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# Trusts and Estates Law Section Newsletter

A publication of the Trusts and Estates Law Section of the New York State Bar Association

## A Message from the Section Chair

We have passed the mid-point of the year and things progress on a number of fronts. The Fall Meeting in New Orleans may have already occurred by the time you receive this message, but I expect that all will be very happy with the excellence of the educational programs and the quality of the cuisine and activities.

The Section has moved forward recently in its technology. In July, the first issue of the Trusts and Estates Law eNews was broadcast e-mailed to all Section members. The first edition addressed the application of IRS Circular 230 to estate planners, and was prepared by former Chair Jonathan Blattmachr, Mitchell Gans and Michael Graham. The broadcast of eNews will not necessarily follow a strict schedule. The officers hope that an eNews broadcast will be sent whenever news of recent legislation or other communication needs to reach the Section members quickly. It is another important reason to be a member of the Section, but of course I don't have to tell you that. We thank the Elder Law Section for leading the way with this communication technique for all Bar members. We want to also thank Gary Freidman for taking on yet another important task, the organization of eNews.

The Estate Litigation Committee, under the leadership of Jonathan Rikoon, has been hard at work on its newest committee assignment, Pre-Death Will Contests. The topic caused much spirited discussion within the Sub-Committee addressing it, and we

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look forward to the conclusions and recommendations they will bring before the Executive Committee in the future.

The substantive program for the Annual Meeting is coalescing under the leadership of Betsy Hartnett, as Program Chair. The topic will be Income Taxation of Estates and Trusts, including exploring new issues in income tax treatment of charitable trusts and income tax problems and opportunities with off-shore and other international trusts.

Communication among our Section members continues to be the key objective of the Section. We will try to give you important information as quickly as possible through eNews and this *Newsletter*. At the same time, each of you should consider making your unique experiences known to the rest of the Section. This could be done by proposing or writing an article for the *Newsletter* or for eNews. It can even be by simply alerting our Editor, Austin Wilkie, or an appropriate Committee Chair when something significant happens in our field of law of which other Section members may be unaware. This could be an unreported case or court position that you encountered or are involved with in your practice.

The Spring Meeting this year will be held in Buffalo. The date is still under discussion but will be determined shortly. It presents a chance to attend a convenient program and have some Section involvement without the travel usually required for those in Western New York. I hope to see many of you there.

**Michael E. O'Connor**

# Editor's Message

According to a recent national survey, 29% of children eat a peanut butter and jelly sandwich at least once a week, and 59% do so at least once a month.[1] As parents have known for generations, spreading the jelly between two thick layers of peanut-buttered bread is an ingenious and foolproof way to safeguard the sandwich's integrity—it's far less likely to collapse into a soggy mess. Corporate America knows this too: U.S. Patent No. 6,004,596, owned by J.M. Smucker Co., describes a sandwich whose "upper and lower fillings are preferably comprised of peanut butter" and whose "center filling is comprised of . . . jelly." In other words, a peanut butter and jelly sandwich.

Most parents would be surprised to learn how often they commit patent infringement while throwing together a quick lunch for the kids. And many estate planning attorneys could be in line for a similarly sobering revelation.

Careful readers of the June 2005 issue of the journal *Estate Planning* were alerted[2] that an estate planning technique outlined in an article which had appeared several months earlier,[3] describing the funding and administration of a grantor retained annuity trust (GRAT) with stock options, was in fact patented. In June, the editors responsibly pointed out to practitioners that "a license is necessary to use this patented technique," known as a "SOGRAT," adding that "the penalties for patent infringement are severe."

In their recent critique of the U.S. patent system, economists Adam Jaffe and Josh Lerner argue that the purpose of patents—to encourage creativity and innovation by offering protection to original ideas, and with it the potential profits flowing from their use—has in recent years become seriously compromised, not only by fundamental changes in the administrative practices of the U.S. Patent Office, but more importantly by an explosion in the proliferation of patent applications and grants, and in the resulting flood of patent litigation.[4]

Along with the appearance of other so-called "business methods" patents, the recent wave of estate planning patents granted by the U.S. Patent Office has not been ignored in the press.[5] Are lawsuits over the use of these techniques also lurking in the wings? While litigation over the infringement of estate planning patents has not yet hit the radar screen, the prospect is not inconceivable. And now that IRS Circular 230, whose many effects on our practice are explored elsewhere in this issue of the *Newsletter*, has firmly discouraged the use of confidentiality agreements in conjunction with tax planning techniques, the patenting of estate planning methods may well emerge as the alternative of choice among estate planning gurus for securing exclusive profits from the original and innovative estate planning strategies they devise.

Patents of all kinds, and the ability to enforce their protections, exist because our society has long recognized the value of rewarding those who generate original, innovative ideas. A patent is, in the end, merely a government-granted right to reserve to your own use, and to prevent others from using, a process you have invented. Whether the SOGRAT is either original or innovative enough to warrant patent protection will not be considered here. But it is no small irony that our government is willing to grant its patent protection to a "business method" whose principal utility derives from limiting the government's own ability to collect tax revenues.

Let us hope that estate planning attorneys may enjoy the same free ride from estate planning patent owners that Smucker's has thus far extended to parents and to young peanut-butter-and-jelly-sandwich lovers everywhere. See you in New Orleans.

## Remember

The *Newsletter* relies on the members of the Section for the majority of its timely, incisive and informative articles on all areas of our practice. We strongly encourage you to contact us if you have an article, or an idea for one, to be considered for publication.

**Austin Wilkie**

## Endnotes

1. Harris Interactive, reported in Ramstack, "Spreading the Wealth," Washington Times, April 8, 2005, at A1.
2. Estate Planning, June 2005, at 25.
3. Goldsbury, "Important Considerations When Making Gifts of Stock Options," Estate Planning, April 2005, at 30.
4. Jaffe and Lerner, "Innovation and Its Discontents: How Our Broken Patent System Is Endangering Innovation and Progress, and What To Do About It," Princeton University Press, 2005.
5. Jacobs, "Patent Pending," Bloomberg Wealth Manager, May 2005, at 41; Silverman, "The Patented Tax Shelter," Wall Street Journal, June 24, 2004, at D1; Davis, "Patenting Tax Strategies," Trusts & Estates, March 2004, at 42.

# Circular 230: What the Trusts and Estates Practitioner Should Know

By Tara Anne Pleat

### Circular 230—What Is It and Where Can I Find It?

Circular 230 is an 83-year-old Treasury Department publication that governs the practice standard of attorneys, accountants and other tax advisors before the Internal Revenue Service. Circular 230 can be found under Title 31 of the Code of Federal Regulations Subtitle A, Part 10. The Treasury Department has proposed revisions to Circular 230 a number of times in the last couple of years, issuing final regulations in December of 2004[1] which were clarified in May of 2005.[2] Effective June 20, 2005, the written advice, including e-mail, of estate planning attorneys will be governed by the revised Circular 230. The Circular 230 regulations in their most up-to-date form can be found on the Internal Revenue Service's website.[3]

Simply stated, Circular 230 is the Treasury Department's version of the New York Code of Professional Responsibility. Circular 230 has always applied to tax practitioners, though the writing requirements of the final revisions are generally new to practitioners who primarily render estate, gift and generation skipping transfer tax advice.

Circular 230 states that all written advice rendered by a tax practitioner (including estate planners) falls into one of two categories: (1) covered opinions; or (2) other written advice. Some have observed that Circular 230 creates a third category of "preliminary advice."[4] This article will only address the first two categories of advice and the requirements that apply to those types of advice, the procedures for compliance and the potential consequences of non-compliance.

### What Is a "Covered Opinion"?

While there has been no published definition of a "Covered Opinion" as it relates to day-to-day estate planning practice, the final regulations revising Circular 230 define a "Covered Opinion"[5] as any written advice, including e-mail, concerning one or more federal tax issues arising from:

(1) a listed transaction[6];

(2) any plan or arrangement where avoidance or evasion of tax is the *principal purpose*; or

(3) any plan or arrangement where the avoidance or evasion of tax is a *significant purpose* if the written advice is (1) a reliance opinion; (2) a marketed opinion; (3) subject to the conditions of confidentiality; or (4) subject to a contractual arrangement.[7]

### What Is a "Principal Purpose" Transaction?

A transaction is a principal purpose transaction if the purpose of avoiding or evading federal tax exceeds any other purpose. Circular 230 dictates that a plan or arrangement will not have the principal purpose of avoiding or evading taxes if the plan or arrangement "has as its purpose the claiming of tax benefits in a manner consistent with the statute and Congressional purpose."[8]

Many practitioners, including this author, believe that advice concerning traditional estate planning strategies are not principal purpose transactions because the advice involves taking advantage of arrangements prescribed in the Internal Revenue Code and Treasury Regulations.

### What Is a "Significant Purpose" Transaction?

Circular 230 indicates that a transaction is a significant purpose transaction if the purpose of avoiding or evading federal tax is significant but is not the principal purpose of the transaction. This vague definition is not terribly helpful since virtually every piece of tax advice a trusts and estates practitioner gives has a significant purpose of reducing or eliminating some type of federal tax. However, this does not in and of itself mean that the practitioner's written advice must be in the form of a covered opinion.

Written advice about a significant purpose transaction must only come in the form of a covered opinion if the opinion is (1) a reliance opinion; (2) a marketed opinion; (3) subject to the conditions of confidentiality; or (4) subject to a contractual arrangement.[9]

#### Marketed Opinion

Unless a practitioner "knows or has reason to know" that his or her written advice will be utilized by someone else in promoting or marketing an entity, plan or arrangement to other taxpayers, the practitioner's written advice is not a marketed opinion.[10] There has been some speculation that continuing legal education or seminar materials could be considered marketed opinions. Since the May 2005 revisions, the Treasury Department has informally indicated that the outlines of practitioners utilized in continuing legal education and other similar presentations will not be regarded by the IRS as marketed opinions.[11]

### Conditions of Confidentiality

If the practitioner does not prohibit his or her clients from discussing the practitioner's advice regarding the tax transaction at issue, the written advice is not subject to conditions of confidentiality.[12]

### Contractual Protection

If the practitioner does not make his or her fees contingent upon success in achieving the tax consequences of the plan or arrangement which is the subject of the written advice, the written advice is not subject to contractual protection.[13]

### Reliance Opinion

A reliance opinion is written advice that "concludes at a confidence level of at least more likely than not that one or more *significant federal tax issues* would be resolved in the taxpayer's favor."[14] A "federal tax issue" is "a question concerning the federal tax treatment of an item of income, gain, loss, deduction, or credit, the existence or absence of a taxable transfer of property, or the value of property for federal tax purposes."[15] A federal tax issue is "significant" if the "IRS has a reasonable basis for a successful challenge and its resolution could have a significant impact under any reasonably foreseeable circumstance, on the overall Federal Tax treatment of the transactions or matters addressed in the opinion."[16]

When a practitioner is considering whether or not the written advice is a reliance opinion, the key is to determine if: (1) the IRS has a reasonable basis for a successful challenge; and (2) that challenge could have a significant impact on the tax treatment of the subject transaction. Most typical estate planning advice does not involve a discussion of issues or use of methods upon which the IRS will have any basis for a successful challenge. This being the case, it seems that most day-to-day estate planning advice will not be subject to the Circular's covered opinion standards.

If the practitioner does believe that the IRS may have a basis for a successful challenge then the practitioner will need to determine whether any such challenge will have a significant impact on the tax treatment of the transaction. Unfortunately, Circular 230 does not define "significant impact," so the practitioner will have to use his or her own judgment. So long as the determination is not made in a unreasonable or reckless fashion, the practitioner should be acting in compliance with Circular 230.[17]

If the practitioner is conservative, Circular 230 gives the practitioner the ability to "opt out" of covered opinion status with respect to a reliance opinion by including a disclaimer prominently disclosing that the written advice was not intended to be used, nor can it be used by the taxpayer for the purpose of avoiding penalties.[18] To be prominently disclosed, the disclaimer must be in a separate section of the written advice and must be in the same or larger font as compared to the rest of the written advice.[19]

## What Are the Requirements for Covered Opinions?

If the practitioner finds that he or she is rendering written advice for a listed transaction, a principal purpose transaction or a significant purpose transaction, then the practitioner's written advice is subject to the following requirements:

(1) The practitioner must use reasonable efforts to identify, ascertain and consider the relevant facts;

(2) The practitioner must not base the opinion on any unreasonable factual assumption(s) or representation(s) that the practitioner knows or should know is incorrect or incomplete;

(3) The writing must relate the law (including potentially applicable judicial doctrines, i.e., step-transaction, sham-transaction, etc.) to the relevant facts and may not assume the favorable resolution of any significant federal tax issue;[20]

(4) The opinion must not contain internally inconsistent legal analyses or conclusions;

(5) The opinion must evaluate all significant federal tax issues and must conclude as to the likelihood the taxpayer will succeed on the merits with regard to each issue;

(6) If the practitioner cannot reach a conclusion with respect to a significant federal tax issue, then the practitioner must state so;

(7) If the practitioner cannot reach a "more likely than not" conclusion with respect to one or more of the significant federal tax issues, then the opinion must disclose that the opin-

ion does not reach such a conclusion with respect to one or more significant federal tax issues addressed in the opinion; and with respect to those issues, the opinion can not be used by the taxpayer to avoid penalties;

(8) In evaluating federal tax issues addressed in the opinion, the practitioner must not take into account the possibility that a return will not be audited, that an issue will not be raised on audit or that an issue will be resolved through settlement if raised; and

(9) For marketed opinions, the disclosure must reach a more likely than not confidence level on *every* significant federal tax issue, or else the marketed opinion cannot be rendered unless it complies with certain disclosure requirements.[21]

Compliance with these regulations will be very time consuming and potentially quite expensive for a client. However, there is no way to opt out of these requirements if the practitioner is rendering written advice regarding a listed transaction (or a transaction substantially similar to a listed transaction) or a principal purpose transaction.

## How Should a Trusts and Estates Practitioner Determine if Written Advice Is a Covered Opinion?

The practitioner should first determine whether or not he or she is providing written advice on a federal tax issue. If so, the practitioner must then determine whether the written advice concerns (1) a listed transaction or a transaction substantially similar to a listed transaction; (2) a plan or arrangement with the principal purpose of tax avoidance or evasion; or (3) a plan or arrangement with a significant purpose of tax avoidance or evasion and the written advice is (i) a reliance opinion; (ii) a marketed opinion; (iii) subject to the conditions of confidentiality; or (iv) subject to contractual protection.[22]

If a practitioner is rendering written advice with regard to a listed transaction or a principal purpose transaction, the written advice must meet the covered opinion requirements set out in 10.35(b) of the Circular.

If a practitioner is rendering written advice with regard to a significant purpose transaction and the written advice is either a reliance opinion or marketed opinion, the written advice must meet the covered opinion requirements of Section 10.35 unless the practitioner opts out of covered opinion status by including the available written disclaimers for those types of opinions.

## What Are the Requirements for "Other Written Advice"?

Section 10.37 of Circular 230 covers *all other written advice* that is not a covered opinion. Specifically, 10.37 prohibits a practitioner from giving written advice on any federal tax issues if the attorney bases the advice on unreasonable factual or legal assumptions, unreasonably relies on representations of the taxpayer or any other person, does not consider all of the relevant facts that the practitioner knows or should know, or in evaluating a federal tax issue considers the possibility that a return will not be audited, that an issue will not be raised on audit or that an issue will be resolved through settlement if raised.

Most cautious practitioners already adhere to these standards for other written advice and therefore should not find them burdensome.

## How Should One's Practice Comply with Circular 230?

Section 10.36 of Circular 230 holds a firm's managing tax practitioner to certain practice and procedure standards. Specifically, Section 10.36 directs that "any practitioner who has or shares principal authority and responsibility for overseeing a firm's practice of providing advice concerning federal tax issues must take reasonable steps to ensure that the firm has adequate procedures in place for all members, associates and employees to comply with Section 10.35."[23]

Thus each firm should have a Circular 230 policy in place.[24] At a minimum, every practitioner should prepare a file memo or some other record of his or her diligent efforts taken to reach the conclusion that the writing to a client regarding a particular transaction is or is not a covered opinion. The diligence would be reflected by an examination of the issues, the proposed advice, and whether or not any of these transactions are noticeably aggressive or are inconsistent with generally accepted principles of transfer tax planning. To the extent that advice is rendered as a covered opinion, a review procedure should be in place to ensure that all covered opinion requirements have been satisfied.

In the author's review of estate planning listserve communications and of everyday correspondence with colleagues, it is apparent that some firms have added a Circular 230 notice to their e-mail correspondence as a precautionary measure.[25] Those firms may have added a similar disclosure to all other client correspondence that the firm has determined is not written advice about a listed transaction or principal purpose transaction. However, each individual firm should determine whether this type of widespread disclosure is appropriate.

## The Best Practice Standards of Circular 230

Much like the Ethical Considerations of the New York Code of Professional Responsibility, Circular 230 proposes its own aspirational best practices for all tax advisors. The Circular directs that practitioners should: (1) maintain clear communication with their clients regarding the scope of their engagements; (2) determine which facts are relevant to the client's situation, and determine whether an assumption or representation is reasonable; (3) apply the applicable law to the relevant facts; (4) advise clients of the import and potential outcomes of reliance upon conclusions reached by the advisor; and (5) act fairly and with integrity before the IRS.[26]

While these "best practice" standards are aspirational only, New York attorneys should already be in the practice of providing clients with a written engagement letter if the fee is expected to exceed $3,000. Most trusts and estates attorneys who are involved in significant transfer tax planning for a client will likely have a fee estimate that exceeds the $3,000 threshold and will be obligated to provide the client with a written engagement letter in any event. As a general rule, given these best practices and for the overall protection of the attorney and the client, a written engagement letter defining the scope of the representation and the expectations of the parties should be created in every case.

There is an inherent expectation that any practitioner who gives tax advice with respect to a particular transaction is evaluating relevant facts, evaluating assumptions and representations, relating the law to the facts and arriving at a conclusion supported by the facts. The failure of a practitioner to do any of the following could well result in a malpractice action by his or her client.

These standards are not unduly burdensome and are already a part of the standard ethical practice of most attorneys. Most advisors already advise their clients of the import of the conclusions that are reached and, as a general matter, each advisor should strive to act with integrity before any entity, including the Internal Revenue Service.

## Enforcement of Circular 230

Section 10.52 of Circular 230 provides that a willful or reckless violation of any regulation in Circular 230, other than Section 10.33, may result in private reprimand, censure, suspension, or disbarment from practice before the IRS. In addition, a practitioner may also be fined for failure to comply with the Circular's requirements.[27]

The Internal Revenue Service's Office of Professional Responsibility is the office responsible for the enforcement of the Circular. As a practical matter, the IRS may institute a proceeding for censure, suspension, or disbarment by filing and serving a complaint. If a complaint is filed, an evidentiary hearing before an administrative law judge would follow. An appeals process is also in place.[28]

## Conclusion

Each trusts and estates practitioner will draw his or her own conclusions about the breadth of Circular 230's application to federal tax issues. Each firm, if it has not done so already, will need to institute a compliance policy. Unfortunately, we won't know what Circular 230 safe harbors exist until enforcement actions begin.

For now, practitioners should take comfort in knowing that so long as the practitioner is not willfully or recklessly violating the regulations of Circular 230, he or she should not be subject to an IRS disciplinary action.[29] Practitioners should also take comfort in knowing that they are not alone—every practitioner who renders advice on federal tax issues is in the same position of trying to navigate the Circular and determine its applicability.

## Endnotes

1. Regulations Governing Practice Before the Internal Revenue Service, 69 Fed. Reg. 75,839 (December 20, 2004) (to be codified at 31 C.F.R. pt. 10).
2. Regulations Governing Practice Before the Internal Revenue Service, 70 Fed. Reg. 28,824 (May 19, 2005) (to be codified at 31 C.F.R. pt. 10).
3. 31 C.F.R. pt. 10 (revised as of June 20, 2005) *available at* http://www.irs.gov/pub/irs-pdf/pcir230.pdf.
4. Natalie B. Choate, *How Will I Comply with Circular 230: The real impact of the IRS' far-reaching new regulation of tax practices*, 144 Trusts and Estates 7, 22 (July 2005).
5. Eight types of advice are specifically excluded from treatment as covered opinions. They include: preliminary advice, state or local bond opinions, advice concerning the qualification of a qualified plan, advice that is included in the document required to be filed with the Securities and Exchange Commission, negative advice, advice written by in-house counsel to his or her employer and advice regarding a filing that has already taken place. Circular 230 § 10.35(b)(2)(ii).
6. For an up-to-date summary of the listed transactions see http://www.irs.gov/businesses/corporations/article/0,,id=120633,00.html.
7. Circular 230 § 10.35(b)(2)(i)(B).
8. Circular 230 § 10.35(b)(10).
9. Circular 230 § 10.35(b)(2)(i)(C)(1-4).

