My Father: The Legal Status of the Posthumously Conceived Child*, 55 Vand. L. Rev. 1001 (Apr. 2002). Unfortunately, because of the small quantity and poor quality of the sperm, Corrine was unable to conceive a child.
12. *Davis v. Davis*, 842 S.W.2d 588 (Tenn. 1992).
13. *Id.*
14. *Id*.
15. *Id*.
16. *Hecht v. Superior Court*, 16 Cal. App. 4th 836 (1993).
17. *Id*.

18. *Id*. Hecht had been named in the will as executor of Kane's estate, but for some reason was not serving as such upon institution of this suit.
19. *Id*.
20. *Id*.
21. *Id*.
22. *Id*.
23. *Id*.
24. *Hecht v. Superior Court*, 50 Cal. App. 4th 1289 (1996). This decision is not published and not citable. In another court proceeding it had been determined that the sperm were property distributable under the settlement.
25. *Id*. The contract being the settlement agreement between Hecht and Kane's grown children.
26. *Kass v. Kass*, 91 N.Y.2d 554; 696 N.E.2d 174; 673 N.Y.S.2d 350 (1998).
27. *Id*.
28. *Kass v. Kass*, 235 A.D.2d 150; 663 N.Y.S.2d 581 (2d Dep't 1997).
29. *A.Z. v. B.Z.*, 431 Mass. 150; 725 N.E.2d 1051 (2000).
30. *Id*.
31. *Id*.
32. *J.B. v. M.B.*, 170 N.J. 9; 783 A.2d 707 (2001).
33. *Id*.
34. *Supra* note 11.
35. *Woodward v. Commissioner*, 435 Mass. 536; 760 N.E.2d 257 (Jan. 2, 2002); *cf. Carr v. Carr*, 46 N.Y.2d; 385 N.E.2d 1234; 413 N.Y.S.2d 305 (1978)
36. *In re Nellenback*, 107 Misc. 2d 1061; 436 N.Y.S.2d 599 (1981).
37. *Levy v. Louisiana*, 391 U.S. 68 (1968). The Court refers to illegitimate children. I have used nonmarital children in the interest of consistency in this article.
38. *Weber v. Aetna Cas. & Sur. Co.*, 406 U.S. 164 (1972).
39. *Id*.
40. *Glona v. American Guar. & Liab. Ins. Co.*, 391 U.S. 73 (1968).
41. *Id*.; *Levy v. Louisiana*, 391 U.S. 68 (1968).
42. *Weber v. Aetna Cas. & Sur. Co.*, 406 U.S. 164 (1972).
43. *New Jersey Welfare Rights Org. v. Cahill*, 411 U.S. 619 (1973).
44. *Trimble v. Gordon*, 430 U.S. 762 (1977).
45. *In re Will of Hoffman*, 53 A.D.2d 55; 385 N.Y.S.2d 49 (1st Dep't 1976).
46. *In re the Estate of Charles H. Crist*, 116 Misc. 2d 1078; 457 N.Y.S.2d 182 (Sur. Ct., Orange Co. 1982). Estates, Powers and Trust Law 4-1.2 (hereinafter "EPTL") is New York's statute outlining the instances in which nonmarital children may inherit from their biological parents. Prior to the 1981 amendment, the statute provided that a nonmarital child was the legitimate child of his mother so that he and his issue could inherit from his mother and his mother kindred; and that the nonmarital child was the legitimate child of his father so that he and his issue could inherit from his father and his paternal kindred if: an order of filiation had been made by a court of competent jurisdiction during the father's lifetime or the mother and father have executed an acknowledgment of paternity and filed it with the registrar of the district where the child's birth certificate was issued; or the father has signed an instrument acknowledging paternity under certain conditions and filed it with the putative father registry. The 1981 amendment added subdivision (a)(2)(C) which allowed paternity to be established by clear and convincing evidence and in which the father has openly and notoriously acknowledged the child as his own. A 1987 amendment subsequently added subdivision (a)(2)(C) which allows paternity to be proved by a blood genetic marker test administered during the lifetime of the father together with other evidence establishing paternity by clear and convincing evidence.
47. *Houghton v. Dickinson*, 196 Mass. 389; 82 N.E. 481 (1907).
48. *Id*.
49. *Doe v. Roe*, 23 Mass. App. Ct. 590; 504 N.E.2d 659 (1987).
50. *L.W.K. v. E.R.C.*, 432 Mass. 438; 735 N.E.2d 359 (2000).
51. *In re the Estate of Dussell, Sr.*, 145 N.J. Super. 363; 367 A.2d 1188 (1976).
52. *Clark v. Jeter*, 486 U.S. 456 (1988). The Supreme Court, applying intermediate scrutiny to discriminatory classifications based on illegitimacy, requires such a statutory classification to be substantially related to an important governmental objective. *Id*.
53. *Id*.
54. *Id*.
55. 1987 Recommendation of the Law Revision Committee, N.Y. Family Court Act § 519 (hereinafter "Fam. Ct. Act").
56. Fam. Ct. Act § 519.
57. *In re Corbett*, 100 Misc. 2d 270; 418 N.Y.S.2d 981 (1979).
58. *In re the Estate of Niles*, 81 Misc. 2d 937; 367 N.Y.S.2d 173 (Sur. Ct., Rensselaer Co. 1975) (The decedent had appeared before the Family Court but no order of filiation had been entered for an unborn child. The order of filiation was entered posthumously so that the decedent's child, who had subsequently been born, could inherit from his father, who had died intestate.); *Charles v. Schweiker*, 569 F. Supp. 1341 (E.D.N.Y. 1983) (The court applied the newly amended EPTL 4-1.2 to allow a nonmarital child to collect Social Security dependent child benefits where the order of filiation had been entered posthumously.); *Joselyn D. v. Oscar O.*, 132 Misc. 2d 964; 505 N.Y.S.2d 791 (Fam. Ct., N.Y. Co. 1986) (The court held Fam. Ct. Act § 518, prior to amendment, violative of equal protection and allowed a paternity action brought more than two months after the death of the putative father.)
59. *Koidl v. Schreiber*, 214 N.J. Super. 513; 520 A.2d 759 (1986). The Uniform Parentage Act has been amended several times, most recently in 2000, and has been adopted by the following states: Alabama, California, Colorado, Delaware, Hawaii, Illinois, Kansas, Minnesota, Missouri, Montana, Nevada, New Jersey, New Mexico, North Dakota, Ohio, Rhode Island, Texas, Washington and Wyoming. *Supra* note 8. Many other states have enacted significant portions of it. Uniform Parentage Act (2000 Revision) Prefatory Note.
60. Uniform Parentage Act, 2000 Revision Prefatory Note.
61. *Supra* note 60 at Comment to section 202.
62. *Karin T. v. Michael T.*, 127 Misc. 2d 14; 484 N.Y.S.2d 780 (1985).
63. *Anne R. v. Estate of Francis C.*, 167 Misc. 2d 343; 634 N.Y.S.2d 339 (1995); *aff'd*, 234 A.D.2d 375; 651 N.Y.S.2d 539 (1996); *leave to appeal denied*, 89 N.Y.2d 815; 681 N.E.2d 1302; 659 N.Y.S.2d 855 (1997).
64. *Id*.; *supra* text at note 56.
65. *Queisser v. Abizeid*, 168 Misc. 2d 1005; 640 N.Y.S.2d 990 (1996).
66. *Labine v. Vincent*, 401 U.S. 532 (1971).
67. *Id*.
68. *Id*.
69. *Id*.

