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Sorting out the Independent Contractor Statute…
Is your independent contractor an employee?

By Michael P. Sams

Introduction

Massachusetts has for some time used what is known as the ABC test for analyzing employment relationships. The Massachusetts test was amended in 2004, however, making it considerably more difficult to classify someone as an independent contractor. Specifically, “An Act Further Regulating Public Construction in the Commonwealth” was signed into law as Chapter 193 of the Acts of 2004 on July 19, 2004. See G.L. c. 149, §148B. Buried within Chapter 193, at §26, but not limited to the public construction field, are the amendments to the independent contractor statute.

Based on the attorney general’s advisory explaining how the amended statute will be enforced, the amendment is significant and affects many industries. As the Attorney General’s Office interprets these amendments, they greatly narrow who may be classified as an independent contractor. They also expand the penalties for misclassification.

Changes to the statute and what they mean

Even before the amendments to the independent contractor statute were passed, a presumption existed under §148B that a work arrangement constituted an employer-employee relationship. This presumption could be overcome by satisfying each step of a three-part test for independent contractor status set forth in §148B. Although the amended statute still provides a three-part test that looks only marginally different from the old test, it is now much more difficult to satisfy the test and establish that a worker is an independent contractor.

The following is a comparison of the three-part test before and after the amendments to the statute (again, note that each of these tests needs to be satisfied for someone to be properly classified as an independent contractor):

<table>
<thead>
<tr>
<th>Pre-Amendment Step 1</th>
<th>Amended Step 1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Such individual has been and will continue to be free from control and direction in connection with the performance of such service under his contract; and</td>
<td>no change to Pre-Amendment Step 1;</td>
</tr>
</tbody>
</table>

Pre-Amendment Step 2

such service is performed either outside the usual course of the business for which the service is performed or is performed outside of all places of business of the enterprise; and

Amended Step 2

such service is performed outside the usual course of the business of the employer; and

Pre-Amendment Step 3

such individual is customarily engaged in an independently established occupation, profession or business of the same nature as that involved in the service performed.

Amended Step 3

such individual is customarily engaged in an independently established trade, occupation, profession or business of the same nature as that involved in the service performed.

A quick comparison of the amended test does not reveal much significance. The first step remained unchanged and the third step added only the word “trade” to the language. Even the second step went unnoticed by many for some time. So difficult to catch was the change to step two that, anecdotally, it has been stated no one on the special committee that helped draft Chapter 193 even knew the three-step test was being altered.

Nonetheless, the change to step two of the test is significant and, if strictly followed, would have a profound effect on the cost of doing business in the commonwealth. The
following summarizes the attorney general’s advisory concerning how to interpret the amended three-part test.

Attorney general’s advisory

1. Freedom from control

The worker must be free from the presumed employer’s control and direction, both in contract and in fact, in performing the service. A contract or job description indicating a worker is free from supervisory direction or control is, by itself, insufficient. The worker must actually perform his work with autonomy.

2. Work performed outside employer’s usual course of business

The worker’s job must be performed outside the employer’s usual course of business. Moreover, a worker who performs the same type of work that is part of the normal service the employer delivers is not an independent contractor.

3. Independent trade, occupation or business

The worker must routinely work in an independently established trade, occupation, profession or business, and the worker’s particular service in question must be similar in nature to that trade, occupation, profession or business. The worker must represent himself to the public as being in the business to perform the same or similar services in question. An independent contractor often has a financial investment in a business related to the service he is performing for the employer.

An analysis of the amended three-part test

1. Freedom from control

Establishing that the individual has autonomy over its means and methods is a substantial piece of satisfying the first requirement in the independent contractor/employee analysis. In other words, is the worker free from the employer’s control and direction in terms of the means and methods pursuant to which the individual performs the work?

The following IRS 20 factor test (IRS Revenue Ruling 87-41) provides a framework that can be used in determining whether the worker possesses the necessary autonomy to satisfy the “freedom from control” analysis (as indicated, some of these factors might also be used to assess the third test (proprietary business test) of the Massachusetts analysis):

1. Instructions – does the individual have to comply with instructions about how, when and where to perform the work?
2. Training – who trained this individual to perform the work?
3. Integration – are the services performed integrated into the employer’s business operations?
4. Personal services – does the individual have to perform the services in person?
5. Use of assistants – does the individual have assistants working for him/her and, if so, who directs those individuals, the individual or the employer?
6. Ongoing relationship – does the individual move from job to job or have some other ongoing working relationship with the employer?
7. Fixed hours of work – who sets the individual’s work hours?
8. Full-time work – is the individual working full time for the employer?
9. Where is the work performed – is all of the individual’s work performed on the employer’s premises or at the employer’s work site?
10. Work flow – are there routines or patterns through which the work is distributed by the employer to the worker?
11. Reports – does the employer require regular report from the worker?
12. Manner of payment – how is the employee paid: by the hour, week, month or on a lump sum basis?
13. Payment of expenses – who pays the worker’s expenses? (Evidence concerning this factor would also apply to the third test in the Massachusetts analysis.)
14. Providing tools and equipment – who provides the tools and equipment? (Evidence concerning this factor would also apply to the third test in the Massachusetts analysis.)
15. Investment – does the worker have any investment in his/her facilities, tools, etc.? (Evidence concerning this factor would also apply to the third test in the Massachusetts analysis.)
16. Profit or loss – can the worker receive a profit or incur a loss as a result of the work? (Evidence concerning this factor would also apply to the third test in the Massachusetts analysis.)
17. Multiple clients – is the individual working for multiple employers at one time? (Evidence concerning this factor would also apply to the third test in the Massachusetts analysis.)
18. Marketing – does the worker market his/her services to the public? (Evidence concerning this factor would also apply to the third test in the Massachusetts analysis.)
19. Right to discharge – can the employer discharge the worker at any time without liability?
20. Right to quit – can the worker quit at any time?

The answer to these questions will go a long way in determining whether the employer controls the individual’s work. Nonetheless, the attorney general has stated in the advisory that,[a]n employment contract or job description indicating that a worker is free from supervisory direction or control is a prerequisite, but is insufficient by itself under the independent contractor law [to classify someone as an independent contractor].

Accordingly, in addition to satisfying the IRS 20 factor test, an employer should provide a written statement to those it considers to be independent contractors confirming that the worker is free from supervisory direction or control.