10. Circular 230 § 10.35(b)(5). If the practitioner believes the written advice is a marketed opinion, Circular 230 § 10.35(b)(5)(ii)(A-C) provides guidelines for a disclaimer that will allow the practitioner to opt out of the covered opinion requirements.
11. Teleseminar: Estate Planners & New Circular 230: How New Standards of IRS Standards Will Impact Estate & Gift Tax Practice (Thursday, June 23, 2005).
12. Circular 230 § 10.35(b)(6).
13. Circular 230 § 10.35(b)(7).
14. Circular 230 § 10.35(b)(4).
15. Circular 230 § 10.35(b)(3).
16. *Id*.
17. Circular 230 § 10.52.
18. Circular 230 § 10.35(b)(4)(ii).
19. Circular 230 § 10.35(b)(8).
20. But see Circular 230 § 10.35(c)(3)(v), describing the circumstances in which a covered opinion can consider less than all of the significant federal tax issues.
21. Circular 230 § 10.35(b)(5)(ii)(A-C).
22. For one example of a decision making procedure, see Mary Ann Mancini and Melissa A.R. May, *Providing Written Advice Under Circular 230* (May 2005) *available at* http://www.brandsystems.net/vtbar/teleseminars/2005teleseminars/062305estateplanners.pdf.
23. Circular 230 § 10.36(a)(1).
24. The American Bar Association's Section of Taxation has sample documents regarding Circular 230 policies and procedures available to its members. The Section of Taxation's website can be found at http://www.abanet.org/tax/home.html.
25. A sample disclaimer is as follows: "In accordance with United States Treasury Department Circular 230, we advise you that any discussion of a federal tax issue in this communication is not intended or written to be used, and it cannot be used, by any recipient, for the purpose of avoiding penalties that may be imposed on the recipient under United States federal tax laws."
26. Circular 230 § 10.33.
27. *See* Circular 230 § 10.50 and § 10.51.
28. *See* Circular 230 § 10.60–§ 10.78.
29. Circular 230 § 10.52(a)(1-2).

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# Calculating the Value of Qualified-Plan Benefits in Determining the Surviving Spouse's Elective Share

By Donald Partland

There is what I believe to be a considerable inequity in the law regarding the calculation of a surviving spouse's elective share under section 5-1.1-A of the Estates, Powers & Trusts Law ("EPTL"). In particular, I submit that clause (G) of EPTL 5-1.1-A(B)(1) of the law, which deals with the inclusion of qualified-plan benefits as testamentary substitutes, is unduly burdensome on decedents' estates, and should be changed.

Let me illustrate with this example. Recently, a Client came to me to write his will in which he would leave his wife, to whom he was recently married, an amount essentially equal to what she would receive if she were to enforce her right of election against his will, that is, one-third of his estate, including certain non-probate assets. As this is a second marriage for both, I presume that each wants his or her own family, and not the other, to receive the bulk of the respective estates.

For purposes of simplicity, the following may be deemed to be the assets in the Client's estate, none of which is jointly held. Further, it may be assumed that the assets are net of administration expenses:

| | |
|---|---|
| Real property, net of mortgage | $300,000 |
| Stocks and bonds | $300,000 |
| Tangible personalty | $100,000 |
| Profit-sharing plan | $400,000 |
| Individual retirement account | $100,000 |
| **Total** | **$1,200,000** |

The Client had purchased the real property and most of the stocks and bonds prior to this marriage. Further, most of the value of his profit-sharing plan account and the individual retirement account were accumulated prior to this marriage. In addition, he designated his brother as the beneficiary of his interest in the profit-sharing plan in 1984 and has not changed it. After September 1, 1992, when EPTL 5-1.1-A became effective, but before his current marriage, he designated his brother the beneficiary of the IRA, which he has not changed.

Under EPTL 5-1.1-A, a surviving spouse has a personal right of election against the decedent spouse's will to the greater of $50,000 and one-third of the decedent's estate. Paragraph (a)(1) of EPTL 5-1.1-A provides that for purposes of the election, certain property described in paragraph (b)(1) of that section, which would not otherwise be included in the decedent's probate estate (called in the statute "testamentary substitutes"), is included for purposes of calculating the surviving spouse's share. Paragraph (a)(4) provides that the elective share is computed by determining the value of the property in the decedent's estate, including the testamentary substitutes, reduced by property that "passes absolutely" to the surviving spouse by (i) intestacy, (ii) by a testamentary substitute, or (iii) by disposition under the decedent's will. For purposes of determining whether an interest "passes absolutely," the statute uses a negative implication: An interest is deemed to pass other than absolutely to the surviving spouse if the interest so passing consists of less than the decedent's entire interest in the property or consists of an interest in a trust or trust equivalent created by the decedent.

In order to provide his wife with her statutory share, the Client wants to name his wife beneficiary of the entire account balance in his profit-sharing plan and to direct that a portion of the stocks and bonds be paid to her, to the extent necessary to meet the remainder of her one-third share. The rest of his estate is to be given to his family. It would appear that letting the wife have the profit-sharing account would satisfy the Client's objective. But EPTL 5-1.1-A is not so accommodating.

Paragraph (b)(1) provides a list of testamentary substitutes that are included both for the purpose of calculating the decedent's estate subject to the right of election and crediting toward the one-third interest the amounts actually passing to the surviving spouse. Clause (G) of the list provides that amounts payable under retirement-type arrangements are included at full value, except that amounts payable under a plan

> to which subsection (a)(11) of section four hundred one of the Internal Revenue Code applies or a defined contribution plan to which such subsection does not apply pursuant to paragraph (B)(iii) thereof, *only to the extent of fifty percent of the capital value thereof*. (Emphasis added).

Subsection 401(a)(11) is one of a number of requirements contained in Section 401(a) of the Internal Revenue Code that retirement plans must meet in order to qualify under Section 401(a) and obtain certain income-tax benefits accorded to qualified plans. Subsection 401(a)(11) (B) applies to: (1) defined-benefit plans (pension plans in which the benefit is fixed or determined by a formula that is usually based on years of service with the sponsor or compensation and years of service with the sponsor); (2) defined-contribution plans that are required to meet certain funding requirements of the Code (pension plans in which the contribution is fixed); and (3) defined-contribution plans that are not required to meet those funding requirements (typically, profit-sharing plans), but contain provisions that permit a participant to receive his benefit in the form of an annuity.

If subsection 401(a)(11)(B) applies to a plan, the Code requires the plan to provide that, in the event of the death of a participant, whether before or after the participant is receiving a retirement payment, the participant's surviving spouse is entitled to an annuity of 50 percent of the annuity that is payable to the participant. If the plan is a defined-benefit plan, the amount is usually expressed as an annuity for the spouse's lifetime. If the plan is a defined-contribution plan, the surviving spouse is entitled to one-half the participant's account balance in the plan, which may be converted into an annuity form.

If the plan is not required to meet the funding requirements of the Code and meets the exception contained in Section 401(a)(11)(B)(iii), the Code requires that the surviving spouse receive 100 percent of the participant's account balance in the event of the participant's death. On the other hand, the surviving spouse is not assured of any share of the participant's account balance; once the participant begins receiving payments, the interest of the spouse is limited to whatever is left in the plan, if anything, at the participant's death. Accordingly, if, under a plan that met this exception, a participant elected to receive his interest in, say, a lump sum, there would be no amount payable under the plan to the surviving spouse. Of course, the full value of whatever was left of the lump-sum distribution from the plan would be included in the decedent spouse's estate for purposes of calculating the elective share.

It is fair both to the decedent's estate and to the spouse to include some amount in the decedent's estate for purposes of the elective share, inasmuch as the decedent's participation in the plan created a benefit for the surviving spouse. But I am uncertain of the reason for the requirement that only half the amount payable be included if the payment is from a qualified plan. Why is there an exception for "qualified" plans? If, for example, a participant in a qualified plan is entitled to receive a life annuity of $1,000 per month, and on his death his spouse is entitled to a life annuity of $500 per month, what is the rationale for including the value of only a $250-per-month annuity in the elective-share base?

The rationale for including only half becomes more suspect in plans that meet the exception contained in Section 401(a)(11)(B)(iii). (I shall refer to this exception hereinafter as the "B(iii) exception.") In order to meet this exception, the Code requires, among other things, that the spouse receive 100 percent of the participant's account balance, irrespective of any designation made by the plan participant to the contrary. Yet only half that account balance is included in the decedent's estate for calculating the elective-share estate and allowing the estate a credit for amounts payable to the surviving spouse.

The legislative history of clause (G) is extremely brief. Clause (G) was proposed in 1991 by the EPTL-SCPA Legislative Advisory Committee, which was chaired by then Surrogates C. Raymond Radigan of Nassau County and Louis D. Laurino of Queens County (popularly called the "Radigan Commission"), whose mission was, among other things, to study and modernize the provisions of EPTL Articles Four and Five.[1] In this report, the Radigan Commission praised the attempts of the Uniform Marital Property Act to establish a community-property concept on property of married individuals, but stopped short of an endorsement of this approach.[2] The Commission promised to produce a further report regarding the inclusion of qualified plans, but to date I have found no such report.[3] The Commission then recommended the provisions of clause (G) essentially as it appears today.[4]

One may conclude that this is an attempt to establish a community-property rule on qualified plans alone. Under the Uniform Marital Property Act,[5] both qualified- and nonqualified-plan benefits are treated, for elective-share purposes, as joint property to some degree. (It may well be that the Commission intended to consider the spouse's one-half share as the spouse's own property, but I find no reference to the Commission's decision to this effect.) By including an interest of the surviving spouse in the elective-share estate and deducting it from the elective share, the law arguably recognizes that the decedent made a transfer to the surviving spouse and the decedent's estate should be entitled to credit for that transfer.

Another possible reason for the 50-percent rule is that the Commission was concerned that the qualified-plan benefit did not easily fit within the statute's concept of "passing absolutely." Let's take the example of the decedent who was receiving a life annuity of $1,000 per month at his death. Under the Code, the surviving spouse is entitled to an annuity of $500 per month. And in a defined-contribution pension plan, if a decedent had at death an account balance of $10,000, the surviving spouse is entitled to $5,000. This benefit could be interpreted as not passing absolutely to the surviving spouse because it arguably does not comprise the decedent's entire interest in the plan, respectively, the $1,000-per-month annuity or the full $10,000 amount. By adopting a 50-percent rule with respect to qualified plans, the Commission could have believed it was avoiding that interpretation. But this does not solve the problem of dealing with plans that meet the B(iii) exception and pay 100 percent of the benefit to the surviving spouse. And, as will be discussed later, this 50-percent rule creates considerable confusion in calculating the elective share.

Turning to the Client's situation again, we see:

| **Asset** | **Value** | **Value for right of election** |
|---|---|---|
| Real property, net of mortgage | $300,000 | $300,000 |
| Stocks and bonds | $300,000 | $300,000 |
| Tangible personalty | $100,000 | $100,000 |
| Profit-sharing plan | $400,000 | $200,000 |
| Individual retirement account | $100,000 | $100,000 |
| **Total** | **$1,200,000** | **$1,000,000** |

By including only half of the value of his profit-sharing account for purposes of the election, his estate is reduced to $1,000,000, and his wife is credited with only $200,000 of the $333,000 that the elective-share rule requires she be given. Therefore, he must bequeath an additional $133,000 to his wife in order to meet the minimum right of election. This results in his wife's receiving a total of $533,000, or almost 45 percent of the elective-share estate, 36 percent more than one would think the statute had intended to give her.

This, of course, assumes that any portion of the profit-sharing account balance must be included in the estate as a testamentary substitute. Clause (G) of EPTL 5-1.1-A(b)(1) expressly excludes from testamentary substitutes those designations of a beneficiary that were made prior to September 1, 1992 and were not changed thereafter. In the case of the Client, he has not yet changed the beneficiary of his profit-sharing plan account from his brother to his wife; nevertheless, under the Code and under the terms of the plan, she is entitled to the full amount in his profit-sharing account. Taking clause (G) at its word, none of the profit-sharing plan account is included in the calculation of the estate subject to the right of election, even though federal law and the terms of the plan require the entire account to be paid to his surviving spouse. The effect of this exclusion is to reduce to $800,000 the value of the estate subject to the election, giving the spouse a right of election of $267,000 as to those remaining assets. Adding that to the $400,000 she is already entitled to receive from the profit-sharing plan gives her $667,000, or 55 percent of the estate.

In *Estate of Farlow*,[6] this exact issue was before the court, which found that the marriage of the decedent effected a change of beneficiary, thus superseding the beneficiary designation that was in effect prior to September 1, 1992. Therefore, 50 percent of the benefit under the qualified plan was counted as a testamentary substitute. That is some consolation, when one considers that the entire amount could have been excluded, giving the surviving spouse a considerable windfall.

Fortunately, there is a simple solution to this particular problem. Under the profit-sharing plan in which he participates, the Client is entitled to a distribution even though he is still an employee (a provision generally unavailable in qualified pension plans). Further, profit-sharing plans that do not contain annuity features may permit a participant to receive his benefit without the consent of his spouse. Therefore, the Client could make an income tax-free "rollover" of his entire account balance to an individual retirement account and make his spouse the beneficiary of this account to the extent of her statutory share. That would increase his estate to $1,200,000 (individual retirement accounts are included at full value) for purposes of the elective share, and the rollover individual retirement account by itself would provide his surviving spouse with the maximum amount to which she is entitled. This solution, however, is only available because the Code allows and the plan permits a participant in a profit-sharing plan who has attained age 59½ to elect a distribution while still an employee.

But the issue still remains for all qualified-plan participants: Clause (G) of EPTL 5-1.1-A(b)(1), by limiting the amounts payable under qualified plans to 50 percent of their value, results in providing a surviving spouse with a greater benefit than is equitable. And this provision can provide greater skewing of the allocation of assets in determining the spouse's entitlement as the qualified-plan assets assume a greater proportion of the decedent's estate. Assume in my example that the qualified-plan assets were $800,000 instead of $400,000, making the value of the estate $1,600,000 and the value subject to the elective share $1,200,000. Leaving the spouse the entire $800,000 would be sufficient to meet the elective-share requirements ($800,000/2 = $400,000) but the surviving spouse would receive half the estate, not the one-third apparently intended.

A case appearing in the *New York Law Journal* in 2001, *Estate of Audrey Cohen*,[7] is instructive of the dilemma engendered by clause (G) of EPTL 5-1.1-A(b)(1). In that case, the decedent was a participant in four separate annuity plans that met the requirements of Section 403(b) of the Code (so-called "403(b) plans"). She made no provision in her will for her husband of a second marriage, stating in her will that she believed ". . . that he is adequately compensated as statutory beneficiary of my pension." Instead, she directed that her husband receive 50 percent of the retirement benefits due under each of three of the separate plans, apparently intending to provide her husband with assets sufficient to satisfy his elective share; the remaining 50 percent was to be paid to her two daughters from a previous marriage. The proceeds of a fourth plan were to be paid to her two daughters. The plans constituted a major portion of her estate.

The surviving spouse filed notice to take his elective share under EPTL 5-1.1-A. He contended that only 50 percent of the aggregate proceeds of the three plans should be included in the elective-share base. The executors, who were the daughters from a previous marriage of the decedent, argued that the clear language of EPTL 5-1.1-A(b)(1)(G) dictates that only those plans that are specifically subject to Code Section 401(a)(11) should be included at the 50-percent rate.

The court, after noting that the general rule of clause (G) includes the full value of retirement-plan benefits in computing the elective-share base and that the one-half rule is an exception, considered whether Section 401(a)(11) applied to any of the three plans. The court conceded that Section 401(a)(11) appears to be limited to plans that qualify under Section 401(a), and that plans that qualify under Section 403(b) are not directly subject to Section 401(a)(11). However, the court found that Treasury Regulation § 1.401-1(a)(20)A-3(d) expanded the ambit of Section 401(a)(11) to include retirement plans that are covered by Title I of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). Therefore, the court held that the provisions of Section 401(a)(11) apply to those 403(b) plans that are covered by Title I of ERISA.

This is not an unreasonable interpretation. Under Department of Labor regulations, a 403(b) plan is not subject to ERISA if, among other things, the employer makes no contributions under the plan.[8] If the employer makes contributions under a plan, the 403(b) plan is subject to ERISA, particularly §§ 201 through 206 of ERISA, which enumerate those provisions that a pension plan must contain in order to satisfy ERISA. ERISA § 205(b) contains the same language as Section 401(a)(11) of the Code, and Reorganization Plan No. 4, established by an executive order, delegated to the Department of the Treasury the responsibility for drawing regulations covering both provisions.[9]

One of the plans, the Tax-Deferred Annuity Plan, provided only for employee contributions that were wholly voluntary by the employee. The court found that under the Department of Labor regulations such plans were not subject to Title I of ERISA. As this plan was not subject to Title I of ERISA, it was not subject to 401(a)(11); accordingly, the amount payable thereunder was fully includable in the elective-share base, and the spouse was credited with the 50 percent that was paid to him.

A second plan, the Defined Contribution Annuity Plan, one to which the employer made contributions, was found to be subject to ERISA, and, therefore, the amount payable thereunder was includable to the extent of 50 percent of its value. However, as the surviving spouse was granted a 50-percent interest in this benefit, the court determined that he received none of this benefit for elective-share purposes; he merely received what federal law had already given him.

The court's defense of its interpretation of the 50-percent rule is illuminating:

> 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.

Then the court went on to state:

> In addition to disputing the extent to which the retirement assets are includable in the elective share base, the parties dispute the extent to which the benefits received by Dr. Wharton reduce the amount of the elective share. This dispute is resolved by the language of the EPTL itself which allows as an offset against the surviving spouse's elective share only amounts received (or renounced) by the spouse which passed (or would have passed) by intestacy, testamentary substitute

identified in EPTL 5-1.1-A or disposition under decedent's will. EPTL 5-1.1-A(a)(4). Consequently, the total value of the plan assets received by Dr. Wharton from the two plans that are fully includable 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.[10]

Thus, the reason for the 50-percent rule, according to the court, is that a surviving spouse, simply by virtue of having been married to the decedent, has been given a federally mandated interest (not a community-property interest, as suggested by the Radigan Commission) in the decedent's plan that the decedent's estate may not include when determining those assets that constitute the estate for purposes of calculating the surviving spouse's elective share. This is an astounding result. A straightforward reading of clause (G) of EPTL 5-1.1-A(b)(1) suggests that half the value of the plan interest be included for purposes of determining the size of the elective-share estate. And EPTL 5-1.1-A(4), cited by the court in drawing its conclusion that the one-half interest passing to the surviving spouse under an ERISA plan should not be included as a testamentary substitute, specifically states that the net elective share should take into account the testamentary substitute under clause (G) of EPTL 5-1.1-A(b)(1).

A third plan, the Transfer Annuity Payout Plan, was found not to be subject to ERISA, on somewhat tenuous grounds. The third plan was a "transferee plan," that is, a plan that was created from the transfer of funds from a previous plan. Unfortunately, there were no documents to show to the court that would clarify the status of the previous plan, so that the court could only draw its conclusion from the few facts presented to it. The court noted that the benefit payable under that plan was a 10-year installment payment that the decedent elected without the consent of the decedent's spouse. The lack of a need for spousal consent led the court to conclude that the plan was not subject to ERISA, and therefore fully includable in the elective-share base.

There is, however, an equally plausible reason that the 10-year installment payment might not have required spousal consent. A plan that qualifies under Section 403(b) may provide that employer contributions are discretionary. If it so provides, the plan may meet the (B)(iii) exception described earlier. In order to meet this exception, three requirements must be met: (i) the plan must provide that *the participant's entire benefit be payable to the surviving spouse in the event of the participant's death* (emphasis added); (ii) the participant *must not elect an annuity* as the form of distribution; and (iii) the plan making the distribution must not be, with respect to the participant, a transferee plan of a plan in which the employer was required to make contributions. Accordingly, it is possible that the third plan was subject to ERISA; that it was a transferee plan of a plan under which the employer was not required to make contributions; and that the surviving spouse was entitled to the entire account balance remaining at the decedent's death, even though the beneficiary designation thereunder granted him only 50 percent of the benefit. (The record does not disclose any information about this plan.) If so, the surviving spouse would be entitled to the entire benefit, but EPTL 5-1.1-A(b)(1)(G) would include only 50 percent of the value in the elective-share base and the estate would claim credit for a 50-percent interest passing to the surviving spouse, a very different result from what the court concluded.