70. *Trimble v. Gordon*, 430 U.S. 762 (1977).
71. *Id*.
72. *Id*.
73. *Id*.
74. *Lalli v. Lalli*, 439 U.S. 259 (1978).
75. *Id*. The New York statute, at the time, also provided that the proceeding for the order of filiation declaring paternity had to have been commenced within two years of the birth of the child. Neither the New York Court of Appeals nor the Supreme Court addressed that portion of the statute, finding it irrelevant in the case at bar because the putative father was deceased. *Id*.
76. *Id*.
77. EPTL 4-1.2. The additional circumstances under which a child can inherit from his or her father are as follows: (a) the mother and father have executed an acknowledgment of paternity under certain conditions, which is subsequently filed with the registrar of the district where the child's birth certificate is filed; or (b) the father signed an instrument acknowledging paternity before a notary public and one witness, and thereafter filed with the putative father registry, and the mother or guardian of the child is then notified of such; or (c) paternity has been established by clear and convincing evidence and the father has openly and notoriously acknowledged the child as his own; or (d) a blood genetic marker test had been administered to the father which together with other evidence establishes paternity by clear and convincing evidence. *Id*.
78. *Supra* note 59.
79. Uniform Parentage Act (2000 Revision) § 509 and Comment to section 509.
80. Uniform Parentage Act (2000 Revision) § 707 and Comment to section 707.
81. Gloria J. Banks, *Traditional Concepts and Nontraditional Conceptions: Social Security Survivor's Benefits for Posthumously Conceived Children*, 32 Loy. L. Rev. 251 (Jan. 1999).
82. *Mathews v. Lucas*, 427 U.S. 495 (1976).
83. *In re the Estate of Kolacy*, 332 N.J. Super. 593; 753 A.2d 1257 (2000). The Superior Court is the trial court in New Jersey.
84. *Id*.
85. *Id*.
86. *Id*.
87. *Id*.
88. *Id*.
89. *Id*.
90. *Id*.
91. *Id*.
92. *Woodward v. Commissioner*, 435 Mass. 536; 760 N.E.2d 257 (Jan. 2, 2002).
93. *Id*.
94. *Id*.
95. *Id*.
96. *Id*.
97. *Id*.
98. *Id*.
99. *Id*.
100. *Id*.
101. *Netting v. Barnhart*, 2002 U.S. Dist. LEXIS 22003 (D. Az. Oct. 24, 2002).
102. *Id*.
103. *Id*.
104. *Id*.
105. *Id*.
106. EPTL 4-1.1 (2002).
107. *In re the Estate of Malavase, Jr.*, 133 A.D.2d 759; 520 N.Y.S.2d 49 (2d Dep't 1987); *In re the Estate of Gibbons*, 149 Misc. 2d 516; 566 N.Y.S.2d 511 (Nassau Sur. Ct. 1991).
108. *Scrivens v. Carrion*, N.Y.L.J., Sept. 12, 1997, at 25.
109. *Supra* note 106.
110. *In re Estate of McLeod, Jr.*, 105 Misc. 2d 1012; 430 N.Y.S.2d 782 (Sur. Ct., Westchester Co. 1980).
111. *Prudential Ins. Co. v. Hernandez*, 63 Misc. 2d 1058; 314 N.Y.S.2d 188 (1970).
112. *In re the Estate of Ross*, 67 Misc. 2d 320; 323 N.Y.S.2d 770 (Sur. Ct., Kings Co. 1971).
113. *In re Estate of Ortiz*, 86 Misc. 2d 790; 383 N.Y.S.2d 502 (Sur. Ct., N.Y. Co. 1976).
114. *In re Estate of Luber*, 109 Misc. 2d 1065; 441 N.Y.S.2d 612 (Sur. Ct., Bronx Co. 1981)
115. *In re the Estate of Sandler*, 160 Misc. 2d 955; 612 N.Y.S.2d 756 (1994).
116. *In re the Estate of Fay*, 44 N.Y.2d 137; 375 N.E.2d 735; 404 N.Y.S.2d 554 (1978).
117. Dorland's Pocket Medical Dictionary, W.B. Saunders Co., 25th ed.
118. *Supra* note 117; Williams Obstetrics, 21st ed., McGraw-Hill Med. Publ'g Div. (2001).
119. *Supra* note 77; although the statute does not explicitly require that blood genetic marker or DNA tests be performed during the lifetime of the putative father, case law has interpreted the statute, because it is phrased in the past tense and because Fam. Ct. Act § 519, which does explicitly require such tests be performed prior to the death of the putative father, to not allow such testing post-death. *In re Janis*, 210 A.D.2d 101; 620 N.Y.S.2d 342 (1st Dep't 1994); *In re Sekanic*, 229 A.D.2d 76; 653 N.Y.S.2d 449 (3d Dep't 1997).
120. *In re Johnson*, N.Y.L.J., Oct. 15, 1997, at 37 (Sur. Ct., Westchester Co.).
121. *In re Bonanno*, 192 Misc. 2d 86; 745 N.Y.S.2d 813 (Apr. 16, 2002).
122. *Id*.
123. *Id*.
124. *In re the Estate of Sekanic*, 271 A.D.2d 802; 705 N.Y.S.2d 734 (2d Dep't 2000).
125. *Id*.
126. *Id*.
127. *In re the Estate of Wilkins*, 184 Misc. 2d 218; 707 N.Y.S.2d 774 (2000).
128. *In re the Estate of Wilkins*, 180 Misc. 2d 568; 691 N.Y.S.2d 878 (1999).