Massachusetts Bar Institute
2. Work performed outside the employer’s usual course of business

The pre-amendment statute allowed a worker to be classified as an independent contractor where that individual performed the same type of work as the employer, so long as the individual worked outside the company’s business location. Those who worked from home instead of the office usually met this part of the test. Construction subcontractors working on a site that met the first and third steps of the three-part test were usually treated as independent contractors as well, even if they performed work typically undertaken by the entity with whom they contracted.

The Attorney General’s Office has made clear, however, that this is no longer the case. A worker performing tasks that are part of the typical business of the employer cannot be classified as an independent contractor. For instance, contractors who hire from temporary employment agencies to supplement their workforce likely do so in violation of the amended independent contractor statute. Those who take on temporary workers to supplement their workforce also likely violate the statute.

For recent cases discussing the statute, please see American Zurich v. Department of Industrial Accidents et al., Suffolk Superior Court C.A. No. 053469A (June 1, 2006)(Memorandum)(Troy, J.); Rainbow Development, LLC dba Auto Shine v. Commonwealth of Massachusetts Department of Industrial Accidents, et al., Suffolk Superior Court C.A. No. 200500435 (November 19, 2005)(Memorandum)(Cratsley, J.); College News v. Dept. of Industrial Accidents, Suffolk Superior Court C.A. No. 04-4559-A (September 14, 2006)(Ruling on Motion For Judgment On The Pleadings )(Sikora, J.); Kalha v. Viking Networks, Inc. et al., Middlesex Superior Court C.A. No. 022171 (January 21, 2005)(Memorandum discussing the statute pre-amendment but including an analysis of the still existing portion of step two in the Massachusetts test)(Gaziano, J.).

3. Independent trade, occupation or business

The Massachusetts Supreme Judicial Court has said that the relevant inquiry under the test’s third prong is:

whether the service in question could be viewed as an independent trade or business because the worker is capable of performing the service to anyone wishing to avail themselves of the services or conversely, whether the nature of the business compels the worker to depend on a single employer for the continuation of the services.


The essential determination is whether the worker is an entrepreneur and is performing such services in that capacity. Id. at 480. As the court in Boston Bicycle found, there are certain recurring factors in the analyses in other jurisdictions tending to show a proprietary interest in an independently established trade or business; primarily that,

1. the individual worker is free both to operate an independent enterprise and to perform services without hindrance from the employing unit;
2. the independent enterprise was created and exists separate and apart from the worker’s relationship with the particular employing unit;
3. the worker’s independent enterprise is not interconnected with, and is not dependent in any way upon, engagement by the particular employing unit, or other companies engaged in the subject industry; and
4. the worker’s independent enterprise would survive as an ongoing business entity, notwithstanding the termination of the relationship with the employing unit.

Id. at 480-81.

Accordingly, whether an employer satisfies the third prong of the test is based upon a comprehensive analysis of the totality of relevant facts and circumstances. Id. at 484.1

The expanded penalties for misclassification

The Act of July 19, 2004, expands an employer’s liability for failing to properly classify an individual as an “employee.” Under the amended statute, an employer is now also liable for violating statutes regarding minimum wage, overtime compensation, compulsory health insurance, employer’s maintenance of employee records, discriminatory acts, worker’s compensation and the withholding of taxes from employee wages. Violating any of these laws exposes an employer to criminal and civil penalties. The following is a summary of the relevant statutes that an employer needs to be aware of, and the penalties for failing to comply.

Summary of the relevant statutes with which the employer must comply

The following is a summary of the statutes referenced in c. 149, §48B with which the employer must comply if an individual is an employee:

G.L. c. 62B:

§2 - Requires employers to deduct and withhold taxes from each employee’s wages.
§4 - Concerns withholding exemption certificates. Every employee must furnish his employer with a withholding exemption certificate on or before the date employment commences. If an employee fails to furnish a signed certificate, the number of his exemptions shall be considered zero. An employee can change the number of exemptions claimed by furnishing a new withholding exemption certificate.
§5 - Requires every employer to provide each employee who had taxes withheld with a written statement showing the employer’s name, the employee’s name and social security number, the total amount of wages subject to taxation, and the total taxes withheld. An employer’s failure to withhold or pay the taxes subjects the employer to personal liability.
§10 - Provides that an employer shall be liable for the payment of the tax required to be withheld under §2.

**G.L. c. 151:**

§1 - Declares it against public policy for an employer to employ any person in Massachusetts at an oppressive and unreasonable wage, which is defined as a wage less than the fair and reasonable value of the services rendered and less than sufficient to meet the minimum cost of living. It conclusively presumes that a wage of less than $6.75/hr in any occupation is oppressive and unreasonable.

§1A - Prohibits an employer from requiring an employee working on wages to work more than 40 hours, unless the employee receives compensation for work in excess of 40 hours at a rate not less than one-and-one-half times the regular wage rate. This section lists 20 categories of individuals who are not deemed employees under this section.

§1B - Provides that an employer who pays/agrees to pay an employee less than the overtime rate required by §1A shall be punished and subject to civil citation or order as provided in G.L. c. 149, §27C. Each week in which an employee is paid less than the overtime rate of compensation shall constitute a separate offense. An employee may bring a civil action against his employer for violating this section.

§15 - Requires employers to keep the following on file for at least two years after the date the record is prepared:

- the name, address and occupation of each employee;
- the amount paid each pay period to employee; and
- the hours worked each day by each employee.

Records must be available for inspection by the attorney general at any reasonable time. An employer also must allow an employee to inspect the records pertaining to that employee at a reasonable time and place. An employee may sue his employer for violating this section.

§19 - Addresses discrimination by employers. An employer violates this section if it discharges an employee because:

- the employee has complained of a violation of the provisions of c. 151;
- the employee has testified or is about to testify in any investigation or proceeding under/related to c. 151; or
- the employer believes the employee may complain of a violation of c. 151.

As with the preceding sections, an employer who violates c. 151, §19 may also be sued by the employee.

**G.L. c. 152:**

An employer who misclassifies a worker as an independent contractor and does not provide workers' compensation insurance for that individual violates G.L. c. 152 and opens the employer up to penalties under §14 as discussed below.

**Penalties**

Workers who have been misclassified may file a civil action and can potentially recover treble damages, attorneys' fees and costs. Civil citations may also issue with penalties between $7,500 and $25,000. Additionally, a contractor faces a two-year debarment when it receives three citations for intentional violations of the statute and a one-year debarment penalty for a failure to comply with civil citations or any administrative order related to the statute.