The economic result of the *Cohen* decision is seen in the table below:

| Contract | Date of death value | Value included as testamentary substitute | Amount received by spouse | Amount treated as received by spouse under EPTL 5-5.1-A |
|---|---|---|---|---|
| Transfer Annuity Payout Plan (TIAA #IE76399-1) | $222,839 | $222,839 | $111,420 | $111,420 |
| Defined-Contribution Retirement Plan (CREF #P783868-1) | $555,340 | $277,670 | $277,670 | $0 |
| Tax-Deferred Annuity Plan (TIAA K140524-6) | $49,159 | $49,159 | $24,580 | $24,580 |
| **Totals** | **$827,338** | **$549,668** | **$413,669** | **$136,005** |

As shown in the table, the surviving spouse received $413,669, yet the estate received credit toward the elective share of only $136,005, resulting in the surviving spouse's receiving $277,670 more than the estate was entitled to claim as a credit.

And the difference between what was included in the elective-share base and what the surviving spouse actually received could conceivably have been even greater had the Transfer Annuity Payout Plan been found to be subject to ERISA. If the Transfer Annuity Payout Plan was found subject to ERISA, only $111,420 of that contract would have been included for elective-share purposes and, under the court's reasoning, none of it would have been treated as received by the surviving spouse. That would have given the surviving spouse the same amount from the plans but would have reduced from $136,005 to $24,580 what he was deemed to have received, and would have required the estate to provide an even greater share to the surviving spouse from other assets of the estate.

The parties did not dispute the decedent's designation of the daughters as beneficiaries of the proceeds of the fourth plan, the Deferred Compensation Plan; it was apparently conceded that this amount could be divided between the daughters, and that the surviving spouse had no interest in that plan. Perhaps, the parties believed that because the designation of the daughters occurred before September 1, 1992, the effective date of the change in the law, the pre-existing designation kept the proceeds out of the elective-share estate and, therefore, could not be attacked by the surviving spouse. But that fact could not prevent the surviving spouse from bringing an action under ERISA for a share of those proceeds as well. If the plan were subject to ERISA, the surviving spouse would have had a statutory interest of at least one-half the proceeds of that plan as well, and the pre-existing designation could not diminish that federal right.[11]

Put simply, the court's holding in *Cohen* is this: If a decedent had at death an interest in a qualified plan, and if the a surviving spouse is entitled only to his statutory share of the amount in the plan, half the amount is included in calculating the elective-share estate, but none of the amount to which the surviving spouse is entitled under the qualified plan may be used as an offset against that elective share. If the proceeds of all four plans were subject to ERISA and the decedent left half of all those proceeds to her surviving spouse, none of the proceeds would have been eligible as a credit against the spouse's elective share. This result should petrify any attorney attempting to put forward an estate plan that takes into account the spouse's elective share.

The inclusion of only one-half the decedent's benefit has a certain logic if the qualified plan is a defined-contribution plan that contains an annuity feature. If the benefit is payable from that type of plan, the surviving spouse is entitled under the Code to a life annuity that can be purchased by one-half the decedent's interest in the plan; the other half may be disposed of as the decedent sees fit. It is not clear from its report which half the Radigan Commission considered as the amount that should be included in the elective-share base. I would have thought that the half to be included in the elective share would be the half that is given by law to the surviving spouse, not the disposable half.

The justification for the 50-percent rule is even more suspect when one considers the effect of including in the rule benefits payable under a plan that meets the B(iii) exception. In the case of a defined-contribution plan that meets the B(iii) exception, a surviving spouse is entitled to the entire account balance remaining at the decedent's spouse's death. Why does clause (G) of EPTL 5-1.1-A(b)(1) limit this interest to 50 percent? In this situation, the surviving spouse has been given a "federal right" to 100 percent of the benefit; accordingly, it would be logical, if somewhat absurd, to exclude the entire amount as a credit against the elective-share base.

Aside from finding the 50-percent rule ambiguous at best, I believe the rule is grossly unfair, and should be abolished. An estate is being denied credit for having enriched a surviving spouse. A spouse immediately becomes entitled to a portion of the other spouse's benefit simply by virtue of the marriage. And, absent a waiver by the surviving spouse, that portion of the benefit can only go to the surviving spouse. Why then limit the credit to the decedent's estate to half the amount?

The court in *Cohen*, above, believed that excluding 50 percent of the benefit from a plan subject to Title I of ERISA was necessary in order to assure that "the federal benefit is fully preserved for the surviving spouse." But New York's inclusion of that benefit in calculating a fair amount to be paid a surviving spouse does no harm to that protected benefit. There is no question that federal law preempts state law, if that is what the court meant.[12] Therefore, New York law could do nothing to affect that benefit nor the individual entitled to that benefit. New York's elective-share law does not reduce this protected federal benefit; the benefit is simply being taken into account in establishing a fair disposition to a spouse, something fully within the jurisdiction of the state.

Although it is not mentioned in the Surrogate's decision, the United States Supreme Court's decision in *Boggs v. Boggs*,[13] may have had an influence on the Surrogate's thinking in deciding *Cohen*. In that case, a Louisiana resident, Isaac Boggs, died, leaving his estate to his second wife, Sandra. Included in the assets of Isaac's estate were qualified-plan benefits that Isaac had "rolled over" into individual retirement accounts prior to his death. Isaac had previously been married to Dorothy, and earned the bulk of the qualified-plan benefits during that marriage. Dorothy had predeceased Isaac. In her will she had left her portion of the community-property estate in a usufruct, the equivalent of a common-law life estate for Isaac, with the remainder to her two sons. Under Louisiana community-property law, Dorothy's estate included one-half the assets Isaac earned during the marriage, including therein the qualified-plan benefits.

Upon Isaac's death, the sons claimed a community-property interest in Isaac's estate through their mother's will, including the qualified-plan benefits that had been distributed to Isaac. Isaac's second wife, Sandra, argued that ERISA dictated how the benefits were to be paid, preempting Louisiana's community-property law, and denying the sons a community-property interest. Speaking for the majority, Justice Kennedy found that the attempts by the sons to make a claim against qualified-plan benefits under Louisiana community-property law were in conflict with ERISA and, therefore, were preempted.

Although it is not mentioned in the opinion, the Surrogate could have believed that the *Boggs* case required her to conclude that a surviving spouse's qualified-plan benefits cannot even be considered for elective-share purposes lest the state law run afoul of the ERISA-mandated benefit. But, as I noted before, that is not the case. New York law merely recognizes the existence of qualified-plan benefits as part of the pool of benefits on which a surviving spouse may draw in order to satisfy the elective-share rule. Nothing changes the entitlement of a surviving spouse under federal law to the benefit mandated by ERISA. What could change is the entitlement to other benefits payable under the decedent's will, as well as under the other testamentary substitutes specified in EPTL 5-5.1-A(b).

I believe EPTL 5.5-1A(b)(1)(G) should be amended to remove the limitation applicable to qualified plans, and provide for full inclusion of those plans in the elective-share base. If it is the intention of the statute to treat an interest in a qualified plan as passing absolutely, even though it is not the decedent's entire interest in the plan, the statute may be amended to so reflect this. And it is imperative that the legislature move quickly, before cases similar to *Cohen* produce even more bizarre results.

## Endnotes

1. First Report to the Legislature of the EPTL Advisory Committee, March 18, 1991, Warren's Heaton on Surrogates' Courts, Volume 14, Appendix 1.01, at 1-5 (2004).
2. *Id.* at 1-9, 10.
3. *Id.* at 1-10.
4. *Id.* at 1-33.
5. Sections 766.01(4) and 766.31(3).
6. 174 Misc. 2d 629, 666 N.Y.S.2d 388 (Surr. Ct., Monroe Co. 1997).
7. N.Y.L.J., Jan. 22, 2001, p. 21 (Surr. Ct., N.Y. Co.).
8. *See* Labor Regulation § 2510-3(f).
9. Executive Order, Reorganization Plan No. 4 of 1978, 43 F.R. 47713, 92 Stat. 3790, as amended Pub. L. 99-514, Sec. 2, Oct. 22, 1986, 100 Stat. 2095.
10. Accord, *In re Farlow,* 174 Misc. 2d 629.
11. *See In re Farlow, supra* note 6.
12. *See* ERISA § 514(a), 29 U.S.C. § 1144(a).
13. 520 U.S. 833 (1997).

# Navigating the Same-Sex Marriage Landscape: A Primer for the New York Private Client Attorney

By Derek B. Dorn

Since the turn of the millennium, and especially over the past year, same-sex marriage has become the issue of our times. Most significantly, in May 2004 Massachusetts became the first state to solemnize (i.e., sanction the creation of) same-sex marriages. While at this writing Massachusetts presently remains the only state in which a same-sex couple can marry, several other states have opened quasi-marital institutions to same-sex couples, chief among these being Vermont's civil union. So, too, has the movement for same-sex marriage advanced abroad, with Belgium, the Netherlands and several Canadian provinces already granting equal marriage rights to same-sex couples.

> *"The legal status of same-sex marriage is evolving rapidly. . . . Until addressed by the Court of Appeals or legislature, the rights of same-sex couples under New York law will be clouded by uncertainty."*

In recent months, New York has emerged as one of the next battleground states. Between October 2004 and February 2005, five separate New York trial courts ruled on whether New York's Constitution or Domestic Relations Law require the state to solemnize same-sex marriages. While four trial courts found no such requirement, the New York Supreme Court for New York County disagreed, holding that the state constitution requires New York to grant equal marriage rights to same-sex couples. Because these decisions conflict, it is almost certain that the New York Court of Appeals will ultimately resolve the issue. An unambiguous extension of equal marriage rights would surely prompt a rush to the wedding altar in New York, home to the second most same-sex couples of any state.[1]

Still, it likely will be a year or longer before the Court of Appeals acts to resolve the conflict among the lower court decisions. In the meantime, authority suggests that New York will respect any same-sex marriage that is valid where created. As such, marrying in Canada or (if possible) Massachusetts,[2] or entering a civil union in Vermont or (beginning in October) Connecticut, might offer same-sex couples a more expeditious route to accessing benefits that New York law extends to married couples, including the unlimited marital deduction from the New York estate tax.

But irrespective of whether New York sanctions the creation of same-sex marriages or accords recognition to same-sex marriages created in other jurisdictions, the Defense of Marriage Act ("DOMA"), enacted by Congress in 1996, prohibits *any* Federal-level recognition of same-sex marriages. Nor are same-sex marriages "portable" to any of the 40 states that have enacted their own such bans. A proposed amendment to the U.S. Constitution would sweepingly prohibit any state from choosing to recognize same-sex marriages.

This complex and rapidly shifting landscape presents a challenge for New York same-sex couples. In considering the question of marriage, these couples must ask not only the familiar (and personal) "if," but also the legal questions of "when" and "in what jurisdiction." Moreover, because their marriages will not be recognized universally, same-sex couples must plan carefully for marriage. In particular, they must be aware of difficulties in obtaining a future divorce and that accessing certain state-level spousal benefits could result in adverse Federal tax consequences.

To help attorneys advise clients on these issues, this article maps the current state of the law and highlights planning considerations. Part I sets the stage by reviewing out-of-state developments. Part II reviews case law concerning the ability of same-sex couples to marry in New York. Part III examines the extent to which New York will recognize same-sex marriages and civil unions that are validly created in other jurisdictions. Part IV discusses Federal non-recognition under DOMA. Finally, Part V evaluates the options for same-sex couples who wish to marry and considers tax and estate planning implications of same-sex marriage.

At the outset, a caveat is necessary: The legal status of same-sex marriage is evolving rapidly, with new case law being issued and statutes being enacted on what seems like a daily basis. Until addressed by the Court of Appeals or legislature, the rights of same-sex couples under New York law will be clouded by uncertainty.

## I. Out-of State Developments

New York attorneys need to be familiar with out-of-state developments for several reasons. First, many New York same-sex couples have traveled, or will travel, to other jurisdictions for the purpose of marrying or becoming civilly united. Second, same-sex couples may become domiciled in New York after having married elsewhere. Third, for the New York same-sex couple who owns property in another jurisdiction, marrying, becoming civilly united or creating a "quasi" marriage might enable the couple to access transfer tax benefits from the other jurisdiction. Finally, these out-of-state developments inform the spectrum of paths that New York's courts or legislature might choose to take.

### A. Vermont Civil Unions

In the first breakthrough with enduring implications,[3] the Vermont Supreme Court ruled in 1999 that denying same-sex couples the benefits of marriage violates the Vermont Constitution's Common Benefits Clause.[4] The court directed the legislature to modify Vermont's marriage statute, either by opening marriage to same-sex couples or by crafting "some equivalent statutory alternative." The legislature chose the latter and created the "civil union."[5]

Because civil unions were intended to be "separate but equal," the civil union statute defines "marriage" as "the legally recognized union of one man and one woman," while also providing that the parties to a civil union shall be known as "spouses" and shall "have all the same benefits, protections and responsibilities under [Vermont] law . . . as are granted to spouses in a marriage."[6] Thus, under Vermont law, the sole distinction between a civil union and a marriage is the nomenclature. Yet when civil unions first became available in July 2000, Vermont's estate tax was still a "sponge" tax—that is, for resident decedents who died with taxable estates, Vermont assessed a tax equal in amount to the state death tax credit that had been allowed against the Federal estate tax under I.R.C. § 2011. Because civil unions are disregarded for Federal estate tax purposes,[7] "a reduction in the Vermont estate tax liability for parties to a civil union based upon the Federal marital deduction would not [have] reduce[d] the total estate tax liability."[8] Accordingly, the civil union statute expressly provided that civil unions shall have no effect for Vermont estate tax purposes. But in 2002, Vermont decoupled its estate tax from Federal law;[9] shortly thereafter, the legislature extended to civilly united spouses the unlimited marital deduction from Vermont estate tax.[10] The extension took effect upon the January 1, 2005 completion of the Federal state death tax credit phase out.[11]

Vermont imposes no residency requirements for entering a civil union. Consequently, thousands of non-Vermont couples, the greatest number of them from New York, have traveled to Vermont to become civilly united.[12] But that Vermont is presently the only state to solemnize civil unions has clouded "portability"—that is, the extent to which civil unions will be recognized in other jurisdictions. Because of strict residency requirements imposed on couples who wish to file for civil union dissolution in Vermont court,[13] this question has been brought to bear in the dissolution context. While trial courts in Iowa and West Virginia have each recognized a Vermont civil union in order to dissolve it,[14] appellate courts in Connecticut and Georgia have refused to do so.[15] As discussed below, the New York Supreme Court for Nassau County is the only non-Vermont court that has extended affirmative rights to civilly united spouses.[16]

### B. Massachusetts Marriage

Nearly four years after the Vermont Supreme Court's historic decision, the Massachusetts Supreme Judicial Court took the further step, ruling in *Goodrich v. Department of Public Health* that "[l]imiting the protections, benefits and obligations of civil marriage to opposite-sex couples violates the basic premise of individual liberty and equality under law protected by the Massachusetts Constitution."[17] When *Goodrich* took effect on May 17, 2004, Massachusetts town clerks became required to issue marriage licenses to same-sex couples.

Same-sex couples who marry are entitled to *all* benefits that Massachusetts extends to married couples, including the ability to file joint state income tax returns and the unlimited marital deduction from Massachusetts estate tax. As a practical matter, because Massachusetts income tax calculations are tied to Federal calculations, the state requires same-sex married couples to complete a *pro forma* Federal income tax return as married, and to submit that return with their Massachusetts return. A similar procedure is required for the Massachusetts estate tax return of a decedent who is survived by a same-sex spouse.[18]

Although *Goodridge* is undoubtedly the most significant development to date, two caveats warrant mention. First, same-sex couples are presently unable to marry in Massachusetts unless both spouses reside, or manifest an intention to reside, in Massachusetts. The limitation stems from an obscure 1913 statute, which provides that "no marriage shall be contracted in [Massachusetts] by a party residing and intending to continue to reside in another jurisdiction if such marriage would be void if contracted in such other jurisdiction, and every marriage contracted in [Massachusetts] in violation hereof shall be null and void."[19] Based on the statute, Massachusetts town clerks have been ordered to "cease and desist" from granting marriage licenses to out-of-state same-sex couples.[20] The statute is now itself the subject of litigation[21] and a legislative repeal effort.[22]

Second, *Goodrich* prompted a movement to amend the Massachusetts Constitution. The proposed amendment simultaneously would prohibit same-sex marriage and create civil unions. To take effect, the amendment must be approved by two consecutive joint meetings of the legislature (known as constitutional conventions) and then by voter referendum. In March 2004, a first constitutional convention approved the proposed amendment. The amendment's prospects in the current legislature are far from certain;[23] it is also unclear if voters would ratify the amendment.[24] The earliest this process could be completed is November 2006.

### C. Connecticut Civil Unions

In April 2005, Connecticut became the first state to enact civil unions without court mandate.[25] The law, which takes effect on October 1, extends to civil union "partners" "all the same benefits, protections and responsibilities under law . . . as are granted to spouses in a marriage." Among these benefits are the exemptions for transfers between civil union partners from the Connecticut succession tax[26] and from the Connecticut gift tax.[27] Unlike its Vermont analog, the Connecticut statute does *not* define the parties to a civil union as "spouses."

### D. Quasi-Marital Institutions

Additionally, several state legislatures have created quasi-marital institutions that make available to same-sex couples certain rights that had previously been reserved for married spouses. At a minimum, these institutions grant registrants hospital visitation and health care decision-making rights. A brief consideration of these institutions illustrates the range of privileges accorded at the state level and the degree to which legislatures in some states have been willing to extend rights to same-sex couples.

Since January 1, California's statewide domestic partnership registry has resembled Vermont's civil union, minus the state tax benefits. The registry extends to domestic partners all non-tax rights available under California law to married spouses, including the intestate inheritance preference.[28] Notably, all property acquired during a partnership will be treated as community property for property law purposes, unless the partners enter a transmutation agreement.[29] The registry is open to non-California couples.[30] Yet because classification as community or separate property is generally based on owner domicile (rather than property situs), community property treatment is probably available only to registrants domiciled in California.[31]

New Jersey's domestic partnership law, which took effect in 2004, extends certain rights as next of kin. But the law extends no intestate inheritance or elective share rights,[32] nor are domestic partners treated as spouses for income and estate tax purposes.[33] The law does, however, exempt transfers to a surviving domestic partner from New Jersey inheritance tax.[34] Given the high marginal rates of this tax, this provision could result in significant state death tax savings for a decedent who dies owning New Jersey property. For instance, if a decedent dying in 2005 bequeaths a $1,000,000 New Jersey house to her same-sex partner, the bequest ordinarily would generate a $153,000 inheritance tax liability on the decedent's estate.[35] But if the decedent and her partner had registered as domestic partners, the same bequest would pass free of any New Jersey inheritance tax.[36]

Couples who register as domestic partners in Maine or as "reciprocal beneficiaries" in Hawaii are entitled under those states' laws to the intestate inheritance preference and right of election.[37] Hawaii also extends funeral and family leave and limited transfer-tax benefits.[38] Maine confers next-of-kin status, victim's compensation rights, and rights of guardianship and conservatorship.[39]

In additional states, legislative efforts are underway to extend various levels of relationship recognition to same-sex couples. Alongside this activity, a number of lawsuits pending in state courts challenge the inability of same-sex couples to marry. As this article goes to press, trial courts in California and Washington have each held that the respective state constitution requires equal marriage rights for same-sex couples.[40] Both of the decisions are on appeal. Similar lawsuits are also pending before Connecticut, Florida, Maryland, New Jersey and Oregon state courts and, as discussed below, the New York Appellate Division (First and Third Departments).[41]

Finally, dozens of U.S. municipalities, including 11 in New York State, offer domestic partnership registries.[42] The statutory rights associated with these municipal registries generally are few. Still, registration could carry significant benefits. For instance, some employers, particularly local governments, make registration a prerequisite to accessing employment-related domestic-partner benefits. Moreover, entering a municipal registry could enable couples to access rights under the statewide registries of other states, such as New Jersey.[43] Registration of a domestic partnership could also provide *prima facie* evidence of a couple's relationship, which could prove essential in a variety of legal contexts.