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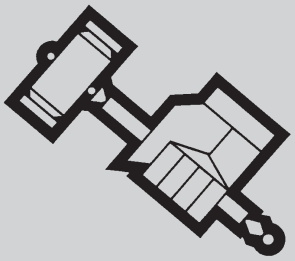

RECENT NEW YORK STATE DECISIONS

Ira Mark Bloom and William P. LaPiana

WILLS

Probate—Entitlement to Jury Trial

Petitioner in probate proceeding was also defending a second proceeding to invalidate a related trust. Objectants in the probate proceeding, who were petitioners in the trust proceeding, properly demanded a jury trial in the probate proceeding. The Surrogate denied the probate petitioner's motion to strike the jury demand and ordered the proceedings tried together with the jury serving as an advisory jury in the trust proceeding. The Appellate Division affirmed the Surrogate, holding that there was no consolidation of the proceedings and no waiver of the objectants' right to a jury trial in the probate proceeding. *In re Chambers*, 300 A.D.2d 482, 751 N.Y.S.2d 569 (2d Dep't 2002).

Construction—Two Separate Gifts Created

Decedent's will left bequests to her daughter and her son and went on to provide that in the event "my daughter . . . and my son . . . do not survive me, the share bequeathed to them shall not lapse, but their share shall be divided equally among their issue surviving them and me." Daughter predeceased testator and executor sought construction of the provision. The Appellate Division upheld the Surrogate's determination that decedent made two separate gifts to her son and daughter and that the above language was intended to duplicate EPTL 3-3.3 in order to prevent lapse. The decision rested on the accepted principles of construction requiring a sympathetic reading of the entire will in light of the surrounding facts and circumstances. *In re Revelli*, 302 A.D.2d 387, 754 N.Y.S.2d 658 (2d Dep't 2003).

Construction—Formula Bequest Tied to Tax Effects

Decedent's will created a trust for his son using a formula to create a credit shelter, pecuniary bequest of the maximum amount by which the federal taxable estate ("determined without regard to this Article of my Will") could be increased without increasing the estate tax payable. As amended by a codicil, a prior article of decedent's will gave his spouse two residences for life or until she remarried. If taken into account, these terminable interests, which did not qualify for the marital deduction, were large enough so that the credit shelter bequest would not be funded. Certain will beneficiaries maintained that the bequest in trust was in actuality a general bequest equal to the then-applicable exclusion amount of $675,000 and that there should be no reduction for the value of the life estates. The Surrogate rejected the argument, holding that the reference to the maximum amount passing free of estate tax and the direction to disregard the language of the bequest in determining the amount, required the tax effects to govern, resulting in no credit shelter bequest. *In re Weissman*, 194 Misc. 2d 578, 755 N.Y.S.2d 562 (Sur. Ct., Nassau Co. 2003).

ADMINISTRATION OF ESTATES

Claims—Medicaid Reimbursement

While resident in a nursing home, decedent transferred a one-half interest in his home to his daughter, which they then held as tenants in common. Decedent received Medicaid assistance after the expiration of the disqualification period resulting from the transfer. He was not required to spend down the resource represented by his half interest in the home because his debt to the nursing home exceed the value of his interest. Before decedent's death, the daughter agreed with the nursing home to be jointly and severally liable for her father's debt and to place sufficient proceeds from the contemplated sale of the home to pay the debt into escrow. After decedent's death, daughter, as executor, sold the home and complied with the escrow agreement. DSS filed a claim which daughter denied, maintaining that because of the escrow arrangement there were no estate assets, that the claim contradicted the no-spend-down of resources regulation, and that the payment of the nursing home claim left the estate without assets. The Surrogate rejected all these arguments, holding the proceeds were estate assets, that DSS's right of recovery was mandated by federal and

state law, and that the preferred creditor status of DSS required it to be paid first. *In re Robinson,* 194 Misc. 2d 695, 754 N.Y.S.2d 525 (Sur. Ct., Nassau Co. 2003).