Criminal prosecution may also ensue. Penalties for each violation include fines of up to $10,000, imprisonment for up to six months, and debarment of contractors from public construction for up to six months for a first violation of the statute where the violation was unintentional. A subsequent unintentional offense can subject the offending company to a fine of up to $25,000, imprisonment for up to one year and debarment for up to three years. A finding that a company willfully violated the statute can result in a criminal fine of up to $25,000, imprisonment for up to one year and a five-year debarment. A subsequent willful offense finding can result in a fine of up to $50,000, imprisonment for up to two years, and a five-year debarment.

**End notes**

1. Emphasis added to show the only change in this step.

Repeated problems in State Medical Examiner’s Office result in unreliable certification as to cause of death

By Joseph M. Desmond

Introduction

The State Medical Examiner’s Office has been repeatedly criticized for a variety of issues that have called into question the competence of the office. Despite the repeated errors of the office, death certificates signed by the medical examiner certifying an opinion as to cause of death are routinely admitted in evidence by statute in both civil and criminal cases with the presumptive weight of reliability and impartiality of the Office of the Chief Medical Examiner for the commonwealth. This article examines the statutory authority that provides a blanket rule of admissibility for death certificates in Massachusetts.

Recent history

The Office of the Chief Medical Examiner has faced renewed scrutiny after the release of a scathing independent report in July 2007. The comprehensive report, commissioned by the Executive Office of Public Safety in the wake of several high-profile mishaps, including the loss of a Cape Cod man’s body following an autopsy, details numerous institutional shortcomings and characterized the OCME as “on the verge of collapse.” The report specifically criticized the OCME’s lack of “written policies and procedures or standard operating procedures on even the most basic of functions,” poor staff training “even on critical functions,” high caseload and general non-compliance with the best practices of the field. Governor Deval Patrick fired the chief medical examiner shortly after the release of the report in an attempt to manage the crisis, but it appears the findings of the report have provided the defense bar with ample fodder for questioning the OCME’s cause of death determinations.

The 2007 report is merely the latest in nearly a decade of strong criticism of the OCME. The office has been investigated by state and federal officials for a myriad of issues, including alleged misuse of grant money and mishandling forensic evidence such as body parts, photos and original autopsy reports. In addition, four separate studies and audits of the agency were commissioned and reported since 2000: the National Association of Medical Examiners (November 2000); The Dallas Report (March 2001); The EOPS Review of Forensic Services (June, 2001); and The Needs Assessment of Forensic Services by the National Forensic Science Technology Center (April 2002). A 2002 report on the Office by the National Forensic Science Technology Center in Florida repeatedly warned of “grave errors” and said “there exists a high risk to the commonwealth that an injustice could occur” due to office practices.

Statutory duty of the office

The State Medical Examiner’s Office is statutorily obligated pursuant to Mass. Gen. Laws. c. 38 to establish a comprehensive system to deliver medicolegal services within the Commonwealth of Massachusetts. The office is responsible for the investigation and certification as to the cause of deaths under its jurisdiction. When notified of a death pursuant to §3, the chief medical examiner is required to carefully inquire into the cause and circumstances of the death. If the chief medical examiner determines that the death was due to violence or other unnatural means, or to natural causes that require further investigation, he is required to take jurisdiction. The manner of death places a death into one of the five categories: natural, homicide, suicide, accident or undetermined, while the cause of death is the disease process or injury responsible for the death.

In carrying out its required investigatory duties, the chief medical examiner “is entitled to review and receive copies of medical records, hospital records or information which he deems relevant to establishing the cause and manner of death.” In this regard, hospitals and medical facilities are obliged to cooperate with the OCME in the investigation of medicolegal cases. Notwithstanding the obvious significance of the responsibilities of the State Medical Examiner’s Office, the OCME has been essentially level funded since its inception in 1983.
Office policies and practices concerning autopsies

Notwithstanding the mandate of Chapter 38, the OCME did not adopt formal policies and procedures concerning investigations until 2002. Prior to the adoption of the current policy manual, autopsies were essentially determined on an ad hoc basis without reference to standardized procedures. A recent policy iteration of this leaves the decision as to whether or not to conduct an autopsy to the discretion of the pathologist on duty. The policy provides a “general guideline” as to cases that may be disposed of by way of external inspection as opposed to an autopsy. The guidelines suggest that an autopsy should be conducted unless the cause of death is reasonably clear from an external examination, such as cases involving suicide where there is a suicide note or evidence of suicidal intent documented in the medical history. Other cases that may be disposed of without autopsy include cases of natural deaths and individuals over the age of 50 where there is evidence of significant medical history available; cases of witnessed drownings; and death thought to be related to a blunt trauma sustained as the result of a motor vehicle accident. When autopsies are conducted, the pathologist is directed to review all available medical records, police reports, ante-mortem and post-mortem x-rays and the medical examiner’s investigative report. In light of the staffing shortages, such a thorough review is likely the exception rather than the rule of the OCME.

Statistics obtained from the Registry of Vital Records and Statistics show that the OCME performs an autopsy in less than 30 percent of its cases. More often, the OCME relies on a simple viewing to make a determination as to the cause of death. The office has been criticized for refusing to conduct autopsies in auto accident cases and other cases.

The advantages of the autopsy are numerous. Autopsies help determine the efficacy of drug therapy and surgical techniques. They provide comfort to families in knowing the cause of death. They discover and define new diseases and environmental hazards. Information obtained from autopsies is essential in establishing valid mortality statistics. These vital statistics are compiled from hospital death certificates.1

In addition to performing relatively few autopsies, it also remains unclear the extent of investigation conducted on non-autopsy cases before the cause of death is certified by the office. In some cases, the OCME certifies the cause of death without an autopsy and without reviewing medical records or consulting with the decedent’s medical providers. Ironically, in many instances, the pathologist signing the death certificate would not pass a Daubert/Canavan challenge if he or she were called to testify at trial as an expert on the cause-of-death. Nonetheless, the determination as to cause of death by the OCME is admissible by statute.

The absence of autopsy findings sufficient to explain death may pose a dilemma for the physician completing the death certificate: This dilemma is not uncommon when causes of death in the elderly are at issue. Unfortunately, due to the low national autopsy rate, especially among the elderly nursing home population, erroneous reporting of the cause-of-death is undoubtedly frequent.2 The autopsy can play a major role in the evaluation of suspected abuse or neglect of the elderly. The nature and extent of specific injury can be documented, and an evaluation of hydration status and metabolic status may be performed.3 “The possibility of causes of death other than abuse/neglect may be evaluated, sometimes exonerating those falsely accused of abuse or neglect.”