### E. Developments Abroad

In 2001, the Netherlands became the world's first jurisdiction to grant full marriage equality to same-sex couples. Belgium followed in 2003. The same year, Ontario's Supreme Court ruled that the Canadian Charter (Canada's equivalent to the Bill of Rights) grants same-sex couples the right to marry. The decision mandated the Province of Ontario to grant same-sex couples marriage licenses and the Canadian Parliament to codify a sex-neutral right to marry.[44] While Canada's Parliament is considering legislation that would satisfy the court's mandate, the highest courts of each of British Columbia, Manitoba, Nova Scotia, Quebec, Saskatchewan and the Yukon Territory have opened marriage in those provinces to same-sex couples. Canada, unlike Belgium and the Netherlands, imposes no nationality or residency requirement to marry. Many United States couples have already traveled to Canada to marry.[45] Meanwhile, Spain is on the brink of extending marriage rights to same-sex couples.[46]

## II. New York Marriage Law

New York's marriage law is codified in the Domestic Relations Law (DRL), which facially imposes only two substantive requirements to create a marriage: a minimum age requirement[47] and the "consent of parties capable in law of making a contract."[48] Although neither requirement is phrased in gender-specific terms, New York courts consistently have held that as a matter of statutory interpretation, the DRL does not authorize the creation of same-sex marriage.[49] At the same time, however, there has never been a New York statute or constitutional provision that expressly *prohibits* the state from sanctioning the creation of same-sex marriages or from recognizing such marriages created in other jurisdictions. Based on this absence, Attorney General Eliot Spitzer concluded in an advisory opinion that although the DRL probably does not authorize the creation of same-sex marriages, the exclusion of same-sex couples from marriage "presents serious constitutional concerns" under the New York Constitution.[50]

Following the Attorney General's pronouncement, five separate lawsuits that challenge the exclusion were filed in New York courts. Each lawsuit asserts that denying same-sex couples the right to marry violates the New York Constitution, which, as the Court of Appeals has acknowledged in another context, "affords the individual greater rights than those provided by its Federal counterpart."[51] In particular, the plaintiffs argue that New York's Due Process Clause grants a fundamental right to marry a person of one's choice, and that under New York's Equal Protection Clause, restricting marriage to opposite-sex couples cannot survive the heightened scrutiny that applies to deprivations of fundamental rights and to classifications based on sex and (possibly) sexual orientation.[52] Two of the lawsuits also raise a statutory argument, claiming that the DRL's facial gender neutrality confers upon same-sex couples a right to marry.

The Supreme Courts for Albany, Rockland and Tompkins Counties all have rejected such challenges (two separate Albany County judges reached this conclusion). As to the due process claim, these courts have declined to find a fundamental right to enter into a *same-sex* marriage. As to the equal protection claims, these courts have denied that the ban on same-sex marriage is tantamount to a sex-based (i.e., suspect) classification. The courts also have rejected the claim that heightened scrutiny applies to classifications that implicate sexual orientation. Having dispensed with these arguments, the courts held that the state has a rational basis for limiting marriage to opposite-sex couples.[53]

In February, the Supreme Court for New York County reached the opposite conclusion, holding that the New York Constitution requires the state to permit same-sex couples to marry. Without determining if heightened scrutiny is applicable, the court applied the rational basis test, concluding that the defendant, City of New York, "has not presented even a legitimate State purpose that is rationally served by barring same-sex marriage."[54] On these grounds, the court held that the DRL must be interpreted to permit same-sex marriage. The court's decision has been stayed, pending an appeal by the City of New York.[55]

Because the New York Court of Appeals has declined to entertain a direct appeal to these decisions, the First and Third Appellate Departments must first rule on the appeals. It is unlikely that the Court of Appeals will resolve the issue before the end of 2006.

## III. Recognition by New York of Out-of-State Same-Sex Marriages

### A. The "Place-of-Celebration" Rule and *Langan v. St. Vincent's Hospital*

As the issue of whether same-sex couples can *create* a marriage in New York moves through state courts, an independent issue is whether New York will *recognize* a same-sex marriage that is created in another jurisdiction. The authority suggests that marrying in Canada or (if possible) in Massachusetts, or entering a civil union in Vermont or Connecticut, might offer a shortcut to spousal recognition under New York law, and thus to all benefits that New York extends to married couples.

To determine if an out-of-state marriage is legally recognizable, most states, including New York, apply the "place-of-celebration" rule: The marriage will be recognized as long as the marriage (i) is valid in the jurisdiction where it was created and (ii) does not violate an important public policy of the forum state.[56] Historically, New York courts have given this rule a broad application. The mere fact that New York law would not permit the creation of a marriage has never been equated with a public policy against the marriage.[57] Rather, marriages have been found to contravene New York public policy only if New York statute expressly prohibits recognition or if recognition would be so "offensive to the public sense of morality to a degree regarded generally with abhorrence."[58] As to the former, no New York statute expressly prohibits the recognition of same-sex marriage. As to the latter, only "polygamy or incest in a degree regarded generally as within the prohibition of natural law" have risen to such a level.[59] Thus, even though New York law prohibits the creation of a common-law marriage,[60] a common law marriage that is lawfully created in Pennsylvania will be recognized in New York.[61] Similarly, while an uncle and niece cannot marry in New York,[62] such a marriage lawfully created in Italy will be recognized in New York.[63]

In 2003, the Supreme Court for Nassau County became the first New York court to apply the place-of-celebration rule in the context of a same-sex spousal relationship. In *Langan v. St. Vincent's Hospital*, the court concluded that the place-of-celebration rule requires New York to recognize the parties to a Vermont civil union as spouses.[64]

*Langan* arose in the context of the Wrongful Death Act,[65] codified in the Estates, Powers & Trusts Law ("EPTL"). The Act extends standing in a wrongful death action to a decedent's distributees,[66] a class defined elsewhere in the EPTL to include, among others, a decedent's "spouse."[67] The question presented was whether the decedent's civil union partner qualified as his spouse, and thus as a "distributee" with standing under the Act. As to the first prong, the court noted that Vermont law calls the parties to a civil union "spouses," and concluded that "[a] civil union under Vermont law is distinguishable from marriage only in title." As to the public policy exception, the court found that recognizing same-sex unions would actually be *consistent* with the public policy of New York, a state that already has extended a panoply of legal protections to same-sex couples.[68] On these bases, the court concluded that the survivor of a civil union is a distributee of the decedent and, as such, has standing under the Act.

### B. Extending *Langan*

A logical extension of *Langan*—though not expressly drawn by the court—is that a same-sex couple who lawfully creates a spousal relationship in another jurisdiction (whether by marrying or by entering a civil union) will be entitled to *all* rights that New York law extends to spouses. Attorney General Spitzer's March 2004 advisory opinion gave *Langan* such an interpretation, stating "New York law presumptively requires that parties to [same-sex unions created in other jurisdictions] must be treated as spouses for purposes of New York law."[69] Following the Attorney General's lead, New York Comptroller Alan Hevesi announced that the New York State and Local Retirement System, over which his office has jurisdiction, will "recognize a same-sex Canadian marriage in the same manner as an opposite-sex New York marriage, based on the principle of comity."[70] The City of New York, as well as the municipal governments of Brighton, Buffalo, East Hampton, Ithaca, Nyack, and Rochester, have also announced that they will recognize any validly created same-sex marriage for all municipal purposes. Several private employers and insurance providers have also indicated that they will recognize New York same-sex couples' marriages that are valid where created.[71]

Still, until a higher court affirms *Langan*, not all state agencies will necessarily respect same-sex spousal relationships that are created outside of New York. Governor Pataki opposes same-sex marriage,[72] making it unclear whether executive-branch agencies will recognize out-of-state same-sex marriages. A spokesman for the New York Department of Taxation and Finance has stated that because New York taxpayers generally are required to use the same filing status on their New York income tax returns as on their Federal tax returns,[73] same-sex couples who have married elsewhere are not to file New York income tax returns as married.[74] Presumably, the Department would take the same position with respect to the New York estate tax. However, such a position is vulnerable to challenge. If, as *Langan* and the Attorney General's Advisory Opinion suggest, New York law requires recognition of same-sex marriages that are valid where created, such recognition would be required for all New York purposes. In fact, as a statutory matter, the New York Tax Law requires the Department to depart from Federal definitions of terms used in the income tax context if "a different meaning is clearly required" under New York law.[75]

## IV. Federal Non-Recognition of Same-Sex Marriage

Notwithstanding these state-level developments, DOMA, signed into law by President Clinton in 1996, has frozen Federal law.

Historically, the Federal government has recognized any marriage that is valid under the laws of any state. But DOMA renders this principle inapplicable to same-sex couples. DOMA defined, for all Federal purposes, "marriage" as "a legal union between one man and one woman as husband and wife" and "spouse" to "refer[] only to a person of the opposite sex who is a husband or wife."[76] As such, same-sex couples—even if recognized as married by one of the fifty states—are denied access to all 1,138 Federal benefits, rights and privileges that are contingent upon marital status,[77] including 179 provisions of Federal tax law (among them the unlimited martial deductions from estate and gift tax).[78]

Besides denying Federal-level recognition of same-sex marriage, DOMA purports to authorize—but not require—each state to refuse to "give effect to any public act, record or judicial proceeding concerning a relationship that is treated as a marriage . . . or a right or claim arising from such relationship."[79] For additional measure, 40 states have enacted their own "mini-DOMAs"—constitutional or statutory provisions that prohibit the creation or recognition of same-sex marriages.[80] Thus, the portability of a same-sex couple's spousal relationship is severely limited as the couple travels across the country, and especially outside the Northeast.

Many scholars have questioned DOMA's constitutionality.[81] But gay rights organizations, believing that a constitutional challenge would fuel efforts to amend the U.S. Constitution, have been discouraging any challenge to the statute. The proposed constitutional amendment would define "marriage" to mean the union of one man and one woman for all Federal, state and local purposes.[82]

## V. Planning for Marriage

The result of these developments is a patchwork of legal rights for New York same-sex couples: They are already able to marry in Canada or to become civilly united in Vermont; New York may itself soon solemnize same-sex marriages; New York law appears to require the state to recognize same-sex spousal relationships that are validly created in other jurisdictions; and the Federal government unambiguously (though perhaps unconstitutionally) denies any recognition of same-sex spousal relationships.

### A. Where and When to Marry

For the New York same-sex couple who have decided to marry, the threshold question becomes *where* to marry.

Canada probably is the best option. New York same-sex couples have an unambiguous right to marry in those Canadian provinces that have already begun to sanction same-sex marriages; it appears highly unlikely that this right will be reversed. New York precedent also suggests that the place-of-celebration rule applies equally to marriages created in other countries as to marriages created in other U.S. states. The case for choosing Canada is not unassailable, however, because of Canada's one-year residency requirement for divorce. Thus, if for some reason New York courts were to deny recognition to a same-sex marriage created in Canada, to obtain a divorce might require one of the spouses to establish residency in Canada.

In contrast to Canada, marrying in Massachusetts is not presently a viable option for most New York resident couples. Massachusetts' marriage application form requires applicants to affirm that both applicants reside or intend to reside in Massachusetts.[83] Couples who marry in violation of the statute will be committing perjury and their marriages will be void *ab initio*.[84] Moreover, because New York's recognition of an out-of-state marriage will hinge on the marriage having been lawfully created, same-sex couples who marry in violation of the statute will have dubious legal status in New York. Furthermore, there is a possibility that Massachusetts will amend its constitution to eliminate same-sex marriage; the proposed amendment would probably "convert" same-sex marriages created in Massachusetts into civil unions.

As between a Canadian marriage and a Vermont or Connecticut civil union, Canadian marriage is probably preferable. *Langan* suggests that civilly united spouses will be able to access all spousal rights under New York law. But if DOMA were to be overturned or repealed, marriage would surely have Federal effect, while civil unions might not. Moreover, other states that might be willing to recognize a same-sex marriage might disagree with *Langan's* conclusion that the "civil union" title is inconsequential. It also warrants mention that Connecticut's civil union statute does not deem the parties "spouses." It is unclear if the fact that Vermont's statute does extend this label was dispositive to *Langan*'s conclusion that the Vermont civil union differs from marriage only in title.

A second question is *when* to marry. Marrying today will immediately enable New York same-sex couples to access benefits from those public and private institutions that have already announced that they will recognize all lawfully created same-sex marriages. These benefits could be significant for some couples, for instance, if one spouse is a participant in the New York State and Local Retirement System. Even without such benefits, couples still might choose to marry today, for doing so would put them in a strong position to access spousal rights if *Langan* were affirmed or if New York marriage were opened to same-sex couples. Other couples may choose to wait for New York law to become clearer. There are, of course, significant non-legal reasons that many couples would decide against marrying in another state or country. In the meantime, these couples may wish to consider registering as domestic partners, in order to ensure a minimum baseline of government recognition of their relationship.

### B. Planning for Marriage

Same-sex couples must plan carefully for marriage, especially because it is not clear that a same-sex marriage can be dissolved as easily as an opposite-sex marriage and because accessing state-level benefits could have Federal tax consequences.

**Prenuptial agreements.** Same-sex couples must be aware of the state-level obligations associated with marriage, such as the support obligation[85] and the spousal elective share.[86] As is true for opposite-sex couples, prenuptial agreements are advisable, both to limit the applicability of such obligations and to establish a baseline for asset distribution if the marriage should end.

For same-sex couples, prenuptial agreements take on added importance because of the difficulty the couple might encounter in obtaining a divorce. Whereas opposite-sex married couples generally can divorce in their state of residence (regardless of whether the marriage was created in that state), such access is not clear for same-sex couples. As of yet, no New York court has ruled as to whether it has authority to dissolve a same-sex marriage or civil union created in another jurisdiction. Moreover, if the married couple were to move to another state, it is not clear the other state would dissolve the relationship. For these couples, returning to the jurisdiction that solemnized the relationship might become the only means of obtaining a divorce. But Canada, Massachusetts and Vermont each require one spouse to satisfy a one-year residency requirement before the spouses can avail themselves of the courts to divorce.

A prenuptial agreement can address such hurdles. The agreement could stipulate that if the spouses decide to dissolve their relationship, one or both spouses will become resident of a jurisdiction that will sanction dissolution. Alternatively, the agreement can provide that if dissolution cannot be obtained in New York, the prenuptial agreement should be construed as a contractual domestic partnership agreement, upon which an arbitrator shall rely to allocate the spouses' assets. Still, if a marriage or civil union cannot be dissolved, the parties probably would not be able to marry or become civilly united again.

For same-sex couples, prenuptial agreements also take on added importance because transfers incident to divorce could trigger Federal transfer and income taxes. The Internal Revenue Code provides for no gain or loss recognition to the recipient of a transfer incident to divorce.[87] But DOMA renders this provision inapplicable to same-sex couples. Thus, a transfer pursuant to dissolution of a same-sex marriage or civil union might be treated as a gift for Federal tax purposes, resulting in gift-tax liability (or an erosion of the $1,000,000 lifetime exclusion) to the extent the transfer exceeds the annual gift-tax exclusion amount (currently $11,000). A prenuptial agreement might anticipate this consequence by stipulating that upon divorce, any asset held prior to the marriage will be returned to the spouse who owned it and that assets acquired during marriage would be divided between the spouses in accordance with consideration furnished.

**Wills, health care proxies and powers of attorney.** In certain states, but not New York,[88] if a testator executes a will prior to marrying, his subsequent marriage will serve to revoke or modify the will, unless the will was executed "in contemplation" of marriage.[89] At a minimum, therefore, parties to a same-sex marriage should evaluate and perhaps revise or republish their wills. In addition, each party to a same-sex marriage will need to confirm that a spousal claim to the elective share will not defeat the party's desired scheme for distribution of probate and non-probate assets.

Individuals who will have taxable estates might also consider revising their wills in anticipation of state-level opportunities for tax deferral or savings. The New York estate tax generally tracks Federal estate tax determinations of a decedent's marital status.[90] But if New York law were to require recognition of same-sex marriages or civil unions, the New York Tax Law would have to be read in a manner that extends equal rights to same-sex spouses. As such, the marital deduction from New York estate tax would be available for transfer at death to a surviving same-sex spouse if the transfer is made outright or, presumably, in QTIP-able form.[91] Similar benefits would be available for the New York decedent who dies owning real or tangible property in a jurisdiction that both imposes death taxes on non-resident estates and recognizes validly-created same-sex marriages or civil unions.[92] But in planning for these potential opportunities at the state level, the estate plan should also take account of a surviving spouse's immediate cash needs, as such needs could be impacted by the Federal estate tax.

Even if these state-level benefits are not currently available, it may be advisable for practitioners to draft wills that anticipate such possibilities, so that the will achieves optimal results if the law later changes and the will is not updated. If both spouses of a same-sex married couple are moderately wealthy, a standard estate plan might provide as follows: The first spouse to die bequeaths (a) the New York credit shelter amount in a credit shelter trust; (b) the difference between the Federal and New York credit shelter amounts to the surviving spouse in a trust that would qualify for the Federal QTIP election (in anticipation of the possibility that New York would treat such trust as if a Federal QTIP election had been made); and (c) the residue to the surviving spouse outright or in QTIP-able form. Such an estate plan would put the estate of the first spouse to die in a strong position to avoid all New York estate taxes, even though the estate would be liable for Federal estate tax on the residue.

Additionally, because same-sex couples who marry will face uncertainty as to whether their marriages will be recognized if something were to happen to them as they travel outside of New York state, the couples should maintain powers of attorney and health care proxies.

### C. Federal Tax Traps

Same-sex couples should be aware that accessing state-level benefits could trigger adverse Federal tax consequences. For instance, numerous states, including New York, permit married couples to take title to property as a tenancy by the entirety, a form that historically has offered greater creditor protection than other forms of joint tenancies.[93] Upon creation, a tenancy by the entirety vests equal property rights in both spouses, regardless of the manner in which consideration was furnished.[94] As a tax matter, however, if both spouses do not furnish equal consideration, the creation of a tenancy by the entirety will be considered a gift for Federal purposes.[95] For opposite-sex couples, the gift would qualify for the Federal gift tax marital deduction; but for same-sex couples, on account of DOMA, the gift would be deductible only to the extent valued at an amount not greater than the annual gift-tax exclusion amount.

Same-sex couples must also be sensitive to generation-skipping transfer tax considerations. Same-sex couples will not benefit from the Federal law presumption that spouses are of the same generation[96] or that a spouse's child is a "skip person" with respect to the transferor for GST purposes.[97] To address the latter treatment, a same-sex spouse might consider legally adopting his partner's children, an option known as "second parent adoption," which is available under New York law.[98]

DOMA's flip side, of course, is that same-sex couples, including those who marry, are not subject to any of the Federal rules governing intrafamily wealth transfer. To take a few familiar planning strategies, a taxpayer who marries her same-sex spouse can continue to shift wealth to her spouse using grantor retained income trusts; the taxpayer can still create a qualified personal residence trust for the benefit of her spouse and then purchase the residence back from the trust prior to the completion of the trust term; the taxpayer will not be subject to the restrictions of Section 2704 for family limited partnerships she creates with her spouse; and the taxpayer's spouse will not necessarily be considered a "related and subordinate party" under Section 672(c).[99] Nor will the taxpayer's spouse necessarily be considered a "disqualified person" for the Chapter 42 private foundation excise taxes.

Nevertheless, it may be advisable for same-sex married couples to avoid taking advantage of such "opportunities." Gay and Lesbian Advocates and Defenders, the organization that represented the *Goodrich* plaintiffs, advises married same-sex couples to disclose their marital status consistently, in order to "prevent others from using the designation of 'single' [for tax purposes] to argue or prove that a person is not really married when that issue arises in other legal contexts."[100] For this reason, the organization advises including on a personal income tax return a statement that the taxpayer was legally married in Canada or Massachusetts but that the taxpayer is filing singly because of DOMA and that the designation of single is only for Federal tax purposes.[101] The same considerations suggest that same-sex married couples act as though they are bound by Code provisions limiting intrafamily wealth transfers. Opting into such requirements would also avoid the need for "emergency planning" if DOMA were to be overturned or repealed and same-sex marriages were to become recognized for Federal tax purposes.

## VI. Conclusion

Five years after civil unions became available in Vermont and one year after Massachusetts began solemnizing same-sex marriages, considerable uncertainty remains. Among the states, New York appears most likely to recognize out-of-state relationships; New York is also a probable contender to become the next state to authorize the creation of same-sex marriages. Even in this climate of uncertainty, there are many reasons why a same-sex couple should evaluate their options. When called upon to advise clients on these issues, estate planning practitioners should draw on two techniques with which they have familiarity from other contexts: planning for contingencies and planning in an environment of decoupled Federal and state tax.