Accounting—Executor's Duty as Attorney-in-Fact

Decedent appointed daughter his attorney-in-fact and executor of his will, which made a general bequest to his two other children and divided the residue in equal shares among all three children. In her accounting, executor maintained that the estate had too few assets available for distribution to satisfy even the general bequest. At trial it was established that daughter used the power of attorney to transfer decedent's assets to herself and her family. The Surrogate held that daughter overcame any presumption of self-dealing, concluding that the transfers were made to compensate for previous gifts to the other children and to compensate daughter for care she provided to the decedent. The Appellate Division modified the Surrogate's order, holding instead that certain transfers by the daughter were unauthorized, amounted to self-dealing and that the presumption that care was provided in consideration of love and affection was not overcome. Daughter was therefore surcharged in the amount of these transfers. The Surrogate was affirmed, however, on his holding that birthday, anniversary and Christmas gifts made by the daughter to herself and other family members were impliedly authorized. *In re Estate of Naumoff*, 301 A.D.2d 802, 754 N.Y.S.2d 70 (3d Dep't 2003), *appeal denied*, 2003 N.Y. LEXIS 939 (N.Y. May 1, 2003).

ESTATES IN LAND

Life Estate—Life Tenant May Force Sale Over Objections by Remainder Interest

Decedent and her husband were tenants in common in the marital home. Her will stated that her husband was to live in the home for as long as he chose and could not be required to sell until he desired to do so long as he bore the costs of maintenance, including taxes and insurance. Over the objections of the remainder interest, husband desired to sell in order to relocate. Held, the husband does have a life estate and he can sell over the objections of the remainder interest because the will effectively gives him total discretion over the decision to sell. *In re Estate of Sauer*, 194 Misc. 2d 634, 753 N.Y.S.2d 318 (Sur. Ct., Nassau Co. 2002).

ATTORNEYS AND CLIENTS

Privilege—Decedent's Personal Representative May Waive Privilege

Plaintiff, decedent's daughter, was assignee of her mother's estate's cause of action for legal malpractice allegedly committed during representation of the decedent in connection with a matrimonial action. She then sought to waive the attorney-client privilege so that the lawyer's files would be available for discovery. Although there are New York cases stating that the privilege may not be waived by decedent's representative, the Appellate Division held, after a thorough examination of cases, that the statutes do not supplant the common law rule allowing waiver and that "it makes no sense to prohibit an executor from waiving the attorney-client privilege of his or her decedent, where such prohibition operates to the detriment of the decedent's estate" and to the benefit of the alleged tortfeasor. *Mayorga v. Tate*, 302 A.D.2d 11, 752 N.Y.S.2d 353 (2d Dep't 2002).

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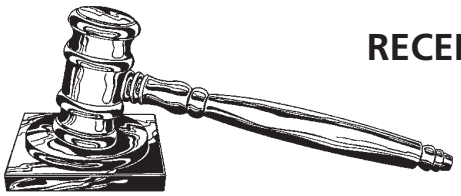
Professors Bloom and LaPiana are the current authors of Bloom and Klipstein, *Drafting New York Wills* (Matthew Bender) (Bloom as principal author; LaPiana as contributing author).



CASE NOTES— RECENT NEW YORK STATE SURROGATE'S AND SUPREME COURT DECISIONS

Ilene Sherwyn Cooper and Donald S. Klein

Accounting Decree

Before the Court was a contested accounting involving the trust created under Article Eighth(B) of the decedent's Will. Objections in the proceeding were raised, inter alia, to the trustee's management of shares of stock in Kodak. The trustee moved to dismiss the objections alleging that they were barred by the doctrine of res judicata. Specifically, the trustee maintained that both the 1977 and 1981 decrees which had been previously entered by the Court in its executors' accounting, and its accounting as co-trustee of the trust created under Article Eighth(A) of the decedent's Will, conclusively resolved all issues regarding its administration of the Kodak shares as against the objectant who appeared in both proceedings and failed to raise any of the allegations raised in the subject accounting.

In opposition to the motion, objectant maintained that the trustee's reliance on res judicata was misplaced inasmuch as the propriety of the trustee's conduct as fiduciary of the Article Eighth(B) trust was never before the Court in either of the previous accountings. Objectant further contended, inter alia, that the trustee was liable as a "successor fiduciary" for failing to redress any misdeeds it committed as co-executor and as co-trustee of the Article Eighth(A) trust.

The Court rejected the trustee's position finding that the policy embodying the "special duty" owed by every multi-capacity fiduciary to its beneficiaries precluded summary application of the doctrine of res judicata to the circumstances presented, such that the objectant could prosecute its allegations that the trustee breached its fiduciary duty in failing to remedy any improprieties it committed as co-executor or co-trustee of the Article Eighth(A) trust.

In reaching this result, the Court relied upon the "special rules" governing a trustee's fiduciary duty as set forth in the Restatement Second, Trusts, sections 177 and 223, as well as applicable case law, which seemingly applied the doctrine of res judicata only to situations where the subsequent fiduciary is a different person or entity than the predecessor fiduciary. Where the predecessor and successor fiduciary are one and the same, as in the case presented, the Court found no explicit authority in New York in which the doctrine of res judicata was applied, but instead, found decisions in other jurisdictions which held the doctrine inapplicable in such circumstances. The Court found these authorities persuasive.