Death certificates

Death certificate information is a major source of statistical data to identify public health problems, to monitor progress in public health, to allocate research funds and to conduct scientific research.4 Notwithstanding the lack of uniformity in reaching a determination as to a cause of death and the lack of information reviewed in some cases, death certificates signed by the OCME are admissible in evidence by statute as prima facie evidence of a decedent’s cause of death.5 M.G.L. c. 46, §19 provides, in relevant part, that:

“...death shall be prima facie evidence of the facts recorded, but nothing contained in the record of a death which has reference to the question of liability for causing the death shall be admissible in evidence. A certificate of such a record, signed by the town clerk or assistant clerk, or a certificate of the copy of the record relative to a...death... shall be admissible as evidence of such record.

M.G.L. ch. 46, §19 provides that in Massachusetts, as a matter of law, opinions expressed in death certificates may be admitted without any inquiry as to the reliability of the opinions. Indeed, the Supreme Judicial Court has acknowledged that with respect to entries by medical examiners on death certificates, “[t]he opinion fact becomes prima facie evidence by virtue of the statute and not because of probative force necessarily inherent in it or the underlying facts.”6 In light of the statute, opinions as to cause of death issued by the State Medical Examiner’s Office will continue to be admitted in Massachusetts state courts as prima facie evidence of death in both homicide cases and wrongful death cases.

Applying the Federal Rules of Evidence, federal district courts in Massachusetts have declined to follow the per se admissibility of death certificates. Rather, the federal courts have maintained the requirement that the information recorded in the death certificate be reliable as a prerequisite to its admission in evidence.7

Conclusion

To the extent that the opinions are unfavorable, counsel must be prepared to attack the reliability of the conclusions with a thorough investigation into whether the OCME complied with its statutory obligations, as well as internal policies, in reaching an opinion as to the cause of death. At a minimum, the office’s policy manual and complete file must be obtained. The recent findings of the independent report can also be used to support the argument that the office deviated from accepted medical practices. Experience teaches that a live keeper of records deposition may be necessary to obtain a complete file. Furthermore, the pathologist certify-
ing the cause of death should be deposed. Former employees of the office (such as former staff pathologists) are likely to provide candid information about the limited resources of the office that in many cases precluded a thorough investigation and reliable conclusion as to the cause of death.

End notes

3. Id.
4. Id.
5. In a death action, the death certificate is “prima facie evidence” of the facts recorded therein, and such facts must be taken as true, in absence of other controlling evidence. Lydon v. Boston Elevated Ry., 309 Mass. 205, 34 N.E.2d 642 (1941); Pahigian v. Mfrs’ Life Ins. Co., 349 Mass. 78, 206 N.E.2d 660 (1965) (finding the insured died of Hodgkin’s disease was compelled where death certificate so stated and there was no evidence to the contrary); Boutillier v. Wesinger, 322 Mass. 495, 78 N.E.2d 195 (1948) (in wrongful death action arising out of automobile collision, evidence concerning violence of impact, position of decedent’s body, and his good health before accident, together with death certificate was sufficient to justify finding that decedent’s death was caused by collision); Mills v. Prudential Ins. Co. of Am., 1 Mass.App.Ct. 188, 294 N.E.2d 542 (1973) (death certificate stating that causes of death were “Acute hepatic necrosis-Cirrhosis-Alcoholism-thermal burns-accident fire from stove at home” required finding that at least one disease was cause of, or contributed to, death).
7. See Blake v. Pellegrino, 329 F.3d 43 (1st Cir. 2003) (exclusion of death certificate proper if the probative value is substantially outweighed by danger of unfair prejudice or juror confusion, such as Daubert expert reliability standards).
Supreme Judicial Court to address “injury or loss” requirement of G.L. C. 93A

By Lee M. Holland, Esq.

“[W]hat constitutes an injury or loss for purposes of a G.L. c. 93A claim, where the plaintiffs had purchased automobiles with allegedly defective door latches, were nonetheless able to use the vehicles, and had not suffered any direct personal injury or economic injury?” That is the question that has been certified to the Supreme Judicial Court in Joseph Iannacchino & others v. Ford Motor Company & another, SJC-10059. Oral argument occurred on Feb. 4, 2008, and the case is expected to be decided by June 2008.

Whether the court recognizes a valid Chapter 93A claim on the facts presented in Iannacchino has broad implications for Massachusetts consumers as well as local, national and international businesses that are potential litigants in the courts of the commonwealth.

Claims, defenses, and procedural posture

The Iannacchino plaintiff class contends that the defendants violated Chapter 93A by failing to recall and fix certain vehicles that allegedly have a defect in their door latching mechanisms which exposes consumers to the risk of serious injury or death. The plaintiffs further contend that the alleged defect amounts to a violation of the implied warranty of fitness. The defendants had evaluated the latch mechanisms and decided against initiating a recall. The defendants contend that the door latches comply with applicable requirements and do not present an unreasonable safety concern. The plaintiffs counter by alleging that the defendants are guided predominantly by economic considerations in declining to initiate a recall.

The Superior Court in Iannacchino granted the defendants’ motion to dismiss the plaintiffs’ Chapter 93A claim upon finding that the plaintiffs had been able to use the allegedly defective vehicles and had not suffered any direct personal or economic injury as a result of the alleged defect. In the pending SJC appeal, the plaintiffs challenge the trial court’s dismissal of the Chapter 93A claim.

Overview of arguments on Chapter 93A claim

The plaintiffs argue that their Chapter 93A claim should not have been dismissed because they are seeking redress before they suffer any physical injury and because the defendants’ conduct has invaded their legally protected rights sufficient to satisfy Chapter 93A’s injury or loss requirement. The latter argument relies on commentary set forth in Aspinall v. Philip Morris Cos., Inc., 442 Mass. 381 (2004), discussed below.

The defendants rely upon Hershenow v. Enterprise Rent-A-Car Co. of Boston, Inc., 445 Mass. 790, 802 (2006), where the court decided that the Chapter 93A claim was properly dismissed because the plaintiffs could not show any actual injury or loss.