## Endnotes

1. *See* Tavia Simmons and Martin O'Connell, *Married-Couple and Unmarried-Partner Households*, Census 2000 Special Reports, CENSR-5, U.S. Department of Commerce, U.S. Census Bureau, Feb. 2003, at 4 (reporting 46,490 same-sex couples in New York, or 1.3% of all New York couples), *but see generally* Lee Badgett and Marc Rodgers, *Left Out of the Count: Missing Same-Sex Couples in the 2000 Census*, Institute for Gay and Lesbian Strategic Studies (2003) (positing that the Census vastly undercounted same-sex couples).
2. Same-sex couples are currently able to marry in Massachusetts only if both spouses reside or intend to reside in Massachusetts. *See infra* Section I.B.
3. The prospect of same-sex marriage first came on the national radar in 1993, when the Hawaii Supreme Court ruled that the denial of marriage rights to same-sex couples might violate the Hawaii Constitution's equal rights provision. *Baehr v. Lewin*, 74 Haw. 645, 852 P.2d 44 (1993). Following the *Baehr* decision, the Hawaii Constitution was amended to allow the state legislature to "reserve marriage to opposite-sex couples" (Haw. Const. art. 1, § 23), which the legislature soon chose to do. Hawaii Stat. § 572-1, 572-3 (2005).
4. *Baker v. State,* 744 A.2d 864, 867 (Vt. 1999).
5. *An Act Relating to Civil Unions*, 2000 Vt. Acts & Resolves 91, *enacted at* 15 Vt. Stat. Ann. §§ 1201–1207 (2005).
6. 15 Vt. Stat. Ann. §§ 1201–1207 (2005).
7. *See infra* Section IV.
8. *See* 2000 Vermont Laws P.A. 91 (H.847), § 22(a), *enacted at* 32 Vt. Stat. § 7401(a) (2000).
9. 32 Vt. Stat. §§ 7402(8), 7442a, 7475, as amended June 21, 2002 (imposing a tax based on Federal death tax credit rates in effect on January 1, 2001).
10. *See* 2002 Vermont Laws P.A. 140 (H. 753), *enacted at* 32 Vt. Stat. § 7401(a) (2005) (providing that "[b]eginning with estates of decedents with a date of death on or after January 1, 2005, [provisions of the Vermont estate tax] shall apply to parties to a civil union and surviving parties to a civil union as if federal estate tax law recognized a civil union in the same manner as Vermont law.").
11. I.R.C. § 2011(f) (2005).
12. *See* Report of the Vermont Civil Union Review Commission, January 2002.
13. To file in Vermont court for civil union dissolution, one spouse must have been a resident of Vermont for the preceding six months; to obtain the dissolution, one spouse must have been a resident for one year preceding the final hearing. 15 Vt. Stat. Ann. § 1206 (2005).
14. *In re Kimberly Brown and Jennifer Perez* (Iowa Dist. Ct., Woodbury Co., Nov. 14, 2003); *In re the Marriage of Misty Gorman and Sherry Gump*, No. 02-D-292 (W.Va. Fam. Ct., Marion Co., Jan. 3, 2003).
15. *Rosengarten v. Downes*, 802 A.2d 170 (Conn. App. Ct.), cert. granted in part but dismissing case as moot upon death of the party, 806 A.2d 1066 (Conn. 2002); *Burns v. Burns*, 560 S.E.2d 47 (Ga. App. 2002).
16. *See infra* Section III.A.
17. 798 N.E.2d 941 (Mass. 2003). In a subsequent advisory opinion, the court clarified that only marriage, and not civil unions, will satisfy constitutional muster. *In re Opinions of the Justices to the Senate*, 803 N.E.2d 565, 567–68 (Mass. 2004).
18. *See* Commonwealth of Massachusetts Department of Revenue, Technical Information Release 04-17: Massachusetts Tax Issues Associated with Same-Sex Marriages (*available at*: http://www.massdor.com/rul_reg/tir/tir_04_17.htm).
19. Mass. Gen. Law c. 207 §§ 10–13, 50 (2005).
20. *See Johnstone v. Reilly*, Brief of the Plaintiffs/Appellants Clerks, Supreme Judicial Court of Massachusetts, SJC No. 09436.
21. The lawsuit alleges that the 1913 statute violates the Massachusetts Constitution or, alternatively, that the statute applies only to residents of those states that would not recognize a Massachusetts same-sex marriage. Relief on either claim would have significant implications for New York same-sex couples since, as explained in Section III., a marriage legally created in another jurisdiction is generally entitled to recognition under New York law, even if such a marriage could not be created under New York law. In August 2004, a Massachusetts trial court denied the plaintiffs' motion for summary judgment. *Cote-Whitacre v. Department of Public Health*, 2004 Mass. Super. LEXIS 341 (Suffolk Co., Aug. 18, 2004). The Massachusetts Supreme Judicial Court has granted a direct appeal.
22. Although a repeal measure handily passed the Massachusetts Senate in 2004, it has yet to be put to a vote in the Massachusetts House. *See* Raphael Lewis & Yvonne Abraham, *Senate Votes to End 1913 Law*, Boston Globe, May 20, 2004.
23. *See* Raphael Lewis, *Same-Sex Marriage Ban Loses Ground*, Boston Globe, Nov. 5, 2004; Frank Phillips, *Bid Seen Weakening to Ban Gay Marriage: Amendment Foes May Get Majority*, Boston Globe, Jan. 18, 2005.
24. *See* Frank Phillips, *Poll Finds Split Over Marriage Amendment*, Boston Globe, Apr. 6, 2004 at B1 ("Massachusetts residents were evenly divided over the Legislature's compromise proposal that bans gay marriage but also provides civil unions for same sex couples, according to a University of Massachusetts poll conducted over the past week.").
25. Civil Union Law, Conn. Public Act 05-10 (enacted Apr. 20, 2005).
26. In 2005, estates of decedents passing to Class C beneficiaries (i.e., any person who does not have a legal marital or familial relationship with the decedent), are taxed at 12% of amounts over $400,000; 13% of amounts above $400,000 and below $600,000; and 14% of amounts over $1 million. *See generally* Conn. Gen. Stat. § 12-344 (2005); State of Connecticut Department of Revenue Services, *Q&A on Succession, Estate, and Generation-Skipping Transfer Taxes*, IP2004(25). Pre-

sumably, Connecticut will implement an administrative rule to reconcile the fact that Connecticut law generally requires a resident taxpayer's Connecticut tax filing status to track the taxpayer's Federal filing status. *See generally* Gay and Lesbian Advocates and Defenders, *Some Questions and Answers About the New Connecticut Civil Unions Law* (Apr. 27, 2005).

27. The gift tax applies only to donors whose taxable gifts for Connecticut gift tax purposes exceed $1 million during a calendar year; the tax in 2005 equals $45,000 plus 6% of the excess over $950,000. Conn. Gen. Stat. § 12-643 (2005).

28. California law provides that "[r]egistered domestic partners shall have all the same rights, protections, and benefits, and shall be subject to the same responsibilities, obligations, and duties under law . . . as are granted to and imposed upon spouses." A.B. 205, 2003-04 Sess. (Cal. 2003) (enacted); *see* Cal. Fam. Code § 297.5(a)-(c) (2005). The law expressly excludes domestic partners from filing joint state tax returns. *See Id.* § 297.5(g).

29. But because Federal law will probably not recognize the domestic partnership, it is unlikely that a surviving domestic partner would be able to claim the double step-up in Federal income tax basis that I.R.C. § 1014(b)(6) generally extends to community property interests. *See infra* Section IV. If Federal law were to respect California's community property treatment, it is possible that the creation of the community property interest could be considered a gift for Federal tax purposes. *See generally* Sodra J. Allphin, *New Domestic Partnership Legislation and Its Impact on Estate Planning and Administration*, Calif. Trusts & Estates Q., Spring 2004, at 4.

30. Similarly, California does not impose a residency requirement for dissolving a domestic partnership. If both partners desire to terminate a California domestic partnership that has lasted less than five years, they need only to file a Notice of Termination of Domestic Partnership with the California Secretary of State, followed by mailing of the Notice to the domestic partner. Otherwise, the domestic partnership can be dissolved in accordance with the procedures required to dissolve a marriage, although the residency requirement is waived for domestic partners. *See* Calif. Fam. Code § 299 (2005).

31. *See generally* W.S. McClanahan, Community Property Law in the United States § 13.2 (1982).

32. 2003 N.J. Sess. Law Serv. 246 (June 5, 2003), codified in pertinent part at N.J.S.A. § 26:8A-1 - :12 (2005).

33. A taxpayer can, however, claim an additional personal exemption from New Jersey income tax if the taxpayer's domestic partner does not file a separate income tax return. N.J. Stat. § 54A:1-2(e) (2005).

34. Under the law, domestic partners are classified among "Class A" beneficiaries, for which transfers at death do not result in inheritance tax, rather than as "Class D" beneficiaries, for which only transfers at death valued at less than $500 are exempt from inheritance tax. N.J. Stat. § 54:34-2 (2005).

35. N.J. Stat. § 54:34-2(d) (2005).

36. *Id.* § 54:34-2(a). While the registry is open only to New Jersey residents and non-residents who are members of a state-administered retirement system (N.J. Stat. 26:8A-3 (2005)), the law expressly provides that New Jersey will recognize any "domestic partnership, civil union or reciprocal beneficiary relationship entered into outside of this State, which is valid under the laws of the jurisdiction under which the partnership was created. . . ." N.J. Stat. § 26:8A-6(c) (2005). However, parties to a same-sex marriage will *not* be treated as domestic partners under New Jersey law. *See generally Hennefeld v. Township of Montclair*, 2005 WL 646650 (N.J. Tax Court, Mar. 15, 2005) (declining to recognize a same-sex marriage entered in Canada).

37. Haw. Stat. § 572C (2005); Maine R.S.A. tit. 24-A, §§ 2832-A, 2741-A (2005).

38. Haw. Stat. § 247-3(4) (2005) (exempting transfers between reciprocal beneficiaries from conveyance tax). Because it did not decouple its estate tax from Federal law, Hawaii effectively no longer imposes an estate tax.

39. Maine Rev. Stat. Ann. Tit. 18-A, § 1-201 (10-A); Tit. 24-A §§ 2832-A, 2741-A (2005).

40. *See Woo v. Lockyer*, Judicial Council Coordination Proceeding No. 4365 (Calif. Sup. Ct., San Francisco Co., Mar. 14, 2005); *Andersen v. Sims*, No. 04-2-04964-4 SEA (Wash. Sup. Ct., King Co., Aug. 4, 2004).

41. For a summary of the pending lawsuits, see National Center for Lesbian Rights, *Marriage Equality Factsheet*, *available at* http://www.nclrights.org/publications/pubs/marriage_equality0305.pdf.

42. *See* New York State Bar Association, *Report and Recommendations of the Special Committee to Study Issues Affecting Same-Sex Couples*, Oct. 2004, at 238. The jurisdictions are the Cities of Albany, New York and Rochester; the Towns of Brighton, Eastchester and Greenburgh; and the Counties of Albany, Tompkins and Westchester. *Id.*

43. N.J. Stat. § 26:8A-6(c) (2005).

44. *Halpern v. Canada* (Attorney General), 215 D.L.R. (4th) 223 (Ontario 2004). For a summary of the procedure for marrying in Canada, see Gay and Lesbian Advocates and Defenders, *What Do I Need to Know to Get Married in Canada?*, October 2004 (*available at* http://www.glad.org/marriage/canadianmarriage_faq.shtml).

45. *See, e.g.*, Rona Marech, *Same-sex couples flock to gay-friendly Canada*, S.F. Chron., Mar. 9, 2004, at A1.

46. *See* Renwick McLean, *Spanish Parliament Gives Approval to Bill to Legalize Same-Sex Marriages*, N.Y. Times, Apr. 22, 2005, at A12.

47. N.Y. Dom. Rel. Law § 15-a (McKinney's 2004).

48. *Id*. § 10.

49. *Hernandez v. Robles*, 2005 WL 363778, 2005 N.Y. Slip Op. 25057 (Sup. Ct., N.Y. Co. Feb. 4, 2005).

50. Op. Att'y Gen. No. 2004-1, March 3, 2004, at 6. Advisory Opinions are not binding, but indicate how the Attorney General's office evaluates a particular issue.

51. *Esler v. Walters*, 56 N.Y.2d 306, 313-14 (1982).

52. The Appellate Division, First Department, has ruled that under the Equal Protection Clause of the New York Constitution, sexual orientation is suspect classification, and that classifications based on sexual orientation are entitled to heightened judicial scrutiny. The Court of Appeals reserved judgment on the issue. *See Under 21 v. City of New York*, 488 N.Y.S. 669 (1st Dep't 1985), *rev'd on other grounds*, 65 N.Y.2d 344, *aff'd*, 482 N.E.2d 1 (N.Y. 1985).

53. *See Kane v. Marsolais*, N.Y. Sup. Ct., Albany Co. (*available at* http://www.nycourts.gov/press/KAN4SAME%SEX%20 DECISION.pdf) (on appeal to the Appellate Division, Third Department); *Samuels v. New York State Department of Health*, Index No. 1967-04 (Sup. Ct., Albany Co., Dec. 7, 2004) (on appeal to the Appellate Division, Third Department); *Seymour v. Holcomb*, 2005 WL440509, 2005 N.Y. Slip Op. 25070 (Sup. Ct., Tompkins Co., Feb. 23, 2005) (on appeal to the Appellate Division, Third Department); *Shields v. Madigan*, 783 N.Y.S.2d 270 (Sup. Ct., Rockland Co. 2004) (on appeal to the Appellate Division, Third Department).

54. *Hernandez v. Robles*, 2005 WL 363778, 2005 N.Y. Slip Op. 25057 (Sup. Ct., N.Y. Co. Feb. 4, 2005).

55. Additionally, the Justice Court of New York for the Town of New Paltz held that the Mayor of New Paltz could not be prosecuted for marrying same-sex couples because the inability of same-sex couples to marry is unconstitutional. *People v. Greenleaf*, 780 N.Y.S. 2d 899 (N.Y. Just. Ct. June 10, 2004).

56. *In re Estate of May*, 305 N.Y. 485, 490 (1953) ("In the absence of a statute expressly regulating within the domiciliary State marriages created abroad, the legality of a marriage between persons *sui juris* is to be determined by the law of the place where it is celebrated."). *See generally* Restatement (Second) Conflict of Laws § 283 (2) (1971) ("a marriage which satisfies the requirements of the state where the marriage was contracted will everywhere be recognized as valid unless it violates the *strong public policy* of another state which had the most significant relationship to the spouses at the time of the marriage.") (emphasis added).

57. *See, e.g., Van Voorhis v. Brintnall*, 86 N.Y. 18 (1881) (upholding the validity of a Connecticut marriage under New York law, even though the marriage could not have been entered in New York and the parties, New York domiciliaries, traveled to Connecticut solely to marry).

58. *In re May's Estate*, 305 N.Y. at 490.

59. *Id.* at 491.

60. N.Y. Dom. Rel. Law §§ 5(3), 11.

61 *Carpenter v. Carpenter*, 208 A.D.2d 882 (2d Dep't 1994); *accord Black v. Moody*, 276 A.D.2d 303 (1st Dep't 2000).

62. N.Y. Dom. Rel. Law § 5(3) (McKinney's 2005).

63. *Campione v. Campione*, 201 Misc. 590 (Sup. Ct., Queens Co. 1951); *accord Estate of May*, 305 N.Y. 486 (1953) (Rhode Island uncle-niece marriage recognized).

64. *Langan*, 196 Misc. 2d 440 (Sup. Ct., Nassau Co. 2003).

65. N.Y. Estates, Powers & Trusts Law § 4-1.1 (McKinney's 2005).

66. *Id.* § 5-4.1.

67. *Id.* §§ 1-2.5, 4-1.1.

68. For instance, New York has recognized the right of second-parent adoption (enabling an individual to adopt the children of her same-sex partner) and allows the survivor of a same-sex relationship to succeed to the lease of a deceased partner's rent-controlled apartment.

69. Op. Att'y Gen. No. 2004-1, March 3, 2004, at 6.

70. George S. King, Counsel to the New York State and Local Retirement System, to Mark E. Daigneault, Oct. 8, 2004.

71. *See, e.g.*, *Top Three Car Insurance Companies in New York Will Respect Gay Couples' Marriages*, *available at* http://www.lambdalegal.org/cgibin/iowa/news/press.html?record=1515.

72. *See* Erin Duggan, *Opinion Mixed on Gay Unions*, Albany Times Union, Mar. 14, 2004.

73. N.Y. Tax Law § 607(b) (McKinney's 2005). However, some exceptions are statutorily required, such as if one spouse is a New York resident and the other is not. *Id.* § 651.

74. *See* Andy Humm, *Gays Denied Married Tax Status; Attorney Gen. Eliot Spitzer Won't Intervene in State Finance Decision*, Gay City News, Jan. 31, 2005.

75. N.Y. Tax Law § 607(a) (McKinney's 2005). *See, e.g.*, *Graham v. Commission,* 48 A.D.2d 444, 445 (App. Div. 3rd Dept. 1975), *aff'd* 389 N.Y.S.2d 362 (1976) (rejecting "strict conformity" with Federal law if Federal law conflicts with overriding principles of New York law).

76. 1 U.S.C. § 7 (2005). Congress expressly provided that these definitions be used "in determining the meaning of any Act of Congress, or of any ruling, regulation, or interpretation of the various administrative bureaus and agencies of the United States." Public Law 104-199 (1996). Accordingly, these definition are codified in Title 1 of the United States Code. 1 U.S.C. § 7.

77. *See* General Accounting Office, Tables of Laws in the United States Code Involving Marriage Status, by Category, January 31, 1997; Dayna K. Shah, Associate General Counsel, Government Accounting Office, to The Honorable Bill Frist, United States Senate, Jan. 23, 2004., *available at* http://www.gao.gov/archive/1997/og97016.pdf. In a 2003 Private Letter Ruling, the Internal Revenue Service confirmed that on account of DOMA, Rev. Rul. 58-66, which provides that the Service will track state-law determinations of marriage, is inapplicable to same-sex marriages. Priv. Ltr. Rul. 200339001 (June 13, 2003).

78. I.R.C. §§ 2056, 2523. The Code privileges transfers by married persons in numerous additional ways. For instance, only married couples can maximize their § 2503(b) annual gift tax exclusion by splitting gifts. I.R.C. § 2513. Only married couples can take advantage of the tax deferral strategies associated with the QTIP election. *Id.* § 2601. Spouses are presumed to be of the same generation for generation-skipping tax purposes. *Id.* § 2651(c)(1). For purposes of estate inclusion, the Code presumes that each spouse furnished one-half of the consideration for all jointly held assets, while creating a rebuttable presumption for non-married persons that the first joint owner to die furnished all consideration for a jointly held asset. *Id.* § 1022(d)(1)(B)(i).

79 P.L. 104-199 (1996), codified at 29 U.S.C. § 1738C.

80. In addition to New York, the states that have not enacted statutory or constitutional prohibitions on same-sex marriage are Connecticut, Maryland, Massachusetts, New Jersey, New Mexico, Rhode Island, Vermont, Wisconsin and Wyoming. Nor has the District of Columbia done so.

81. Commentators argue that by distinguishing same-sex marriage from opposite-sex marriage, DOMA violates the Equal Protection clause of the Fourteenth Amendment, by nationalizing a definition of marriage, it usurps a power that is constitutionally reserved to the states, and by excusing states from recognizing a sister state's marriage, it violates the Constitutional requirement that states give "full faith and credit" to the "public acts, records, and judicial proceedings" of every other state. *See generally* Andrew Koppelman, *Dumb and DOMA: Why the Defense of Marriage Act is Unconstitutional*, 83 Iowa L. Rev. 1 (1997); Scott Ruskay-Kidd, Note, The Defense of Marriage Act and the Overextension of Constitutional Authority, 97 Colum. L. Rev. 1435 (1997). A Federal District Court in Florida recently upheld the statute's constitutionality; the petitioners have not appealed the decision. *See Wilson v. Ake*, 354 F. Supp. 2d 1298 (M.D. Fla. 2005).

82. *See* H.J. Res. 56; S.J. Res. 30.