Further, the Court found that the "identity of parties" necessary to warrant application of the doctrine of res judicata did not apply to all the objections at issue, that the objectant was not seeking to open the prior accounting decrees, and that the actions of the trustee as fiduciary of the Article Eighth(B) trust were never before the Court.

Finally, the Court held that it was reluctant to invoke the doctrine of res judicata under circumstances where a colorable claim for breach of trust duty had been raised. *In re Estate of Hunter*, N.Y.L.J., Jan. 14, 2003, p. 33 (Sur. Ct., Westchester Co., Surr. Scalping).

Accounting Decree

Before the Court was an accounting with respect to a common trust fund where the Court also had occasion to consider the finality of an accounting decree, but within the context of a proceeding involving a common trust fund. At issue was the third account of the trustee covering the period from January 1, 1990, to December 31, 1998. The Court had settled two prior accounts of the trustee through the period ending December 31, 1989.

The guardian ad litem representing the beneficiaries of the principal of the trust fund raised two objections to the account. In pertinent part, these objections took issue with the purchase of a bond by the trustee at a premium during the prior accounting period, on the ground that the investment was imprudent. With regard to this transaction, the record reflected that in 1989 the fund purchased $6,690,000 subordinated capital notes ("Notes") for the premium price of $1,057,500. The Notes accrued interest at the rate of 12.5% and matured on November 15, 1996. In the prior account, because the trustee still held the Notes in the fund, it posted an unrealized loss on the investment of $857,670. No objec-

tions were raised to the investment when the prior account was filed, and a decree was entered judicially discharging the trustee. Thereafter, in 1993, the Notes were called, and a realized loss was sustained by the Fund for the entire premium. This loss was reported in the accounting period before the Court and was the subject of the guardian ad litem's first objection.

On the question of whether this objection presented a triable issue, the guardian ad litem argued that although the investment decision was made during the prior accounting period, the wisdom of the transaction could nevertheless be examined in the accounting before the Court because the actual loss occurred during the accounting period in issue. He further claimed that had the investment been objected to in the last account there could have been no remedy since the loss was not yet realized. Hence, the propriety of the investment remained an open question to which objections could be made.

The Court dismissed the guardian ad litem's objection as meritless, finding, on the basis of the Banking Law, section 100-c(6), that, in the absence of intentional deception, once judicially settled, any questions that could have been raised in a common trust fund accounting but were not, could no longer be reviewed by the Court.

Moreover, the Court noted that the prudent person rule does not always require proof of a realized loss. Instead, under that rule, a "trustee's investment decisions [are] to be measured in light of the business and economic circumstances existing *at the time they were made*." *In re Janes*, 90 N.Y.2d 41, 51 (emphasis supplied).

Finally, the Court rejected the guardian ad litem's contention that some imprudent investments would escape remedy finding, *inter alia*, that it had plenary power during an accounting period to remedy an imprudent investment. *Stortecky v. Mazzone*, 85 N.Y.2d 518, 524–525, *et al.* Nevertheless, the Court held that since the decision to purchase the Notes was made during the previous accounting period, which had already been judicially settled, it could not be further scrutinized.

In re Settlement of the Third Account of Proceedings of Morgan Guaranty, N.Y.L.J., Feb. 13, 2003, p. 19 (Sur. Ct., N.Y. Co., Surr. Preminger)

Appointment of Administrator for Infant's Estate

Upon application of the public administrator, the Court appointed an administrator for the estate of an infant who lived 13 hours after delivery by emergency caesarian section. The infant's mother died after being struck by a police officer's car that ran a red light.

The record revealed that the grand jury had heard sufficient evidence to conclude that the infant was a person capable of being a homicide victim. In view thereof, the Court found that it could not be said that the infant was incapable of experiencing pain and suffering. The Court ruled that an action for wrongful death could be brought on behalf of an infant that is born alive, but dies shortly after birth. *In re Estate of Herrera*, N.Y.L.J., Jan. 14, 2003, p. 21 (Sur. Ct., Kings Co., Surr. Feinberg)

Appointment of Guardian ad Litem

Before the Court was an omnibus proceeding commenced by the decedent's surviving spouse in her individual capacity as well as guardian of the property of her infant child. The infant was a person interested in the estate as an afterborn child, possibly entitled to inherit pursuant to EPTL 5-3.2.

The Court determined that it was mandated to appoint a guardian ad litem. The issue became whether this appointment barred the appearance of the guardian of the property as a party. In a prior decision, the Court rejected such a challenge, holding that the appointment of a guardian ad litem in no way usurps the rights of a legally appointed guardian to appear by counsel on behalf of an infant and to take all legal actions deemed appropriate for the infant's benefit. Although the Court noted that some commentators have suggested that under certain circumstances the guardian ad litem may be directed to appear in lieu of the guardian of the property, others have determined that concurrent appearances by a guardian ad litem and guardian of the property are not necessarily redundant. Generally, when a guardian ad litem is appointed in such situations it is designed as a safety net for the ward in the proceeding.

As such, in the context of the pending proceeding, the Court held that while the guardian of the property could appear as a co-petitioner on her own behalf and on behalf of her child, an independent guardian ad litem would fully protect the interests of the ward. *In re Estate of Seviroli*, N.Y.L.J., Dec. 17, 2002 (Sur. Ct., Nassau Co., Surr. Riordan)

Claims Against an Estate/Estate Assets Defined

In a contested proceeding to determine the validity of a claim, the Department of Social Services moved for summary judgment directing the fiduci-

ary to pay it the sum of $38,672.39, representing the cost of medical assistance provided to the decedent prior to his death. The executrix opposed the motion on the grounds that there were no estate assets available from which the Department of Social Services could be paid.