Chapter 93A precedent highlighted by the SJC

In its request for amicus briefs, the SJC specifically referenced Hershenow and Aspinall, as follows:

In this reported class action, the issue presented, among others, is: what constitutes an injury or loss for purposes of a G.L. c. 93A claim, where the plaintiffs had purchased automobiles with allegedly defective door latches, were nonethe-

Hershenow addressed whether consumers who had rented cars and purchased optional collision damage insurance were harmed by a waiver provision in the rental contract that failed to comply with statutory requirements (G.L. c. 90, §32E½, regulating such collision damage waivers), even though the consumers had not been in an accident while driving the rented vehicles. The Hershenow plaintiffs appealed from the trial court’s order granting the defendant rental car agencies summary judgment and judgment on the pleadings. The SJC on its own initiative took direct appellate review of the case. After consideration of legislative changes to Chapter 93A made in 1979, described by the SJC in Hershenow as “intended to permit recovery when an unfair or deceptive act caused a personal injury such as emotional distress, even if the consumer lost no ‘money’ or ‘property,’” the Court affirmed the outcome and held that “a consumer lost no ‘money’ or ‘property,’” the conduct.

Hershenow, 445 Mass. at 800-01; 840 N.E.2d at 534-35.

Aspinall involved a plaintiff class of consumers that sued the manufacturers of “light” cigarettes under a theory of false advertising. A single justice of the Appeals Court decertified the class. The SJC granted the plaintiffs’ application for direct appellate review and reversed, reasoning that a class action was not merely an appropriate means to address the allegations that had been raised, but was in fact the only means for doing so. Aspinall, 442 Mass. at 393; 813 N.E.2d at 486.

After the SJC reached its holding on the class certification issue in Aspinall, it provided commentary suggesting that deceptive advertising may cause injury sufficient to satisfy the injury or loss requirement in Chapter 93A. Since Aspinall focused upon the propriety of the certification of the plaintiff class, however, the commentary Aspinall provides regarding the injury or loss requirement of Chapter 93A may fairly be characterized as dicta.5

[T]he deceptive advertising, as alleged by the plaintiffs in this case, if proved, effected a per se injury on consumers who purchased the cigarettes represented to be lower in tar and nicotine... As a matter of law, because [the defendants’ advertising]... created the overall misleading impression that all smokers would receive ‘lowered tar and nicotine’... all [plaintiffs in the class] will be entitled to statutory damages, without regard to whether... consumers were overcharged for the deceptively advertised cigarettes.

Aspinall, 442 Mass. at 399-400; 813 N.E.2d at 490-91.

In sum, whereas Hershenow requires a plaintiff to demonstrate a loss even in instances of per se deception, Aspinall implies that certain deceptive conduct in and of itself constitutes sufficient injury for purposes of Chapter 93A.

Consumer protection and the efficient use of resources

Several strong but competing policy arguments exist for the SJC to consider. Consumer advocate groups argue that the ultimate goal should be improved consumer safety, and that it would be perverse to interpret existing law to require a consumer to suffer physical injury as a prerequisite to bringing her claim where she can establish that a defect exists which reasonably poses an increased risk of causing harm to consumers situated similarly to her. While it is true that marketplace factors have resulted in significant improvements in consumer safety, courts must continue to play their vital role in framing expectations and enforcing a baseline for permissible conduct.

Proponents of the brighter line drawn in Hershenow emphasize that consumers are adequately protected under existing law, but even more so by demand for improvements in safety. Manufacturers have an economic interest in achieving safe products where the market demands them, such as in the consumer automobile industry. Litigation regarding an alleged safety defect that has not resulted in any physical injury consumes resources that manufacturers might otherwise invest in product research and development, thereby hindering efforts to advance safety.

Broader societal costs may exist as well. For instance, an unanticipated increase in the litigation risks to which corporations doing business in the commonwealth are exposed could operate as a disincentive to economic growth to the ultimate disservice of many interest groups, including consumers.

Conclusions

Iannacchino has the potential to be a very significant case not only for consumers but for the commonwealth as a whole. The question facing the SJC has to do with the proximity of the injury or loss necessary to maintain a Chapter 93A claim. At one end of the proximity spectrum is Hershenow, which involved a plaintiff class that only fleetingly faced the risk of being injured by an illegal provision in a car rental agreement. The injury never materialized, and the risk of injury terminated with the agreement. Toward the other end of the proximity spectrum is Aspinall, which presented a plaintiff class that had purchased and used “light” cigarettes under the misimpression that they were safer than other products on the market. The class’ exposure to an inherently dangerous product under such circum-

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stances sufficiently constituted an injury for purposes of Chapter 93A.

*Iannacchino* is somewhere in between. It is true that the plaintiffs have been able to use their vehicles and have not suffered any direct injury. Assuming a defect exists in the door latches, however, it is also true that the *Iannacchino* plaintiffs face an elevated risk of injury every time they go for a drive.

**End notes**

1. The SJC solicited *amicus curiae* briefs on October 15, 2007.

2. Middlesex Superior Court, Civil Action No. 05-0538.

3. Should the SJC desire to do so, it could dispose of the appeal without reaching the “injury or loss” issue discussed in this article. The Superior Court granted the defendants’ motion for judgment as to the Chapter 93A claim, but denied the motion as to the plaintiffs’ breach of warranty claim. The court declined to dismiss the warranty claim after concluding that the plaintiff had sufficiently alleged the possibility of economic damages. On appeal, however, the plaintiffs and the defendants both point to a perceived inconsistency in the Superior Court’s rulings on the Chapter 93A and warranty claims. The plaintiffs argue that neither claim should have been dismissed. The defendants argue the opposite. As the court’s Dec. 1, 2006 order on the defendants’ motion for judgment acknowledged, at Page 5, citing *Slaney v. Westwood Auto, Inc.*, 366 Mass. 688, 702 (1974), a breach of warranty can constitute a Chapter 93A violation.


5. After reaching its holding, the *Aspinall* court stated as follows: “What has been said above disposes of the class certification issue. We take this opportunity to comment on the nature of damages under G.L. c. 93A.” *Aspinall*, 442 Mass. at 398; 813 N.E.2d at 489-90.
The problem

Many children are inappropriately detained in the juvenile justice system, with deleterious effects on their development, mental health and legal outcomes. A number of promising initiatives focus on addressing the current tendency to detain juveniles inappropriately and unnecessarily, but further efforts should be made to educate advocates, judges, and even parents, who can all intervene to prevent this harm from occurring.

Children charged with minor offenses comprise the largest number of children detained on pretrial matters in the Department of Youth Services. In 2006, 53 percent of all youth detained in Massachusetts were held for non-violent offenses, and 45 percent detained in 2006 were held on misdemeanor charges. According to DYS statistics from January through August 2007, the majority of children detained were charged with low-level offenses, such as disorderly conduct and domestic assault and battery.