83. It is not entirely clear how such intent is demonstrated. The Governor's Office has instructed Massachusetts Town Clerks that "intends to continue to reside" means "that the individual has the present intention either to remain where he currently lives, or to establish a new home or residence in another state in the near future, even if a specific address or town has not been selected. A vague intent to someday have a residence in a state is sufficient." The Governor's office has also suggested that a person can be a Massachusetts resident if the person "owns homes in three different states, and divides his time between those homes throughout the year." This notion is consistent with the concept that an individual has only one domicile but can have numerous residences. *See Presentation of Governor's Legal Counsel Daniel Winslow to Municipal Clerks*, May 4, 2004 (*available at* http://www.provincetowngov.org/marriage/GovpowerpointQA.pdf).

84. Mass. Gen. Law ch. 207, § 52 (2005).

85. N.Y. Fam. Ct. Act § 412 (McKinney's 2005) ("A married person is chargeable with the support of his or her spouse and, if possessed of sufficient means or able to earn such means, may be required to pay for his or her support a fair and reasonable sum, as the court may determine, having due regard to the circumstances of the respective parties).

86. N.Y. Estates, Powers & Trusts Law § 5-1.1 (McKinney's 2005).

87. I.R.C. § 1041(a)(2).

88. New York instead gives the spouse a right of election under either EPTL 5-1.1.

89. *See, e.g.*, Ore. Stat. § 112.305 (2005); *see also* Unif. Probate Code § 2-102.

90. *See* N.Y. Tax Law § 961 (McKinney's 2005).

91. Presently, there is no independent QTIP election for New York estate tax purposes. But the experience in Massachusetts suggests that if New York were to accord recognition to same-sex spousal relationships, the executor of the estate of a decedent who died married to a same-sex spouse would file a *pro forma* Federal return, on which the executor would make a QTIP election that would be respected for New York purposes.

92. These opportunities will be available for transfers to a surviving same-sex spouse of Massachusetts or Vermont property. The same result appears likely for transfers of Rhode Island property. *See* Department of the Attorney General, State of Rhode Island, *Attorney General Lynch's Statement Concerning Same-Sex Marriage* (May 17, 2004) ("This Office's review of Rhode Island law suggests that Rhode Island would recognize any marriage validly performed in another state unless doing so would run contrary to the strong public policy of this State. Public policy can be determined by statute, legal precedent, and common law."). If the couple has registered as domestic partners, the result also appears likely for transfers of New Jersey property. *See supra* note 43.

93. 11 U.S.C. § 522(b)(2)(B) (2005) (under the Bankruptcy Code, a debtor's estate may exclude property that the debtor owns as a tenant by the entirety to the extent that the property is exempt from process under state law); *see* EPTL 6-2.1(4) (recognizing tenancies by the entirety for real property and, after January 1, 1996, for cooperative apartments).

94. *See, e.g.*, *In re Estate of Violi*, 65 N.Y.2d 392 (1985).

95. Treas. Regs. *25*.2512-2.

96. I.R.C. § 2651.

97. I.R.C. § 2651(c)(1).

98. Because adoption is not contingent on spousal status, such second-parent adoptions will be respected for GST purposes. *See* I.R.C. § 2651(b)(3)(A) (a legal adoption is treated as a relationship by blood).

99. *See generally* 813-2nd T.M., Estate Planning for the Unmarried Adult (BNA) (2005).

100. Gay and Lesbian Advocates and Defenders, *Navigating Income Taxes for Married Same-Sex Couples*, *available at* http://www.glad.org/rights/taxes_for_married_couples.html."

101. *Id*.

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# The Investment of Property by Guardian of an Infant

By Michael E. O'Connor

Over the long term, the rewards of investing in equities have outweighed the risks of the stock market's short-term ups and downs. The S&P 500 is an index composed of stock from 500 of the world's largest companies, spread across different industries. By measuring the performance of so many companies across various sectors, the S&P 500 is commonly looked to as an index for the entire market. Although stocks have proven to provide higher rates of return over the long run, there is a greater risk in investing in equities in the short-term. Low-risk alternatives do exist such as bonds and certificates of deposits (CDs), which typically provide lower rates of return, but mitigate the short-term risks of investing in stocks.

From 1872 to 2000, the average real return on the S&P 500 was 8.8% per year.[1] In contrast, the average real return on commercial paper (debt instruments) over the course of the same 129-year period was 3.2% per year.[2] This disparity in return can have a dramatic impact over long periods of time. For example, an investor who made an initial investment of $10,000 in equities with a rate of return of 8.8% compounded annually would have $54,022.90 after 20 years. If the same investor bought a twenty-year bond for the same amount at an interest rate of 3.2%, at the time of maturity he would have only $18,775.61.

Although market growth has slowed over the past four years, interest rates have dropped to historical lows. In the period of 2002–2004, CD rates averaged 1.79%.[3] Since early 2003, the S&P 500 has made a steady climb to return to early 2001 performance levels with a current index value of over 1,200.[4]

The dramatic difference in returns available from CDs and equity investments causes the historic preference of most courts to restrict the investment of funds held in guardianship for an infant to bank accounts, under the continuing control of the court to warrant review. In particular, this article looks at the utility of Section 529 College Savings Plans as a possible guardianship investment.

## Investment Authority of Guardian

A Guardian appointed for the property of an infant is charged with protecting that property, preserving it and managing it.[5] The relationship between the Guardian of the property and the ward is similar to that of a trustee and a beneficiary.[6] As with other fiduciaries, the Guardian is subject to the Prudent Investor Act. Unlike the Fiduciary's Powers Act, the Prudent Investor Act specifically includes Guardians within its definition of "fiduciary."[7] While the Guardian has the duty to manage the property of the infant, the powers granted to the Guardian to accomplish this are far more limited than other fiduciaries. The Fiduciary Powers Act of EPTL 11-1.1 does not apply to a Guardian, since that role is not within the definition of "fiduciary" in that section.[8] As a result of the lack of enunciated statutory powers, the scope of the Guardian's investment authority is typically set out in the order of appointment. The prudent investor rule is default legislation, and its application may be limited by the express provisions of a governing instrument.[9] The "governing instrument" includes a Court Order.[10]

## Bonding Requirement of Guardian

The statute generally requires that all property of the infant shall be secured by a bond.[11] The court may dispense with a bond only in certain narrow circumstances provided by the statute. Such circumstances includes:

(1) Where the Order directs that the funds of the infant be deposited in the name of the Guardian, subject to the Order of the Court, with a bank, savings bank, trust company, safe deposit company or State or Federal credit union designated in the Order (commonly referred to as "joint control");[12]

(2) Where the Order authorizes the Guardian to purchase and invest in United States Savings Bonds, Treasury Bills, Treasury Notes, Treasury Bonds, or bonds of the State of New York, or bonds or other obligations of any County, City, Town, Village or School District of the State of New York for the benefit of the infant, and directs the Guardian to deposit such instruments with a bank, savings bank, trust company, safe deposit company or State or Federal credit union invested in the name of the Guardian, subject to Order of the Court;[13]

(3) Where the Order authorizes the Guardian to deposit guardianship funds pursuant to an Investment Advisory Agreement with a bank, trust company, brokerage house or other financial services entity acceptable to the Court. Such agreement must provide that the guardianship funds will be invested under the provisions of EPTL 11-2.3, and that

the funds will not be released from the custody of the custodian except on Order of the Court. The Petition must include a copy of the agreement, or two agreements, if the custodian and investment advisor are not the same;[14]

(4) Where an infant is the beneficiary of a life insurance contract and the funds are left on deposit with the insurance company by an election of the Guardian, on condition there is an order prohibiting the insurance company from paying the funds out to the Guardian.[15]

## Prudent Investor Act

As previously noted, the Guardian is subject to the Prudent Investor Act of EPTL 11-2.3. Because the court typically requires joint control for a guardianship account, the discretion of the Guardian to exercise control over the investment sufficient to be fully subject to the Prudent Investor Act is not typical. Since the Prudent Investor Act is default legislation, most applications are limited by an Order which directs investment by joint control.

An Investment Advisory Agreement would appear to be a delegation of investment authority pursuant to the Prudent Investor Act.[16] Any costs associated with a delegation would be allowed only to the extent they are appropriate and reasonable in relation to the purpose of the governing instrument (Order), the assets held by the fiduciary and the skills of the fiduciary.[17] A paid professional investment advisor is held to a higher standard of skill than would be an inexperienced individual.[18]

The delegation of investment or management functions will require that the Guardian exercise care, skill and caution in: (1) selecting a suitable delegee; (2) establishing the scope and terms of the delegation consistent with the Order; (3) periodically reviewing the delegee's exercise of the delegated function; and (4) controlling the overall costs resulting from the delegation.[19]

By accepting the delegation of the Guardian's function, the delegee submits to the jurisdiction of the courts of New York, and even if a delegation agreement provides otherwise, the delegee may be made a party to any proceeding that places in issue the decisions or actions of the delegee.[20] To the extent Surrogates in New York have considered the question, proposed Investment Advisory Committees have been rejected. An agreement which attempted to exonerate the advisor from the standards of the Prudent Investor Act, and which provided for mandatory arbitration and compensation schedules not subject to court supervision, was rejected.[21] Similarly, a proposed agreement was rejected as inappropriate because of the small size of the fund ($25,000), and because only three years remained of the infancy.[22]

## College Savings Plan

Internal Revenue Code (I.R.C.) § 529 allows for states to create tax-exempt college saving plans, using various investment strategies to maximize the amount available to the beneficiary for paying college expenses.[23] New York has such a plan managed by Vanguard Group. Section 529 College Savings Plans are similar in many respects to retirement plans, such as 401(k)s and IRAs. The contribution levels can be much higher, however, and such plans have even more favorable tax treatment than retirement plans.

The amount held in a Section 529 Plan is exempt from income taxation during the period it accumulates. Presently, redemptions from the plan to pay qualified higher education expenses, such as tuition, room and board, fees, books, supplies and equipment, are also exempt from federal income taxation. A New York State income tax deduction can be taken for a contribution to a Section 529 Plan, with a maximum annual deduction of $5,000 ($10,000 on a joint return). Series EE and I U.S. savings bonds issued after December 31, 1989 may be redeemed tax-free in order to contribute the proceeds to a Section 529 Plan.

When a contribution is made to a Section 529 Plan by a person other than the beneficiary, the contribution is also eligible for the annual gift tax exclusion of $11,000 per beneficiary ($22,000 for married couples).[24] The section further allows for "borrowing" the annual exclusion for the four years going forward from the year of contribution. This results in a married couple being able to contribute $110,000 to such a plan at one time for one beneficiary.[25] If future annual exclusions are used, they cannot be used again for other gifts to the infant during these years. If the donor's death occurs during the five-year period, any unused exclusion becomes taxable in the donor's estate.[26] Even though the donor has a right to withdraw the funds contributed to a Section 529 Plan, the law allows the annual exclusion to be claimed as if the gift were of a present interest.

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) will expire on December 31, 2010, unless extended by Congress. If the law is not extended, distributions used for qualified higher education expenses would be taxed as ordinary income to the beneficiary to the extent they exceeded the original contributions to the plan.

Payments from the plan are tax free to the extent made for tuition, fees, books, supplies and equipment required for enrollment or attendance at an eligible higher education institution.[27] Room and board may be paid only for students who are enrolled at least half-time. Room and board expenses are limited to actual school charges for students who live on campus or in housing owned or operated by the school (and other special rules apply to students who live off campus but not at home). Room and board for students who live at home is not included. Computers are included as higher education expenses only if the school specifically requires a computer for enrollment or attendance. Special needs services may be included if they are incurred by a special needs beneficiary. The educational institution does not have to be located in New York in order for the expenditure to be qualified.

At the time a New York Section 529 Plan is opened, an investment strategy is chosen. The strategy can be fixed for the duration of the account, or structured so that as the beneficiary ages the nature of the Plan investments shifts from equities to less volatile securities. An account owner may change the investment strategy selected for the account once each calendar year.[28] An account owner also retains the right to change the designated beneficiary to another member of the family of the original designated beneficiary. Presumably, the right to change the beneficiary would apply even to an account to which the beneficiary himself has contributed. If the owner of the plan withdraws funds for uses other than qualified educational expenses, then the accrued income in the plan (excess over original contribution) is considered taxable income. In addition, a 10% penalty would apply, but only upon the appreciation in the account, not the initial contribution.

## College Savings Plan as Guardianship Investment

When the facts and circumstances are appropriate, a Section 529 Plan could provide a substantial advantage to an infant. Like other investments, the appropriateness of a Section 529 Plan depends on issues such as the age of the infant, the size of the fund available to the infant, the college prospects of the infant and other resources which might be available to him or her.

Under New York law it is possible for the owner and beneficiary to be the same individual. Therefore, as the representative of the infant, the Guardian could be the owner during the minority period and the beneficiary could thereafter succeed to ownership as with other guardianship assets. A New York State income tax deduction could be available to the infant upon funding, with the deduction being as much as $5,000. Because the plan is totally tax deferred or exempt, there would be no need for income tax returns to be filed as a result of the creation of a Section 529 Plan for the infant. A broad range of investment options is available, depending on whether an aggressive, moderate or conservative investment style is appropriate.

Upon application by a Guardian to establish a Section 529 Plan with an infant's funds, the court could specifically address the type of investment to be used and restrict the Guardian from changing investment strategies without prior court approval. The maximum contribution to all Section 529 Plans for the same beneficiary in New York is $235,000.[29] The New York plan, managed by Vanguard Group, involves no sales charge (load). The fee of the manager for its services is a maximum of 0.60% and a minimum of 0.55%. As the total amount under management in the New York plan grows, the management fee shrinks. If the total amount under management is over $5 billion, then the management fee is 0.55%. There are no other fees for opening an account, maintaining an account or for withdrawing from it. While New York's Section 529 Plan has a number of investment options, some changing by formula over time, it does not appear to be a delegation of investment and management functions as defined in the Prudent Investor Act.[30] It is more akin to a selection of mutual funds which the Guardian has the option of changing each year (with court authority or approval).

However, if the infant chooses to terminate the account and withdraw the funds upon reaching majority, then the earnings in the account would become income taxable to him or her. In addition, there would be a 10% penalty on the earnings.

The New York Section 529 Plan does not appear to qualify as an investment advisory account under SCPA 1708(2)(c), so as to allow the court to waive the bonding requirement. Since the cost of a bond could not be paid from the Section 529 Plan without incurring a penalty and income taxation, such a plan would appear to be viable only in cases where part of the guardianship funds are placed in the Section 529 Plan and part are kept out, with a bond being paid from the non-plan assets. SCPA 1708(2)(b) allows for the waiver of a bond of the Guardian when the court authorizes the purchase of governmental bonds and other debt obligations. Perhaps an affirmative legislative proposal should be considered to include New York's Section 529 College Savings Plan in that list. Alternatively, SCPA 1708(2)(c) could be amended to incorporate such plan accounts in the waiver of a bond.

## Endnotes

1. Chen, Gabriel. *Dissecting the Equity Premium Puzzle*, *available at* http://www.duke.edu/~gwc/The%20equity%20 premium%20puzzle.htm.
2. *Id.*
3. AIM Investments, *What's the Real Return on CDs? available at* http://www.aiminvestments.com/education/ 0,2908,-1_5114,00,html.
4. Yahoo Finance, *S&P 500 Index*, *available at* http:// finance.yahoo.com/q/bc?s=%5EGSPC&t=5y.
5. SCPA 1723.
6. *Warren v. Union Bank of Rochester*, 157 N.Y. 259 (1899).
7. EPTL 11-2.3(e)(1).
8. EPTL 11-1.1(a)(3).
9. EPTL 11-2.3(a).
10. EPTL 11-2.3(e)(3).
11. SCPA 1708(1).
12. SCPA 1708(2)(a).
13. SCPA 1708(2)(b).
14. SCPA 1708(2)(c).
15. SCPA 1708(3).
16. EPTL 11-2.3(b)(4)(C).
17. EPTL 11-2.3(b)(4)(D).
18. EPTL 11-2.3(b)(6).
19. EPTL 11-2.3(c)(1).
20. EPTL 11-2.3(c)(3).
21. *In re Corapi*, N.Y.L.J., June 13, 2001, at 25 (Sur. Ct., Onondaga Co.).
22. *In re Bryant*, 188 Misc. 2d 462 (Sur. Ct., Broome Co. 2001).
23 I.R.C. § 529.
24. I.R.C. § 529(c)(2)(A) * I.R.C. § 2503(b).
25. I.R.C. § 528(c)(2)(B).
26. I.R.C. § 529(c)(4)(C).
27. I.R.C. § 529(e)(3)(A).
28. IRS Notice 2001 - 55.
29. Prop. Reg. 1.529-2(i).
30. EPTL 11-2.3(b)(4)(C).

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# The Changing Role of the International Tax and Estate Planning Practitioner: *Pasquantino*, Circular 230—What's Next?

By Jeffrey Morse and Marnin Michaels

In the last three months, there have been dramatic changes in the way tax lawyers advising international clients must conduct their practices. On April 26, 2005, the United States Supreme Court handed down a watershed decision in *Pasquantino,* threatening lawyers with criminal prosecution when the advice they give clients assists deprivation of "property" of others, including deprivation of a foreign tax authority of tax revenue. In addition, on June 21, 2005, new regulations came into effect under Circular 230 (the ethical rules governing practice before the Internal Revenue Service and the Tax Court) which greatly increased the burden on tax practitioners and clients receiving tax advice.

The long-term effect of these two developments is currently being debated and a consensus among commentators has not yet been reached. Some see a doomsday scenario-in-waiting, while others argue that these developments simply codify and articulate obligations and duties lawyers had all along under state Bar regulations and at common law. Regardless of the view one takes, it is clear that lawyers working with international clients had better be aware of and become familiar with these new developments.

This article explores these two recent developments and discusses their potential impact on the practice of international tax law for private clients.

## I. *Pasquantino v. United States*

On April 26, 2005, the United States Supreme Court held in *Pasquantino v. United States*[1] that a "plot to defraud a foreign government of tax revenues" can, where the requisite nexus to the U.S. exists, constitute a wire fraud violation under the U.S. Criminal Code. Significantly, wire fraud is a predicate offense under the U.S. money laundering statutes and also under the Racketeer Influenced and Corrupt Organizations Act ("RICO"). Thus, a person charged with wire fraud is also exposed to possible additional charges under the money laundering and RICO statutes. The penalties levied under these statutes are extremely punitive and can include forfeiture, treble damages, liability for opposing parties' costs and attorneys' fees, and severe criminal penalties including long-term imprisonment.

The defendants in *Pasquantino* ordered liquor over the telephone in calls made from New York to Maryland. After picking up a truckload of liquor in Maryland, they smuggled the contraband across the border into Canada. The defendants failed to declare the liquor to the Canadian authorities at the border and, as a result, failed to pay the requisite excise taxes. The defendants had hoped to move the alcohol into Canada without notice and without paying the taxes, thus attempting to make a nice profit when they sold the liquor in Canada—at the expense of the Canadian treasury.

In a 5-4 decision, the Supreme Court held that the defendants' actions in *Pasquantino* constituted wire fraud under the federal wire fraud statute (18 U.S.C. § 1343). The wire fraud statute prohibits "any scheme or artifice to defraud or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises transmitted by means of wire, radio, or television communication in interstate or foreign commerce."[2] The Court noted that the defendants had used U.S. interstate wires (i.e., telephone lines) to execute their scheme to defraud the Canadian government of tax revenue. Although some would argue that the actual fraud did not occur until the drivers failed to declare the liquor on Canadian customs forms, the Court focused on the defendants' prior activities on U.S. soil.

The wire fraud statute requires a "scheme or artifice to defraud" within interstate or foreign commerce. This "scheme or artifice" element is satisfied if the scheme is designed to "defraud by [false] representations." *Pasquantino* held that the intentional failure of the drivers to declare goods that were subject to Canadian excise taxes, and their failure to pay the required tax on those goods, was enough to satisfy the "representational" element of wire fraud. It was sufficient that the U.S. "wires" were used as part of a scheme to defraud a foreign government of taxes owed. The Court found that there was no requirement that any particular type of false statement or declaration be made. Finally, the Court concluded that because Canada's right to taxes was "property," as that term is used in the wire fraud statute, the defendants' acts met all of the elements necessary for prosecution under the statute.