The undisputed facts revealed that the decedent resided in a nursing home before he died and was initially denied medical assistance due to excess resources. Approximately two months after being denied assistance, the decedent transferred a one-half interest in his home to his daughter, whereupon the two held title as tenants in common. Eight months later, the decedent's application for medical assistance was approved and assistance was thereafter provided to the decedent until his death.

In the interim, the decedent and his sister entered an agreement with the nursing facility in which the decedent resided which provided, inter alia, that the decedent owed the facility approximately $51,000, that the decedent's sister was jointly and severally liable for the debt, and that upon the closing of the sale of the decedent's home, the full amount of the indebtedness would be held by counsel in escrow pending payment to the home.

The house was sold after the decedent's death, and one-half of the proceeds were placed in escrow subject to the claim of the nursing home. This claim was paid seven months after the appointment of the decedent's sister as executrix of his estate. In the interim, the Department of Social Services filed a verified claim against the estate.

On the basis of the foregoing, the Court granted summary judgment to the Department of Social Services and surcharged the executrix for the full amount of its claim. The Court rejected the executrix's arguments as to the lack of estate assets to pay the claim, finding that the decedent's interest in his home was tenant in common with his daughter constituted an estate asset subject to creditor's claims at the time of his death. Although the property was subsequently sold and half of the proceeds were held in escrow, the holding of the funds in escrow did not change the extent of the estate's interest in the monies.

Further, the Court found that the Department of Social Services was entitled, pursuant to federal and state law, to seek recovery against the decedent's home inasmuch as the property was a part of the decedent's estate, the decedent was 55 years of age when he was receiving medical assistance, and he was not survived by a spouse, or by a child under the age of 21, or one who was blind or totally disabled. *See* 42 U.S.C. § 1396p(b)(2); Social Services Law § 369.2(b)(i).

Further, the Court held that it was improper for the executrix to pay the nursing facility in advance of the Department of Social Services, thereby leaving the estate without assets with which to satisfy the Department's claim. The Court reasoned that pursuant to the provisions of Social Services Law § 104(1), the Department of Social Services was a preferred creditor of the estate, and as such was entitled to have its claim paid prior to that of the nursing home. The Court noted that the Department of Social Services had timely presented its claim within seven months of the issuance of letters, and that the executrix acted at her peril when she opted to prefer the claim of the nursing facility to the detriment of the Department of Social Services. *In re Estate of Snell*, N.Y.L.J., Feb. 14, 2003, p. 25 (Sur. Ct., Nassau Co., Surr. Riordan)

Construction of Will

In a construction proceeding, the Court was asked to determine whether a pre-residuary bequest under the decedent's Will of "cash on deposit in any accounts" was intended to dispose of the funds in the decedent's mutual fund account. The account constituted the decedent's sole probate asset at death.

The executrix of the estate took the position that the funds in the mutual fund account could not be utilized in order to satisfy the bequest, and that as such it abated. The respondent and the guardian ad litem argued that the account was the equivalent of cash and therefore should be distributed to the pre-residuary legatees.

The Court noted that historically "cash" has meant ready money, or money available at command, subject to free disposal. The term "cash" has therefore been held to include money in a bank account that may be drawn on demand, and generally does not include stocks, bonds or mutual funds.

This being the case, the Court found that the words "cash" or "cash on deposit" as contained in the decedent's Will were not intended to include mutual funds, but instead, its ordinary meaning of coins, bills, savings and checking accounts or so-called "demand deposits." The Court rejected the respondent's argument that the mutual fund shares were "cash" because they could readily be converted into cash by a simple instruction to the broker. Additionally, the Court found unconvincing the respondent's argument that because the decedent had little or no cash at death that he intended the pre-resid-

uary disposition to include his mutual fund account. *In re Estate of Poppe*, N.Y.L.J., Jan. 2, 2003 (Sur. Ct., Nassau Co., Surr. Riordan)

Construction of Will

In a construction proceeding, the Court was asked to construe and reform the decedent's Will such that Paragraph 6 thereof qualified as a charitable remainder unitrust. The Court found that a careful reading of the Will led to the inescapable conclusion that the decedent intended to create the charitable trust. Hence, the proposed construction was granted by the Court. *In re Estate of Engum*, N.Y.L.J., Jan. 13, 2003, p. 23 (Sur. Ct., Richmond Co., Surr. Fusco)

Examination Before Trial of Corporate Witness

In an action for breach of contract and for an account stated, the defendant moved to compel plaintiff, corporation, to produce a named employee for an examination before trial. The Court denied the motion, holding that a party corporation has the right to determine which of its representatives will appear for an examination before trial. If the defendant desires to depose other representatives, he or she must show that the representatives who have already been deposed had insufficient knowledge, or were otherwise inadequate, and there is a likelihood that the person he or she wants to depose possesses information which is material and necessary.

The Court determined that the defendant failed to make a sufficient showing in this regard, and thus denied the requested examination. *Goldstein, Rubinton, Goldstein & DiFazio*, N.Y.L.J., Dec. 18, 2002 (Dist. Ct., Suffolk Co.)

Revocation of Letters

The decedent executed a Last Will and Testament, dated June 5, 2000, naming five executors, her brother and her sister, her stepson, and two attorney-fiduciaries, one of whom was the attorney-draftsman, and the other, who was the attorney-draftsman's partner. According to memoranda to the file prepared by the attorney-draftsman, the decedent insisted that there be five executors of her estate, and that their compensation not be reduced. After decedent executed her Will, a letter was sent by the draftsman's law firm to her, enclosing several copies of the Will, describing the Will's contents, and in a footnote, calculating the total executor's commissions, and the amount payable to each executor.