DYS census statistics from Nov. 1, 2007, show that 79 percent of the children detained on bail status fell into one or more of the following categories: aged 14 years or younger; held on low level offenses; held on bail amounts less than $100; held on probation violations; or held awaiting DSS placements or §68A court clinic evaluations. A number of children detained in DYS are held on probation violations or on allegations that they violated pretrial conditions of release. According to DYS statistics, 37 percent of children detained in DYS were held on probation violations.

Detention has a disproportionate impact on children of color. Compared with their percentage of the population, a disproportionately high number of children of color are held in secure detention. Black and Hispanic youth comprised over 50 percent of the children detained in DYS on Nov. 1, 2007.

Reasons for detention

A number of reasons account for the high percentage of inappropriate detentions of juveniles. Bail decisions by judges, which determine whether the child will be held or released, are supposed to be based on two criteria: flight risk and dangerousness. The bail statute establishes a presumption that a child should be released on personal recognizance unless the judge determines that “such a release will not reasonably assure the appearance of the person before the court.” The court may also hold a child in detention after an evidentiary “dangerousness” hearing, where a judge determines that the child is dangerous and no conditions of release will reasonably assure public safety.

Many of the children currently held in DYS facilities do not pose a flight risk and were not determined to be “dangerous” at an evidentiary hearing and therefore should not be held. In fact, the vast majority of detained youth will not be committed to DYS after their cases are resolved. In 2006, of the 5,438 youth detained in DYS, only 20 percent were later committed to DYS.

In many instances, children are inappropriately held on bail due to misguided decisions made by parents or guardians. Many children who either have no prior record or a minimal record are detained because a parent refuses to take them home. Judges set low cash bails, such as $1 bail, in these situations. These types of cases usually involve minor offenses — many of them domestic incidents involving family members, such as siblings fighting over the television remote control — in which the parent or guardian expresses frustration about the child’s behavior at home or at school and does not wish to take the child home. The child may not be obeying the parent’s rules at home or may not be attending school. The parent often sees the delinquency case as an opportunity to “teach him a lesson” by leaving the child in DYS detention for a short period of time. The judge then sets a low bail so that the parents or guardians can then bail the child out if they change their minds.

These cases can frustrate judges who feel that they do not want to send a child home when the parent or guardian is not willing to take them, but who know that holding the child on bail in DYS detention will not help him or her receive the necessary services to address the underlying problem.
In fact, detention can have a harmful effect on the child.

Dangers of detention

Studies have shown that detention can have many negative consequences on children who are held. Detention can be a very traumatic experience for children. Many detained children suffer from mental health problems and can be much better served in the community through the Department of Mental Health or other community-based counseling services. Instead of receiving treatment, children with behavioral health problems get worse in detention, not better. One study found that for one-third of incarcerated youth diagnosed with depression, the depression set in after they began their incarceration. Another study suggests that the combination of poor mental health and conditions of confinement can make it more likely that incarcerated teens will attempt suicide and self-harm.

Detention can have serious negative consequences on a child's education. Children detained in DYS are taken off their medical education services and enrolled in school but dropped out after only one year. In many cases, bails set in the community through the Department of Social Services are also an option for children whose parents do not want to take them home. An abuse and neglect petition (“51A”) can be filed against the parent or guardian and the child placed in DSS custody. This option, however, may not be a desirable one for the child because he or she could be taken out of the home and possibly put in a foster placement.

Referring the child to the Department of Social Services is also an option for children whose parents do not want to take them home. An abuse and neglect petition (“51A”) can be filed against the parent or guardian and the child placed in DSS custody. This option, however, may not be a desirable one for the child because he or she could be taken out of the home and possibly put in a foster placement.

What attorneys can do

Attorneys should seek to appeal bails to Superior Court if the judge sets an inappropriately high bail. In many cases, bails set in the juvenile court are later reduced by a Superior Court judge at a bail appeal hearing. In contrast to the adult bail appeal process, the juvenile bail appeal process can be somewhat burdensome for busy attorneys, since many counties require the attorney to obtain the paperwork from the juvenile court and probation department, and then deliver it to both DYS and the Superior Court. The juvenile courts should streamline the process so that the difficulty of obtaining paperwork does not serve as an obstacle to attorneys who should appeal excessive bails.

Many children who end up charged with delinquencies suffer from undiagnosed mental health issues or learning disabilities. They may not be receiving the appropriate services, such as counseling or special education services in school. Many of the issues resulting in the client's court involvement can be addressed through a Child in Need of Services petition. Seeking community-based services to address the underlying problems is more effective than detaining the child in DYS, where the child will not receive individualized services.

Detention can also significantly affect the outcome of the case. For example, many children held on bail want to plead out on the case in order to get out of detention even though pleading out would not be the best legal outcome or in the client's best interests. The strength of the evidence against the client may be weak, and the case might otherwise be dismissed or end in acquittal. If the child is detained, he or she may be reluctant to wait for the case to work its way through the court process and appropriately and rashly decide to plead out to the case. While pleading out may allow the client to get out of detention, it has long-term consequences that the child may not fully appreciate at the time.

For example, unless the prosecutor agrees to dismiss the case or give pretrial probation, the client will likely be placed on probation if he or she decides to enter a plea. Probation can prove problematic, as many children find it difficult to complete probation successfully and later find themselves facing probation violations, which can sometimes lead to a commitment to DYS. Preventing children from accepting dispositions on cases that would have ultimately been dismissed or otherwise favorably resolved is another important reason attorneys should make every effort to keep their clients from being detained.

Attorneys can also seek funds from the court to obtain the services of a social worker as an alternative to DSS. This option has the advantage of allowing the social worker to set up services for the client while maintaining some control over information that is conveyed to the court. Depending on the level of expertise, the social worker can also write a psychosocial assessment that the attorney can present to the court as an aid in disposition.

Counsel for children should exercise caution when agreeing to conditions of release that could serve to set the child up to fail if
the client cannot meet the conditions. Under Commonwealth v. Jake J., 433 Mass. 70 (2000), a judge may revoke bail and hold a child in custody if the juvenile fails to obey conditions of release. In Jake J., the judge took the juvenile into custody for failing to obey school rules. This practice routinely occurs, and attorneys should resist agreeing to conditions of release that may be difficult for the client to meet and that are unrelated to the client’s charges, unless absolutely necessary to avoid detention.