The *Pasquantino* Court rejected the defendants' argument that criminalizing their conduct violated the long-standing common law "revenue rule." The revenue rule is a doctrine under which courts in the United States (and in other common law jurisdictions) refuse to enforce the tax laws of other nations. The Court emphasized that the case before it was not a suit to recover a foreign tax liability, but a U.S. criminal prosecution to punish criminal conduct that occurred within the territory of the United States and within the stream of commerce.

The dissenting justices made the argument that the Court's decision was contrary to the long-established common law revenue rule and gave the wire fraud statute extraterritorial effect by allowing persons to be prosecuted in the United States for crimes committed in another country. The majority also rejected this argument, reasoning that the defendants were being punished solely for their acts within the United States, when they called to order the liquor with the intent to defraud the Canadian Treasury, and not those which occurred in Canada. Arguing in the alternative, the Court stated that even if the acts were outside of the U.S. the statute itself contains language authorizing such a prosecution. The Court noted that when Congress drafted the statute they used the language "in interstate or *foreign* commerce," and thus concluded, "this is surely not a statute in which Congress had only domestic concerns in mind."

### A. How Does *Pasquantino* Impact the International Tax Practitioner?

The ramifications of the *Pasquantino* decision are potentially far-reaching. It is, for the first time, crystal clear that if a non-U.S. government is being defrauded of tax revenues, this extraterritorial fact will not bar a criminal prosecution in the United States. Thus, any assistance a lawyer gives his client which results in the failure to pay taxes when due in another country could conceivably constitute a crime under the wire fraud statute in the United States so long as the mail or a wire is used when giving the advice. As one can imagine, the process of advising a client with regard to undeclared funds will undoubtedly involve some use of telephones, faxes or other "wires" in the process—bringing the client, and possibly his attorney, within the statute. In the modern age, virtually all communication is accomplished with the assistance of cell phones, facsimile devises, electronic and regular mail, and other devices falling within the ambit of the wire fraud statute.

The *Pasquantino* decision has already had an effect on other cases. Two weeks after the decision, the Supreme Court remanded a Second Circuit Court of Appeals decision in a case brought by the European Community ("EC") against several domestic and foreign tobacco companies under the RICO statute. According to the complaint, the defendants were participating in tobacco smuggling operations in order to evade excise taxes in the EC. The Second Circuit held that the EC's claims were barred by the common law revenue rule because the EC was seeking to enforce its tax laws in the United States.[3] The Supreme Court has now remanded the case back to the Second Circuit for reevaluation in light of the *Pasquantino* decision. It is quite evident that the Second Circuit will reverse itself in light of the remand.

The Supreme Court also recently denied a *writ of certiorari* filed by an individual seeking reversal of his conviction for money laundering and wire fraud. The individual had been engaged in a currency exchange business, which involved exchanging Canadian and U.S. currency and transporting cigarettes into Canada. According to the government, the whole purpose of the defendant's activities was to evade Canadian tobacco taxes. The Second Circuit upheld his conviction based on its finding that the tax owed to the Canadian government was property for purposes of the wire fraud statute.[4] The denial of the *writ of certiorari*, resulting in the Court's acquiescence in the Second Circuit's decision, is easy to understand given the fact that the lower court's decision was congruent with the Court's analysis in *Pasquantino*.

If a lawyer participates directly in his client's fraud then such lawyer should be prosecuted for his part in the fraud. That conclusion remains uncontroverted. With regard to attorneys representing clients having undeclared funds, however, a distinction should be made between estate and tax planning services, on the one hand, and the intentional creation of erroneous documentation intended to mislead tax authorities, on the other. What is most troubling here is not the situation where the attorney is directly involved in the fraud, but where the attorney assists the client by giving him legitimate United States or international tax advice while the client maintains undeclared funds outside of his home country. The attorney's actions may be perceived as aiding and abetting the client in defrauding his home country when that was never the attorney's intent. When a client maintains undeclared funds outside of his home country, is he clearly defrauding his home country? It is thus possible that courts could conclude, consistent with the *Pasquantino* ruling, that the client and the attorney have conspired to commit a crime and they may be prosecuted under the wire fraud statute if the advice furthers or assists the fraud in any way.

The filing of a tax return in the client's home country that fails to report the undeclared funds, and the consequent failure to pay the tax on those funds, may be analogous to the failure to declare the contraband liquor and to pay the tax in *Pasquantino*. The person is in both cases making a false representation for purposes of evading tax. The attorney's participation, however, appears uncertain as he has made no representation. This is true even if the attorney assisted the client in setting up structures to hide the funds. However, a representation or false statement is not absolutely required for prosecution under the wire fraud statute. The model criminal jury instructions in the Ninth Circuit (which are similar to those of other circuits) make clear that the government need not prove a defendant made a specific false statement.[5] It is thus an open question, and remains a threat, whether U.S. prosecutors will take the position that an attorney participated in the fraud either as a co-conspirator or in aiding and abetting the crime—even if the attorney had no affirmative duty to declare the client's funds and, in most cases, could not do so because of the attorney-client privilege. A U.S. attorney who is providing legitimate U.S. tax advice, but is at the same time somehow implicated in the client's tax evasion in a non-U.S jurisdiction, is therefore at risk of being prosecuted for conspiracy to commit wire fraud (18 U.S.C. § 371), aiding and abetting wire fraud (18 U.S.C. § 2), as well as wire fraud itself, money laundering and violations of the RICO statute. The penalties for aiding and abetting, or conspiracy, are as draconian as the penalties for committing the act itself and not the type of penalties an attorney would want to face.

### B. To What Extent Might *Pasquantino* Be Applied to Tax Advisors?

Consider the following fact patterns:

1. A U.S.-trained attorney exchanges correspondence through the U.S. mail advising his non-U.S. client on how to establish a trust and foreign company for estate planning and asset protection purposes. Following the attorney's advice would effectively minimize the client's U.S. taxation and allow the client to pass on his assets to his intended heirs. Assume the planning is fully compliant with U.S. tax laws and is otherwise legitimate legal advice. However, the advice also reduces the flow of information to the tax authorities in the client's home country.
2. A Venezuelan businessman wants to open a bank account with a Cayman Island bank to purchase U.S. investments, especially shares in U.S. companies. He consults a U.S. tax attorney who explains to the Venezuelan businessman that in order to avoid U.S. estate tax, he should hold the U.S. stock in a Cayman Island company. The tax attorney is clearly providing legitimate U.S. tax advice. However, the attorney knows that given the fact that the Cayman Islands is a black-listed country in Venezuela, the funds deposited there to fund the company will not be declared in Venezuela.
3. A U.S.-trained attorney agrees to act as trustee of his client's foreign trust and the trustee/attorney manages the assets of the trust in a way to minimize tax exposure. Again, assume the attorney only manages the assets consistent with the U.S. tax laws and other laws of the U.S. However, the beneficiary/client is not declaring his interests in the trust in his home country, which, in this example, is because the beneficiary/client's tax home is Mexico, a country where kidnapping of wealthy persons regularly occurs. The beneficiary/client fears for his own safety as well as the safety of his family. Moreover, because of these concerns, the trust deed was drafted by the attorney to make distributions impossible until the statute of limitations on the reporting requirement has run in Mexico.

The first and second examples are designed to show that even innocent activities of an attorney in assisting a client in U.S. tax planning may be criminal under the wire fraud, money laundering, and RICO statutes if the *Pasquantino* decision is applied to its logical conclusion. The third example is, of course, more troubling, as the attorney has greater participation in the fraud when he takes on the duty of managing the undeclared funds—and thus may have an affirmative duty to declare the funds. Under all three examples, however, we see that the line between legitimate benign legal advice and acts which are now subject to criminal sanction is a slippery slope. Under any of the three fact patterns, an aggressive prosecutor may take the position that the attorney aided and abetted the client, or was a co-conspirator in the crime of tax fraud, when the attorney assisted the client.

The sort of activities involved in *Pasquantino* (transporting liquor across an international border and defrauding a government of liquor taxes) are often associated with organized crime. Money laundering and tax evasion are also associated with organized crime and historically these crimes have been committed in connection with offshore bank accounts. Sometimes, the crimes include the use of offshore companies and trusts. And, almost certainly, the proceeds of the illegal activities are not reported to the home country of the persons involved and thus the requisite taxes go unpaid. Given the powers granted the U.S. government under the Patriot Act and the aggressive demeanor of the U.S. government in attempting to discover any illegal plot post 9/11, especially if it can tie the activity in some way to "terrorism," it is easy to conclude that the U.S. government will use the new tool of *Pasquantino* to prosecute targets to the fullest extent possible under the law.

As stated at the beginning of this article, there is no consensus regarding how far the U.S. government will push the *Pasquantino* ruling and what this means for international tax and estate planning practitioners. It will be interesting to see whether attorneys will start to refuse cases which involve undeclared funds. It will also be interesting to see if accountants, private bankers, and other service providers will face the same or similar risks attorneys face under *Pasquantino* when they provide services to a client who has undeclared funds. One thing is certain—attorneys working with these types of clients had better make sure they document the scope of their advice and include in their advice the recommendation that the clients make voluntary disclosures in their home countries and come clean regarding their undeclared funds. Absent clear advice to follow the tax laws of the foreign country and pay the tax in the client's home country, the attorney remains at risk of prosecution per *Pasquantino.*

## II. Circular 230

After June 21, 2005, clients can no longer rely on most U.S. tax advice, other than so-called "reliance opinions," to avoid penalties imposed by the IRS if the advice is later determined by the IRS or a U.S. court to be incorrect. In order to ensure that clients are made aware of this new development, after June 20, 2005 the IRS has required all U.S. tax advice that is not a reliance opinion to include a legend that will put clients on notice that the communication is not intended to be used, and cannot be used, for the purpose of (i) avoiding penalties imposed under the United States Internal Revenue Code, or (ii) promoting, marketing, or recommending to another person any tax-related matter. If the attorney providing U.S. tax advice fails to include the legend when required, they may be fined, professionally censured, or barred from practice before the IRS or U.S. Tax Court.

The new rules were adopted in response to abuses by some tax advisors and their clients, primarily in connection with so-called "tax shelters." Tax shelters are usually transactions or structures motivated solely by tax savings. In other words, most tax shelters have no business purpose other than tax minimization.

Until now, the IRS could not impose some types of penalties against taxpayers if the taxpayers' return positions were based on an opinion of counsel. This IRS practice gave taxpayers an incentive to obtain tax opinions from U.S. tax advisors as "insurance" against penalties, especially in large transactions and in transactions that were of questionable validity, such as tax shelters. In some cases, tax advisors would issue opinions without knowing all of the relevant facts or the business purpose (if any) of the particular transaction. Moreover, considerable confusion existed as to what types of advice constituted an "opinion" sufficient to protect against penalties.

The new rules are designed to achieve two goals. The first is to define the requirements for so-called "reliance opinions," i.e., tax opinions upon which clients may rely for protection from IRS penalties. The second is to ensure that clients are aware that they may *not* rely on any tax advice other than "reliance opinions" to avoid IRS penalties. The requirement to include the legend on all U.S. tax advice other than reliance opinions is designed to achieve this latter goal. The legend must be included on all "written communication," including memoranda, letters, electronic mail, and faxes, that are not intended to be reliance opinions.

Thus, with the exception of reliance opinions, the traditional legal advice previously received by clients, whether by letter, memorandum, electronic mail, or fax, will now include such a disclaimer. One of the benefits of clients receiving advice with this disclaimer is that the advice will likely remain protected from disclosure under the attorney-client privilege (assuming all the other requirements for the application of that privilege are satisfied). Reliance opinions are not privileged.

Written advice from counsel constitutes a reliance opinion (and thus need not bear the legend) only if a number of very strict requirements are satisfied. In order to satisfy these requirements:

a) The written communication must be reviewed by competent counsel;

b) A representation letter concerning any facts set forth in the written communication, and any assumptions to be made, is obtained from the client;

c) All factual representations relied on are set forth in a separate section of the written communication;

d) All factual assumptions made in the written communication (other than assumptions based on client representations), if any, are set forth in a separate section of the written communication;

e) The written communication includes (i) a discussion of all significant federal tax issues, (ii) a conclusion as to the likely treatment with respect to each significant federal tax issue, and (iii) an overall conclusion as to the likely federal tax treatment of the transaction or matter and the reasons for that conclusion; and

f) The written communication satisfies certain other standards as prescribed by the IRS.

At first blush the requirements set forth by Circular 230, such as the inclusion of a "statement of facts" in any written advice considered to be a reliance opinion, may seem benign and common practice. However, the implementation of these requirements can be rather complex. For example, if an attorney gives estate planning advice regarding a Guernsey trust—which in some respects is reliant on U.S. tax laws, such as estate tax inclusion rules for U.S. beneficiaries—does such advice need to fulfill all of the new Circular 230 requirements? What if an attorney is counseling a client regarding the establishment of a German partnership, and one tangential issue is how the foreign tax credit will apply in the U.S.—does this advice need to follow the new rules? The application of Circular 230 remains very unclear. So as not to run afoul of the new rules, most mainstream law firms have began implementing the requirements on all advice, thus removing any ambiguities as to when the rules must be followed.

However, fulfilling the new requirements of Circular 230 will cost the clients time and money. In the past, if a client wanted to obtain an opinion for reliance purposes in order to avoid penalties, he could call his attorney, explain the relevant facts over the telephone, and expect the opinion in rather short order. Now, the client must send a "representation letter" to the attorney setting forth all of the relevant facts and assumptions to be used in giving the advice. In some cases, the facts can be quite substantial and intricate. Some clients may be savvy enough and have sufficient time to draft such a representation letter on their own, but in most cases the attorneys will be asked to draft and forward such a letter for the client's consideration and signature. Moreover, even if the client does draft the letter himself, the attorney will have to review it and there may be some redrafts, edits, and letters back and forth before a sufficient writing is produced. In either event, there will be considerable time spent meeting the Circular 230 requirements before the attorney can get down to the actual business of drafting a reliance opinion. This extra time and effort will undoubtedly add significant costs.

The enforcement procedures promulgated by the new Circular 230 rules have not gone unnoticed by IRS personnel. Remember, it is the attorney who is under threat of censure, disbarment or fine should the IRS or a U.S. court determine that the Circular 230 requirements have not been met. There have already been complaints to the IRS Commissioner about IRS personnel using the threat of Circular 230 as leverage in tax controversies. Although such a threat by an IRS agent is clearly improper, it nevertheless changes the balance of power with regard to litigants involved in conflicts with the IRS. When attorneys can be threatened personally with sanctions, especially when the sanctions include disbarment, based on subjective determinations regarding the sufficiency of a "statement of facts" or "representation letter" within a reliance opinion, some attorneys will be intimidated, even by the mere possibility of sanction, and it may cause them to be less aggressive in advocating their clients' positions.

## III. Impact on International Tax Practitioners

Working in the international legal arena has always been a balancing act, requiring an understanding of multi-jurisdictional rules, both in common law and civil law jurisdictions, as well as the cultural differences our clients bring to each matter. Now, with the *Pasquantino* decision and the new rules under Circular 230, new layers of complexity, and potential heartaches, have been added to the mix. Both under *Pasquantino* and under Circular 230 attorneys are now threatened with severe punishment and in both cases the rules are not entirely clear. When is offering legal advice sufficient to cause the attorney to become subject to criminal sanctions under the wire fraud statutes, and when is the requisite "representation letter" and "statement of facts" sufficient to fulfill the new Circular 230 requirements? These are subjective judgments which by necessity must be made on a case-by-case basis. The severity of the consequences should give pause to the international practitioner, and should prompt him to make every effort to protect himself in these uncertain times.

## Endnotes

1. 73 U.S.L.W. 4287 (2005).
2. Had the defendants used the U.S. mail, the provisions of the mail fraud statute (18 U.S.C. § 1341) would have applied.
3. *The European Community, et al. v. RJR Nabisco, et al.*, 355 F.3d 123 (2d Cir. 2004).
4. *John Fountain v. United States*, 357 F.3d 250 (2d Cir. 2004).
5. *See U.S. v. Woods*, 335 F.3d 993, 999 (9th Cir. 2003). "Under the mail fraud statute the government is not required to prove any particular false statement was made. Rather, there are alternative routes to a mail fraud conviction, one being proof of a scheme or artifice to defraud, which may or may not involve any specific false statements." *Id., quoting United States v. Munoz*, 233 F.3d 1117, 1131 (9th Cir. 2000).

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# RECENT NEW YORK STATE DECISIONS

Ira Mark Bloom and William P. LaPiana

## ADMINISTRATION OF ESTATES

### Non-Marital Children: Proof of Open and Notorious Acknowledgment Need Not Precede Order for DNA Testing

The decedent's alleged non-marital children made a motion pursuant to CPLR 3124 to compel production of blood and tissue samples from the decedent in order to conduct DNA testing so that they might prove paternity under EPTL 4-1.2(a)(2)(C), which requires that they also produce clear and convincing evidence of their acknowledgment by the decedent. The Appellate Division affirmed the Surrogate's grant of the motion, turning aside the martial children's argument that DNA testing cannot proceed without a prior showing of acknowledgment. *In re Morningstar*, 17 A.D.3d 1060, 794 N.Y.S.2d 205 (4th Dep't 2005).

### Non-Marital Children: Two DNA Tests Provide Evidence of Paternity

Decedent acknowledged his non-marital child to several persons. After his death the child sought to fulfill his burden to show clear and convincing evidence of paternity required in addition to acknowledgment by EPTL 4-1.2(a)(2)(C). A lock of decedent's hair submitted for testing contained no hair follicles and could not be submitted for nuclear DNA testing. A toothbrush allegedly belonging to decedent was then submitted for nuclear DNA testing and the result showed a 99.79% probability that the decedent was the biological father of the child by comparing the DNA from the toothbrush with a DNA sample from the child. The toothbrush was proven to be the decedent's by matching the mitochondrial DNA from the toothbrush to the mitochondrial DNA from the hair. The court accepted the DNA tests as clear and convincing proof of paternity. *In re Michael R.*, 7 Misc. 3d 250, 793 N.Y.S.2d 710 (Sur. Ct., Rockland Co. 2004).

### Executor Must Resist Claim Barred by Statute of Limitations

Asserting that his father's will directed the payment of all debts, whether time-barred or not, son submitted a claim for funds allegedly due him under an agreement with his father relating to a transfer of real estate. The claim was time-barred but son argued that the will provision compelled the executor to pay the claim. The Appellate Division affirmed the Surrogate's order dismissing the claim, even though the decedent's will did not appear in the record, affirming the long-established rule that an executor has no authority to allow a claim barred by the statute of limitations. *In re Skeele*, 16 A.D.3d 1157, 791 N.Y.S.2d 759 (4th Dep't 2005).

## ATTORNEYS-IN-FACT

### Lack of Contemporaneous Records Makes Attorney-in-Fact Liable for Entire Amount

Property management guardian brought a proceeding to compel an accounting by the ward's attorney-in-fact. The Appellate Division affirmed the order of the Supreme Court requiring the attorney-in-fact to reimburse the estate for the entire amount of cash withdrawals allegedly made to finance gifts and other expenditures on the ward's behalf. The inability of the attorney-in-fact to produce contemporaneous records of the cash expenditures makes him liable for the entire amount expended. *In re Garson*, 17 A.D.3d 243, 793 N.Y.S.2d 397 (1st Dep't 2005).

### Lifetime Trust May Not Be Amended by Creator's Attorney-in-Fact Absent Express Authority

Decedent's wife executed an amendment to decedent's revocable lifetime trust as his attorney-in-fact under a New York short-form durable power of attorney. The amendment revoked the disposition of the residue of the trust. Instead of the couple's four children sharing equally in the trust property, the amendment gave decedent's wife a special power of appointment to distribute the trust among the four children. Decedent died three days after the execution of the purported amendment and wife died fourteen months later, leaving a will that exercised the power in favor of three of the four children and also disinherited the fourth child.

The disinherited child moved for summary judgment on his petition to set aside the exercise of the power of appointment. The Surrogate granted summary judgment for petitioner. First, while the trust agreement did authorize the creator to revoke or amend the trust by an instrument executed and acknowledged by the creator and delivered to the trustees, it did not expressly authorize the instrument to be executed by the creator's attorney-in-fact. Second, the short-form durable power of attorney does not authorize the execution of the amendment. The reference in GOL §§ 5-1502A(9), 5-1502B(7) and 5-1502C(9) to modification of trusts concerns dispositions of interests in the type of assets described in each section. The amendment of the trust has nothing to do with a disposition but rather with "the designation of persons entitled to take the residue of a trust." In addition, GOL § 5-1505G dealing with estate transactions says nothing about amending trusts. To interpret any part of the durable power of attorney statute as granting authority to modify trusts would contradict cases stating that the power to amend and revoke is a personal power and that a trust can only be amended according to its terms. Finally, the revocable lifetime trust in this case functions as a will and to recognize the amendment as valid would require recognition of a codicil to the principal's will executed by the attorney-in-fact, contrary to current law. *In re Goetz*, 8 Misc. 3d 200, 793 N.Y.S.2d 318 (Sur. Ct., Westchester Co. 2005).