After the death of the decedent, a one-sentence document was found amongst her personal effects. The document, which was signed by the decedent and witnessed by her personal secretary, stated that the decedent removed her stepson from any position whatsoever with respect to her estate, and specifically as the executor under her Will, dated June 5, 2000. Although the document was known to all the executors at the time the Will was offered for probate, it was not implemented, presumably because it had not been executed in accordance with the statutory formalities. Thereafter, all five executors petitioned for probate of the Will.

Approximately one year later, the decedent's brother and sister petitioned, *inter alia*, for removal of the attorney-draftsman and the decedent's stepson as executors of the estate, and for denial of their commissions. The petitioners alleged that both executors had committed fraud upon the decedent, in that the attorney-draftsman led the decedent to believe that she could remove her stepson as a fiduciary of her estate simply by signing the one-sentence document with only one instead of two witnesses, although he knew that one witness would be insufficient. Petitioners further alleged that the attorney-draftsman committed overreaching and abused his fiduciary relationship with the decedent in being appointed one of her executors, and that he failed to fully inform the decedent of the consequences of his appointment before the execution of the Will. The petitioners' assertions were predicated, in part, upon an affidavit supplied by the decedent's personal secretary.

The attorney-draftsman and stepson moved to dismiss the petition on the grounds that it failed to state a cause of action and judicial estoppel. The decedent's stepson additionally claimed that the one-sentence document could not be utilized to remove him inasmuch as it was not a Will, and that any fraud involved in its execution could not be imputed to him.

The Court found that the statute setting forth the grounds for revocation of letters explicitly contemplates that objections not raised at probate can be raised post-probate. The Court reasoned that allowing objections beyond probate to a fiduciary's appointment preserves the court's continuing role in ensuring the orderly administration of decedent's estates and thereby affords additional protection to the various beneficiaries and creditors of the estate. The Court found, however, that a party cannot always raise objections post-probate, particularly where would-be objectants have investigated possible objections, and concluded that none should be

filed. Under such circumstances, the party can be estopped from seeking removal. Nevertheless, in the context of attorney-draftspersons nominated as executors, courts are reluctant to apply judicial estoppel unless a party was represented by separate counsel, actively investigated the nomination of the draftsperson as executor and then concluded that no objections should be filed.

In this context, the Court determined that the fact that the petitioners signed the petition for probate and thus attested to the validity of the Will did not make out an estoppel, particularly since petitioners did not actively advocate the propriety of the nomination of their co-fiduciaries, and did not state that they would forego objections to their fitness. "Neither the statutes dealing with objections to probate or removal of fiduciaries nor the case law suggests such a rule. To the contrary, the cases support the proposition that inquiry into a person's overreaching in being named executor can occur at any time, even during the executor's account . . ."

Additionally, the Court found that the affidavit of the decedent's personal secretary regarding the circumstances surrounding the execution of the one-page document was sufficient to survive the attorney-draftsman's motion to dismiss petitioners' claims regarding his unfitness to serve.

As to the petitioners' claims against the decedent's stepson, the Court found that no cause of action was stated for fraud or conspiracy to defraud the decedent regarding the one-page document. *In re Estate of Berkman*, N.Y.L.J., Jan. 24, 2003, p. 19 (Sur. Ct., N.Y. Co., Surr. Preminger)

Summary Judgment—Probate

In a contested probate proceeding, the Court granted the proponent's application for summary judgment admitting the decedent's Will and Codicil to probate. Objections to probate were filed on the grounds of lack of due execution, lack of testamentary capacity, fraud and undue influence. In addition, the objectant maintained that the entire Will was a mistake, inasmuch as the percentages used to dispose of the residuary estate did not add up to 100%.

The objectant claimed, *inter alia*, that the presumption of due execution and the testimony of the attesting witnesses should be disregarded because one of the witnesses to the Codicil, who was also named as a co-executor and a co-trustee of the decedent's lifetime trust, was a convicted felon. This person was the decedent's accountant, her attorney-in-fact, and was given her health care proxy. Nevertheless, although this person was involved in the drafting of the propounded instruments, the Court found that he had no beneficial interest thereunder, and the only pecuniary advantage he could have attained, i.e., commissions, was rendered academic by virtue of his felony conviction. In view of the fact that the witness thus had nothing to gain or lose from the outcome of the proceeding, the Court concluded that to discredit his testimony, and thereby deny the proponent's motion, would be an injustice. Hence, summary judgment was granted to the proponent on the issue of due execution.

Additionally, the Court found no basis for denying the proponent's motion on the issues of testamentary capacity, fraud and undue influence. As to the issue of mistake, the Court noted that to prevail on that allegation the objectant had to prove that the mistake was such that the decedent did not understand the contents of the Will, or that the attorney who drafted the Will misinterpreted the decedent's instructions. The Court found that the mistake alleged did not rise to such a level, but rather, it was simply a mathematical error, which might require construction. Accordingly, the objections to probate were dismissed. *In re Estate of Possenriede*, N.Y.L.J., Feb. 26, 2003, p. 26 (Sur. Ct., Nassau Co., Surr. Riordan)

Three Year/Two Year Rule

Before the Court was a motion for an order compelling a witness to answer questions at an examination pursuant to SCPA 1404.

The decedent died with a Will and a Codicil. The Codicil changed the named executor of the Will to a corporate fiduciary as well as amended several dispositive provisions. Respondents alleged that the Codicil was the product of undue influence.