Subsequently, attorneys should also argue for a reduction in bail if circumstances have changed — such as if a DSS placement has been found or if other social services have been identified. Judges will often be amenable to releasing the child if attorneys present alternatives to detention or other services to address the child’s needs.

Strategies for change

One promising effort currently in the early stages of implementation in Massachusetts is the Juvenile Detention Alternatives Initiative. Massachusetts was designated a JDAI site by the Annie E. Casey Foundation in October 2006, and DYS has launched pilot sites in Suffolk and Worcester counties. The goals of JDAI include promoting changes to policies, practices, and programs to reduce reliance on secure detention, improve public safety, reduce racial disparities and bias, and stimulate overall juvenile justice reforms. Alternatives to detention can decrease crime and recidivism better than detention. Research has shown that youth who are incarcerated are more likely to recidivate than youth supervised in a community-based setting or youth who are not detained at all.16

Studies have shown that juvenile detention is not a cost-effective method of promoting public safety or meeting the needs of detained youth.17 One study has shown that for every dollar spent on county juvenile detention systems, $1.98 of “benefits” with respect to reduced crime and costs of crime to taxpayers was achieved.18 In contrast, diversion and mentoring programs produced $3.36 of benefits for every dollar spent, and multi-systemic therapy produced $13 of benefits for every dollar spent.19

More resources should be allocated to community-based alternatives to detention. In fiscal year 2005, Massachusetts allocated five times more money for providing secure residential services to young people in DYS custody than for community-based or nonresidential services.20 Community-based programs such as the Detention Diversion Advocacy Project, which works with youth in the Dorchester Juvenile Court, also concentrate resources on working closely with young people who are at risk of being detained. Alternatives to detention programs can help reduce the number of detained youth and provide them with services that they would not receive in detention. For example, youth involved in San Francisco’s Detention Diversion Advocacy Program recidivate at half the rate of young people in detention.21

While JDAI and DDAP are promising initiatives for addressing the detention problem, juvenile advocates should continue to zealously advocate for their juvenile clients to prevent detention and work for their release if they are detained. Attorneys should educate decision-makers, such as judges and parents, about the harmful effects of detention and present them with community-based alternatives to detention to address the child’s needs.

End notes

2. Detention Census Statistics, Department of Youth Services (Jan.-Aug. 2007). Out of 3,365 children held, 497 were charged with Grid 1 offenses and 1,530 were charged with Grid 2 offenses. DYS classifies offenses into four “Grid” levels, with Level 1 and Level 2 being the least serious offenses.
3. Detention Census Statistics, Department of Youth Services (Nov. 1, 2007).
4. Id.
5. Id.
12. Id. (citing David Mace et al., “Psychological Patterns of Depression and Suicidal Behavior of Adolescents in a Juvenile Detention Facility.” Journal of Juvenile Justice and Detention Services, Vol. 12, No. 1, 18-23 (1997)).
13. Id. at 9 (citing Linda A. LeBlanc, U.S. Dept’ of Justice, Unlocking Learning: Chapter 1 in Correctional Facilities. (1991)).
14. Id. at 5.
16. Id. at 6.
17. Id. at 11.
18. Id. (citing Steve Aos, Washington State Institute for Public Policy, The Juvenile Justice System in Washington State: Recommendations to Improve Cost-Effectiveness (2002)).
19. Id.
20. Justice Policy Institute, Act 4 Juvenile Justice Fact Sheet ($86 million for secure residential services and $19 million for pretrial detention, compared to almost $20 million for nonresidential services).
What’s wrong with REAL ID?

By Nancy Murray, director of education, ACLU of Massachusetts

The REAL ID Act is a federal law that was introduced by Rep. James Sensenbrenner (R-WI) who claimed it was an essential terror-fighting tool. It never had a Senate hearing. Instead, it was whisked through Congress in May 2005 on the coattails of “must pass” emergency supplemental legislation providing funds for the war in Iraq and tsunami relief.

If implemented, it will lay the groundwork for a de facto national ID card that could, step by step, turn us into a “show me your papers” society.

The makings of an internal passport system

The REAL ID Act currently mandates that if a state wants its residents to be able to use their drivers licenses for federal ID purposes, such as entering a federal courthouse or getting on an airplane, each state Registry of Motor Vehicles must create a vast new database containing the most personal information of applicants for drivers’ licenses, from original copies of birth certificates to Social Security numbers and more. The state databases will interconnect and be accessible to state, federal and local government agencies.

States will have to remake their drivers’ licenses, create an extensive new document storage system and expand security measures. They will have to verify the “issuance, validity and completeness” of every birth certificate, every immigration document, every utility bill, and every other document — not just when a driver’s license is first issued, but every time it is renewed as well.

The license will contain a standardized set of information backed up by the national database of ID information. It will also contain a standardized “machine-readable zone” which makes it easy for our private information to be stolen and for our movements to be monitored.

The REAL ID Act would prevent use of a non-REAL ID-compliant driver’s license for identification to board planes and enter federal buildings. But that’s just the beginning. Congressional proposals have already been floated about using REAL ID for voting identification, for job applications, for getting benefits like Medicaid or federal housing assistance.

As the uses for REAL ID expand, so will the tracking of Americans. How long will it be before the swipe of a REAL ID will be required to enter office buildings? To board subways and buses? And what kind of information will the card’s barcode contain?

On May 8, 2007, Jim Harper of the Cato Institute testified before the Senate Judiciary Committee that REAL ID makes possible the systematic tracking of Americans based on their race since the card’s two-dimensional barcode includes the cardholder’s race/ethnicity as one of the data elements. Americans have always associated national identity cards with repressive regimes that want to control movement or keep track of particular ethnic and racial groups. Do we really want to go down that path?

Flawed premise, unforeseen consequences

REAL ID was supposed to make the nation secure by preventing terrorists from getting drivers’ licenses. But knowing the name, phone number and other information of a person who is planning a terrorist act does not by itself prevent that act. And all of the 9/11 terrorists possessed passports that would enable them to fly, even under the REAL ID regime.

Critics wonder what is more likely to be impacted by the REAL ID: the plans of terrorists or the day-to-day lives and civil liberties of Americans?

How long will it take before the REAL ID databases become as unmanageable and error-riddled as the other vast databases, such as no fly lists, that have been created in the name of fighting terrorism, and which result in the harassment of entirely innocent individuals? How long will it be before the REAL ID database is used for data mining on a hitherto unprecedented scale? Despite calls that it expressly forbids the data mining of information that would be stored in the database, the Department of Homeland Security has resisted doing so.