## SURROGATE'S COURT

### Venue in Lifetime Trust Proceeding Does Not Lie Where Probate Commenced

Decedent's will was offered for probate in Ulster County where he was domiciled. Decedent had established a lifetime trust naming his son, a resident of Westchester County, as trustee. One trust beneficiary petitioned the Westchester County Surrogate's Court for a compulsory accounting. The court granted the petition, the trustee filed the accounting, and the court then issued citation to all trust beneficiaries, including one who had previously asked the Ulster County Surrogate's Court to compel an accounting. The Ulster court eventually ordered the transfer of the Westchester County proceeding to itself.

The Appellate Division reversed the order, holding first that Ulster County is not the proper venue for an accounting in the lifetime trust. Venue lies where the assets are located, where the creator was domiciled when proceedings were commenced, or where the trustee resides. (SCPA 207(1)). Here, the creator was deceased at the time the proceeding was begun and the dead have no domicile. The only proper venue is Westchester County where the trustee resides. Although the trustee is also executor of the creator's will, the executor is deemed a resident of the county where the will was admitted to probate only for purposes of litigation regarding the estate. A trustee appointed by a court is deemed a resident of the county where the appointment was made; the trustee was not appointed by a court but was named trustee in the trust instrument. Second, the order to transfer the matter to the Ulster County court was improper because under the New York Constitution (Art. VI, § 19(h)) the Surrogate's Court can only transfer pending proceedings *out to* other courts; it cannot transfer proceedings *in from* other courts. *In re Kelly*, 17 A.D.3d 791, 794 N.Y.S.2d 458 (3d Dep't 2005).

## TRUSTS

### Trustees May Take Into Account Other Resources of Income Beneficiary in Deciding Whether to Make Distributions of Trust Principal That Are Subject to a Health and Support Standard

Decedent's will created a trust for his mother which directed the trustees to pay the beneficiary all the income from the trust and gave the trustees power to invade principal in their "absolute and unreviewable discretion" as they deem advisable for the beneficiary's "health, support and maintenance." When decedent died, his mother's assets totaled approximately $1,000,000 but she was incapacitated and unable to handle her own affairs. The executors of the son's will made expenditures for the beneficiary's benefit totaling almost $250,000, far in excess of the trust income (the trust corpus totaled approximately $1,600,000). The beneficiary died very shortly after the appointment of a temporary guardian. The trustees asserted a claim against her estate for the amount expended in excess of trust income. There was no evidence that the expenditures from principal were a loan.

After an extensive review of cases, the Surrogate held that the decedent intended the beneficiary's assets to be one factor to be considered by the trustees in exercising their discretion to invade principal, citing in support Restatement Third of Trusts § 50(2) Comment *e* for the departure from those cases which state that if there is a gift of income there is no discretion to invade principal until the beneficiary's resources are depleted. In this case, the beneficiary's assets were unavailable to her until the appointment of a guardian, and in that situation the payment of the beneficiary's expenses out of principal until a guardian was appointed furthered the decedent's intent. The trustees' claim was disallowed except to the extent they sought reimbursement of the personal funds they had expended for the beneficiary. *In re Goodman*, 7 Misc. 3d 893, 790 N.Y.S.2d 837 (Sur. Ct., Kings Co. 2005).

### Reformation to Supplemental Needs Trust Granted

On decedent's death in 1982 his will created a trust for his mentally retarded son which directed mandatory payment of income and gave the trustee discretion to invade principal. The beneficiary eventually entered a Medicaid-funded day treatment program but was ineligible for Medicaid funding because the trust is not an exempt resource. The trustee then petitioned the Court to reform the trust into a supplemental needs trust by making the distribution of both income and principal discretionary.

Citing the legislative history of EPTL 7-1.2 creating supplemental needs trusts (*In re Escher*, 94 Misc. 2d 952, 407 N.Y.S.2d 106 (Sur. Ct., Bronx Co. 1978), *aff'd,* 52 N.Y.2d 1006, 438 N.Y.S.2d 293, 420 N.E.2d 91 (1981)), the testator's intention to care for his retarded child, the command that the beneficiary's guardians act in his best interest, the use of substituted judgment which leads to the conclusion that the beneficiary would renounce the right to income in order to create a supplemental needs trust, and the public policy approving Medicaid planning, the Court ordered the reformation. The Court expressly disagreed with the opinion in *In re Rubin* (4 Misc. 3d 634, 781 N.Y.S.2d 421 (Sur. Ct., N.Y. Co. 2004)), which refused reformation under similar circumstances and held that reformation could not be used to change the terms of the trust to deal with unforeseen circumstances. *In re Kamp*, 7 Misc. 3d 615, 790 N.Y.S.2d 852 (Sur. Ct., Broome Co. 2005).

### Adopteds; Exclusion of Adopteds Does Not Apply to Gestational Surrogacy

In 1959 settlor created New York trusts for the issue of his children which expressly stated that "adoptions shall not be recognized." One of settlor's daughters and her husband became parents of fraternal twins through a surrogacy arrangement under which anonymously donated ova were fertilized with husband's sperm and carried to term by an unrelated surrogate mother. The agreement was governed by California law and a California court subsequently issued a judgment of paternal relationship establishing daughter and her husband as the twins' parents. The trustees petitioned for construction of the trust and the Surrogate held that settlor did not intend to extend the exclusion of "adoptions" to the assisted reproductions techniques at issue and that the California paternity order was entitled to full faith and credit in New York. *In re Doe*, 7 Misc. 3d 352 , 793 N.Y.S.2d 878 (Sur. Ct., N.Y. Co. 2005).

## WILLS

### No Contest Clause: Clause May Not Be Construed Before Will Admitted to Probate

In *In re Martin* (1 Misc. 3d 769, 771 N.Y.S.2d 292 (Sur. Ct., Nassau Co. 2003)), the Surrogate construed a no contest clause not to apply to a challenge to a codicil to the will containing the clause before either instrument was admitted to probate. The Appellate Division reversed the Surrogate, stating that the long-established rule that a will must be admitted to probate before it can be construed applies to no contest clauses. *In re Martin*, 17 A.D.3d 598, 793 N.Y.S.2d 458 (2d Dep't 2005).

### Acknowledgment of Disclosure of Consequences of Appointment of Attorney as Executor Required Where Drafter's Paralegal Designated Executor

Decedent's will designated as executor a paralegal employed by the attorney who drafted the will. The decedent executed the disclosure required by SCPA 2307-a at the time the will was executed but the disclosure was witnessed only by the attorney. The paralegal was not a close friend of decedent and she became acquainted with him only through her employment. Given the lack of a relationship between the paralegal and decedent and her relationship with the attorney, the court was concerned that the goals of a proper SCPA 2307-a disclosure statement could be circumvented where only the attorney witnessed the document. Because the disclosure statement fails the requirement that it be witnessed by someone other than the executor-designee, the statement is void and the executor is limited to one-half the statutory commission. *In re Wagoner*, 7 Misc. 3d 445, 794 N.Y.S.2d 573 (Sur. Ct., Albany Co. 2005).

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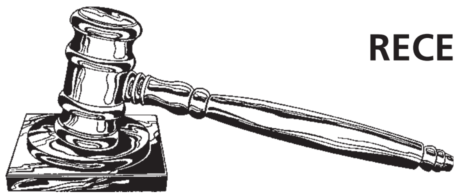

# CASE NOTES— RECENT NEW YORK STATE SURROGATE'S AND SUPREME COURT DECISIONS

**Ilene Sherwyn Cooper**

## Confidentiality of Court Records

In a contested accounting proceeding, the executrix of the decedent's estate sought a confidentiality order to protect information, testimony and materials that might be elicited concerning the decedent's companies. The application was opposed by the guardian ad litem representing residuary beneficiaries of the estate, who argued that there had been no showing that the circumstances in the proceeding, which dealt with the valuation of those companies, were unusual, and that he had a right and duty to conduct an unfettered investigation in order to protect his ward's interest.

In denying the application, the Court opined that a confidentiality order may only be entered where the moving party demonstrates a legitimate concern for exposure of trade secrets. More specifically, a two-fold analysis is required; first, the movant must substantiate that compelling disclosure of certain materials would reveal trade secrets, and second, upon such a showing being made, the party opposing confidentiality must demonstrate that the information sought is indispensable to support its case and that it could not be acquired in any other way. A statement by counsel, made upon information and belief, is insufficient to establish that materials contain trade secrets. Rather, an affidavit made by a person with knowledge about the business which contains non-conclusory assertions giving rise to a genuine concern relating to disclosure of information is required.

Inasmuch as the movant had merely submitted an attorney's affirmation made upon information and belief, the court concluded that she had failed to satisfy her burden of establishing the confidentiality of the information at issue, and her application was denied with leave to renew upon a proper showing.

*In re Estate of Seviroli*, N.Y.L.J., April 12, 2005, p. 20 (Sur. Ct., Nassau Co., Surr. Riordan).

## Constructive Trust

In a proceeding to, *inter alia*, impress a constructive trust, respondents, who were also the executors of the estate, moved to dismiss on the basis of the statute of limitations.

The record revealed that the decedent died on April 24, 2004. In June, 2004, a proceeding was instituted for probate of the decedent's will, which application was granted by decree of the court, which issued letters testamentary to the named executors, on September 16, 2004.

The subject of the application for a constructive trust was a parcel of real property which was transferred to the respondents without consideration on May 1, 1988. The respondents claimed that this request was barred by a six-year statute of limitations, which began to run on the date of the transaction. Based on this analysis, the statute would have expired on the date of the decedent's death.

However, in referring to the provisions of CPLR 210(a), the court noted that where a person entitled to commence an action dies before the statute of limitations expires and the action survives, the same may be commenced by his representative within one year from his date of death. This being the case, the representative of the estate had until April 30, 2005 to commence the action.

Moreover, inasmuch as the petitioner was not the representative of the estate, and therefore lacked standing to institute the action, the court in the exercise of its equitable jurisdiction, and in order to avoid completely foreclosing recommencement of the action in the event that it was dismissed, deemed that portion of the proceeding which sought to impose a constructive trust as an application to request limited letters of administration cta to petitioner pursuant to SCPA 702(9).

Accordingly, the motion to dismiss the application as time-barred was denied, and limited letters of administration cta were granted to the petitioner.

*In re Estate of Frederick A. Nickolas*, N.Y.L.J., April 27, 2005, p. 27 (Sur. Ct., Suffolk Co., Surr. Czygier).

## Elective Share

At issue before the court was whether the guardian's application for authority to file a notice of election on behalf of the incapacitated person was rendered moot by reason of her death.

The record revealed that the guardian had served a notice of election upon the executors of the decedent's estate, but that the Surrogate's Court had rejected its filing without an order of the Supreme Court authorizing the guardian to exercise the right. Consequently, the guardian moved by order to show cause in the Supreme Court for said authority. However, one day before the order to show cause was signed, the incapacitated person died.

The court opined that the exercise of a statutory right of election is personal to a surviving spouse. As such, where the exercise of an elective share is sought by someone other than the spouse, as, for example, in the case where a guardian seeks to do so on behalf of an incapacitated spouse, the service, filing and recording of the notice of election must be accompanied by an authorization from the guardianship court.

Inasmuch as this authorization was not obtained prior to the death of the incapacitated spouse, the application by the guardian was denied.

*In re Rivera*, N.Y.L.J., June 2, 2005, p. 18 (Sup. Ct., N.Y.) (Justice Suarez).

### Post-Nuptial Agreement

In a matrimonial action, defendant wife sought to enforce the terms of a postnuptial agreement she had entered into with the plaintiff husband. The agreement was executed in the State of Florida, although the certificate of acknowledgment revealed that it was made before a New York notary. The plaintiff opposed the application, claiming that the agreement was invalid and unenforceable on the grounds that it was not acknowledged or proven in a manner required to entitle a deed to be recorded.

In denying the defendant's application, the court relied upon the opinion by the Court of Appeals in *Matisoff v. Dobi*, 90 N.Y.2d 127 (1997), which applied a bright line rule requiring marital agreements to be acknowledged in the manner required to entitle a deed to be recorded, regardless of the circumstances.

Because the acknowledgment at issue was taken by a New York notary in the State of Florida, the court concluded that it could only be made before a notary qualified in the State of Florida, or a commissioner of deeds appointed in New York state to take acknowledgments outside the state. No evidence of the notary's compliance with these requirements was presented to the court. Absent such proof, the court held that a notary public qualified in New York state is only empowered to receive and certify acknowledgments within and throughout New York state. As such, the court held that the acknowledgment by the New York notary in the State of Florida was ineffective.

Because the subject agreement was never properly acknowledged, the court concluded that it was invalid and unenforceable. Significantly, the court reached this result despite proof that the parties had complied with the terms of the agreement for a period of eight years, concluding that the decision by the Court of Appeals in Matisoff, *supra*, required strict compliance. Additionally, the court rejected defendant's argument that the agreement was a binding stipulation enforceable pursuant to CPLR 2104, holding that it had been entered into prior to the commencement of the action and not in settlement of an existing action.

*Kudrow v. Kudrow*, N.Y.L.J., March 8, 2005, p. 20 (Sup. Ct., Kings Co.) (Justice Krauss).

### Pre-Objection Discovery

In a probate proceeding, motions were made with respect to a subpoena and a demand for discovery and inspection of documents served by the potential objectants who have requested SCPA 1404 examinations.

The subpoena at issue was served upon an accountant, a non-party witness, directing that he produce numerous documents relating to the decedent's assets and tax returns of either, or both, the decedent and his spouse. Also at issue was a demand for discovery and inspection served upon the proponent, the nominated executor, which, *inter alia*, sought information with regard to legal services provided to the surviving spouse, information pertaining to joint assets of the decedent and his spouse, income tax returns of the decedent, and the past and continued marital status of the surviving spouse. The proponent moved to quash the subpoena.

The court opined that a party conducting SCPA 1404 examinations is entitled to utilize the provisions of Article 31 of the CPLR to obtain document discovery. However, the court held that pursuant to CPLR 3120(3) a subpoena must be served upon the non-party, as well as all other parties. Inasmuch as the subpoena at issue was not served upon the decedent's surviving spouse, who was both a party to the probate proceeding and the subject, in whole or in part, of some of the documents in the possession of the accountant, the motion to quash the subpoena was granted.

With respect to the demand for discovery and inspection, the court noted that the trend has been to broaden the scope of discovery in SCPA 1404 examinations in order to afford a potential objectant with a complete opportunity to determine whether any grounds for objecting to probate exists. In the case at bar, the court determined that the potential objectant wanted to explore whether transactions between the decedent and his spouse, who was married previously, might support objections alleging either lack of testamentary capacity or undue influence. To this extent, it held the decedent's tax returns and assets the decedent held jointly with his spouse to be relevant in proving such objections. On the other hand, the court determined that the request for information pertaining to legal services provided to the surviving spouse was not only irrelevant to the probate of the decedent's will, but also privileged.

*In re Estate of Jack Roth*, N.Y.L.J., April 20, 2005, p. 25 (Sur. Ct., Bronx Co., Surr. Holzman).

## Sanctions

In a case for wrongful discharge, defendants moved for a protective order and sanctions against plaintiff's counsel on the grounds that they intentionally turned over to the media the videotape deposition of defendant's president and chief executive officer, with the intent of harassing and injuring defendants.

In granting defendants' application, the court held that examinations before trial are not sittings of courts which are required to be open to the public. Instead, the court stated, depositions are private matters between the parties designed to assist them in their search for issues relevant to trial. Hence, the court found that while the media may play an important role in disseminating information to the public, it is a role which must be limited during the pretrial stage of discovery. See DR 7-107 establishing the parameters for attorneys relative to trial publicity. This was particularly so in the case *sub judice*, where the parties did not request that the media be present at the subject deposition.

Accordingly, the court ordered that all discovery and depositions held in the matter were to be confidential, and were not to be disseminated to the press or any other persons with the exception of the attorneys and the court.

With respect to the request for sanctions and costs, the court found that the actions taken by plaintiff's counsel were deliberate and calculated to harass the defendants, and were in violation of the provisions of DR 7-107. Plaintiff's counsel had admitted, with no justification, to soliciting and turning over the videotaped deposition to the media. The court ordered that plaintiff's counsel be sanctioned, pay the costs associated with the application, including but not limited to defendants' attorney's fees, and that they pay $7,500 to the Lawyer's Fund for Client Protection.

*Seaman v. Wyckoff Heights Medical Center Inc*., N.Y.L.J., April 12, 2005, p. 19 (Sup. Ct., Nassau Co.) (Justice Davis).

## Sale of Life Estate

In a miscellaneous proceeding, the life tenant of trust property, who was also the settlor of the subject trust, sought a court order directing a sale of the premises and a distribution to him of the value of his life estate. The application was opposed by the trustee of the trust, who was a remainderman of the trust, together with her children and the settlor's son.

In granting the application, the court held that a life tenant is tantamount to the owner of property, entitled to all the benefits and burdens of such ownership, so long as the remainder interest is not affected. On an application to sell an interest in real property, the life tenant must show that the proposed sale is expedient, i.e., suitable, practical and efficient in achieving a particular end which is proper and advantageous under the circumstances.

In support of the application, the life tenant asserted that he was currently living in an assisted living facility where he desired to remain, and that the proceeds of sale could be utilized towards his costs of living. In opposition, the trustee maintained, *inter alia*, that the sale of the property and payment of the value to the petitioner would contravene the purpose for which the trust was created, i.e., to protect the settlor's assets for Medicaid purposes.

The court nevertheless found that the settlor's primary purpose in creating the trust was to insure that he would have a place to live during his lifetime, and that a sale would enable him to continue that purpose by paying the expenses of the assisted living facility. As such, the court held that granting the application was expedient, as well as suitable, practical and efficient. Additionally, the court directed that petitioner be paid the value of his life estate outright pursuant to the provisions of RPAPL § 967.

*In re The William J. Bornkamp Family Trust*, N.Y.L.J., June 14, 2005, p. 18 (Sur. Ct., Nassau Co., Surr. Riordan).

## Standing

In a contested probate proceeding, the petitioners raised the issue of the right of the decedent's son-in-law to file objections to probate.

The decedent/wife and her husband died in an automobile accident. He died shortly after she did. They had executed mutual wills which created credit shelter trusts, with the income payable to a niece and charitable foundations of the trustee's choosing, and upon termination, the residue payable to two nieces. The residue of the estate was left to the surviving spouse, who was also named as the executor.

The will of the decedent was offered for probate and objections were filed by her stepson, i.e., the son of the decedent's husband from a prior marriage. The proponents of the will moved to dismiss the objections on the grounds that the objectant was not a distributee of the decedent. The application was opposed by the stepson who alleged that he had standing as the distributee of his late father's estate. The son also filed objections to his father's will.

In addressing the issue, the court noted that the question of the right to file objections upon the death of a legatee involves two competing interests: on the one hand that the adverse consequences be direct, and on the other hand, the public policy in favor of disposing of challenges to probate on the merits. The fact that someone has a contingent interest does not preclude that person from filing objections.

Within this context, the court found that the stepson's interest in the decedent's estate was not direct in that it derived from an interest in his father's estate, which was contingent upon his succeeding in his objections to his father's will. Since he would receive nothing from his father's estate if he were to lose his challenge to probate, his interest in his stepmother's estate was both contingent and remote.

Upon examination of prevailing case law on the subject, the court opined that the cases interpreting the provisions of SCPA 1410 have implicitly rejected the standing of distibutees of a post-deceased distributee. The court held that any other interpretation was too broad, and would subject an estate to an ever-expanding list of possible objectants. Nevertheless, the court held that the fiduciary of a post-deceased distributee's estate did have standing. Since one of those fiduciarys had a conflict of interest, the court, though it granted the proponents' motion to dismiss, authorized the decedent's stepson to apply for restricted letters for the purpose of filing objections in the name of his father's estate, upon the posting of security for costs.

*In re Estate of Shidlovsky*, N.Y.L.J., April 7, 2005, p. 28 (Sur. Ct., Kings Co., Surr. Tomei).

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