At the SCPA 1404 examination of the named executor under the Codicil, counsel instructed the witness not to answer questions concerning the history of litigation between his company and the decedent. Counsel argued that the questions were beyond the scope of UCR 207.27. Respondents argued that the litigation between the named executor and the decedent spanned approximately 30 years, and that the decedent would never have selected the company to serve as executor but for possible undue influence.

Although the Court recognized that UCR 207.27 limits examinations conducted pursuant to SCPA 1404 to the period three years prior to the date of the instrument and two years thereafter or to the date of the decedent's death, whichever is shorter, it also noted that the rule can be extended in special cir-

cumstances most commonly, where there is a scheme to defraud or a continuing course of conduct resulting in undue influence. Although respondents did not charge the named corporate fiduciary with undue influence in procuring the Codicil, they did contend that the adverse relationship between the company and the decedent led to an inference that undue influence was perpetrated by a beneficiary under the propounded Codicil. The proponents argued that respondents' contentions of undue influence were purely speculative.

The Court found that the propounded Codicil was a departure from the decedent's prior testamentary instrument, that it was executed in close proximity to the decedent's death, and that the attorney-draftsman had no direct communication with the decedent regarding its contents. These circumstances, it held, created a sufficient suspicion of undue influence to warrant extension of the three year/two year rule, the Court opining that "[d]iscovery should not be foreclosed because Respondents' argument rests upon the probability, not certainty, that the decedent would not have selected [the corporate fiduciary to serve.]" Accordingly, the motion was granted. *In re Estate of Martin*, N.Y.L.J., Mar. 12, 2003, p. 21 (Sur. Ct., Nassau Co., Surr. Riordan)

Validity of Antenuptial Agreement Determined

In a contested proceeding for letters of administration, the issue before the Court was whether the respondent, the decedent's surviving spouse, was precluded from being appointed the administrator of his estate by virtue of the terms of an antenuptial agreement.

The antenuptial agreement provided that if one of the parties should die, the survivor had no interest in the other's estate by way of inheritance, succession, family allowance or homestead. The agreement further provided that neither party made any representations as to the value of his or her real or personal property, and that the wife agreed not to make a claim against the decedent's estate after his death.

The issue was whether the antenuptial agreement extinguished the interest of the decedent's surviving spouse in his estate.

The factual circumstances surrounding the execution of the agreement revealed that the respondent was a native of the Philippines, and that although English was not her native language, she had sufficient command to pass her professional examinations in English. She testified that three days prior to her marriage to the decedent, he took her to an attorney's office and asked her to sign the antenuptial agreement, which she saw for the first time. The agreement did not include a statement of assets and respondent was not represented by separate counsel. The meeting at counsel's office lasted five or ten minutes. Respondent further testified that counsel had informed her that the agreement was valid for only two years.

The Court found that respondent's lack of independent counsel, the absence of any opportunity for her to consider the terms of the agreement prior to its execution, the brevity of the meeting to review the agreement and execute it, the conversation which took place between respondent and decedent's attorney at such time, and the absence of any disclosure regarding decedent's assets demonstrated a level of inequality in the negotiation of the agreement which shifted the burden of proof to the petitioner to show the absence of fraud and undue influence.

The Court determined that petitioner failed to sustain this burden, introducing no facts to establish that respondent had knowingly waived her rights in the decedent's estate. The Court held that the mere fact that respondent had a college education and a command of the English language was insufficient. *In re Estate of Holtzman*, N.Y.L.J., Dec. 20, 2002, p. 20 (Sur. Ct., N.Y. Co., Surr. Preminger)

Ilene S. Cooper—Counsel, Farrell Fritz, P.C., Uniondale, New York.

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Scenes from the Trusts and Estates Law Section

Spring Meeting

April 24 - 25, 2003 • Albany, New York


The North


BLACK CAPITAL:
HARLEM IN THE 1920s

New York State Bar Association
Trusts and Estates Law Section
Presents

2003 Fall Meeting

September 11–14, 2003

The New Millennium: Exercising Discretionary Investment and Administration Powers, and Concurrent Liabilities Facing the Trustee and Executor

Program Description:

While some attorneys believe a crystal ball is necessary when evaluating the discretionary investment and administration decisions the fiduciary client must make, the more prudent approach is to find out the answers from a panel of experts who deal with such issues. By addressing a series of questions based upon prepared scenarios, our panel will examine:

- investment before and after the prudent investor act;
- measuring damages where there are losses;
- funding a trust where assets are unproductive or appreciating;
- allocation of interests among beneficiaries;
- the "standard of impartiality";
- maintaining records, establishing a pattern of action;
- conflicts among co-fiduciaries;
- self-dealing, corporate investing in mutual funds;
- attorney-client privilege is reignited, now how do you apply it?;
- burden of proving and defending against an allegation of imprudence;
- changing situs, is it imprudent not to?;
- jurisdiction in cyberspace;
- administering assets in multiple jurisdictions;
- distributing assets and discharge, is there finality?;
- the alien spouse, drafting issues.

Program Faculty:

Co-chairs: Charles F. Gibbs, Esq. and Colleen F. Carew, Esq.

Panelists:
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Hon. John Czygier, Surrogate, Surrogate's Court, Suffolk County
Charles F. Gibbs, Esq., Holland & Knight LLP
Kenneth Joyce, Esq., Professor SUNY Buffalo Law School
Georgiana Slade, Esq., Milbank, Tweed, Hadley & McCloy LLP
Hon. Anthony A. Scarpino, Jr., Surrogate, Surrogate's Court, Westchester County
Michael JA Smith, Esq., Deutsche Bank
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Unless stated to the contrary, all published articles represent the viewpoint of the author and should not be regarded as representing the views of the Editor or the Trusts and Estates Law Section or substantive approval of the contents therein.

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