And what are the implications of your REAL ID card being stolen? How hard will it be for individuals to re-establish their identity if someone else has copies of their birth certificates and other documents?
One-stop shopping for identity thieves

We are all aware of the danger of identity theft. The TJX Company is currently facing costs of $256 million or more because hackers were able to intercept wireless transfers of customer information and gain entrance into its central databases for more than a year.

Imagine what a honey pot the REAL ID will create. The personal information on all drivers will become an irresistible target for hackers, burglars, rogue officials and insider criminals. A single break in security in any of the jurisdictions with interlocking REAL ID databases could compromise the personal information of 240 million people. Clearly, the whole system will only be as secure as the state with the weakest security, making all Americans less secure, not more.

The Association for Computing Machinery testified before the Senate Judiciary Committee that, “Ultimately, REAL ID provides an identity document that increases the risk of identity theft, exposes more personal data, and is a greater target for fraud and abuse.”

The REAL ID effort is estimated to cost $23 billion over 10 years, with the states picking up most of the tab. Not only will lines be longer at the registry and tempers shorter as many people get caught in the nightmare of inflexible verification requirements, fees will also be higher.

States are saying no to REAL ID

In 2008 states are supposed to be in compliance with the REAL ID Act if they want their residents’ drivers’ licenses to be acceptable for federal ID purposes. But 17 state legislatures have gone on record in opposition, either—as in the case of seven states—by passing laws barring the appropriation of funds for REAL ID, or by passing resolutions condemning REAL ID and urging Congress to repeal it.

So far, the Identity Security Enhancement Act (S. 717) filed by U.S. Senators Akaka and Sununu that would repeal the driver’s license portion of REAL ID has gone nowhere. But in late July, the Senate, by a vote of 50-44 refused to adopt an amendment that would increase funding to implement REAL ID from the current $50 million to $300 million across the states. And on the Senate floor, U.S. Senator John Kerry has described it as “profoundly flawed.”

Massachusetts officials have used similar language. In fact, at a June 2007 Statehouse hearing on legislation opposing REAL ID introduced by state Senator Richard T. Moore, not a single person testified in favor of REAL ID. Attorney General Martha Coakley testified REAL ID represents “a total loss of common sense” that is “almost logistically and financially impossible to execute,” that will be “counterproductive in security terms, increase the chance for falsification of documents” and create a “horrible inconvenience to every law-abiding Massachusetts holder of a license.”

The hearing was a good start, but the commonwealth has still not taken a stand against compliance with REAL ID, and members of our congressional delegation have yet to sign onto federal roll back legislation (S. 717 and H.R. 117). As the 2008 deadline approaches, Governor Patrick should be urged to go on record opposing REAL ID. With his leadership, Massachusetts can help ensure the defeat of this dangerous and unworkable program.
Got rights? The legal landscape for nursing women in the workplace

By Itia Roth

There has been a lot of discussion recently — particularly in the media and on private blogs — over the case of Sophie Currier, the Harvard medical student who requested an accommodation from the National Board of Medical Examiners for extra break time during her licensing exam to express breast milk for her five-month-old daughter. The NBME denied Currier’s request, but later offered her some accommodations — such as the use of a private room during the standard allotted break time and permission to bring food and drink into her testing room. Currier sought a preliminary injunction requiring the NBME to provide her with 60 extra minutes of break time per test day. A Superior Court judge denied her request. Currier appealed to a single justice of the Massachusetts Appeals Court who vacated the lower court’s order and granted Currier’s petition.

In arriving at its decision, the court considered the health benefits of breastfeeding for both children and nursing mothers and the potentially severe physical consequences that would result for Currier if she were not able to properly express breast milk during the exam. The court found that since the amount of break time normally provided by the NBME — 45 minutes for eight hours of exam time — was insufficient to allow Currier to express milk, and take care of her other personal necessities, she was at a disadvantage compared to the “male and non-lactating female examinees.” In the court’s words: “Without the allocation of an additional sixty minutes [to express breast milk], the petitioner must make a significant Hobbesian choice: use her break time to incompletely express breast milk and ignore her bodily functions, or negate her decision to express breast milk, resulting in significant pain. Under either avenue, the petitioner is placed at significant disadvantage in comparison to her peers.” The single justice determined that, especially in light of the NBME’s admitted ease in logistically accommodating Currier’s request, the only way to equalize the playing field was to grant her requested accommodation.

What is perhaps most interesting about this decision, and what makes it particularly significant to employers, is its legal reasoning. Currier’s claims were brought under the Massachusetts Declaration of Rights and the Massachusetts Equal Rights Amendment, alleging that the NBME’s refusal to provide additional break time in which to express milk had a disparate impact on nursing mothers and therefore constituted sex discrimination. Yet many of the cases cited by the court for its precedent were claims of pregnancy discrimination, brought under M.G.L. ch. 151B. The court seemed to gloss over any legally significant difference that may exist between a pregnant woman and a nursing woman, even referring to lactating as a “post-pregnancy condition,” and implying that discrimination based on either is challengeable as sex discrimination, under whatever statute.

Given the court’s approach, there is good reason to believe that the court’s holding will have broad impact on nursing women’s rights in the workplace. Indeed, by the court’s reasoning, to the extent that discrimination based on pregnancy is prohibited by Chapter 151B, so too is discrimination based on lactating. Thus, any employment policy that may have a disparate impact on nursing mothers should probably be reconsidered. Moreover, it may become necessary for employers to provide their nursing mother employees with appropriate break times and private areas in which to express milk.

To some degree, whether or not the court’s rationale is sound is beside the point. Public policy clearly favors accommodating a woman’s choice to breastfeed her child (and thus to express milk when she cannot do so directly). Creating an employment environment where women do not feel that they can make this choice, where nursing mothers feel uniquely burdened and uncomfortable — in ways that their male counterparts do not — seems unwise even if not unlawful. Employers should be supporting their new mothers in their return to the work after childbirth, not making it more difficult for them. Providing comfortable, clean environments in which to express milk, as well as the time to do so, goes a long way in helping with that transition.

In light of the public policy considerations favoring breastfeeding, there is a bill currently pending in the legislature that would provide specific protections to nursing mothers, in the workplace and beyond. Among other things, Senate Bill No. 2704 will make it unlawful for employers to prohibit an employee from expressing milk, will require employers to provide unpaid break time and make reasonable efforts to provide an appropriate place to do so, and will explicitly make it unlawful to take an adverse employment action against an employee who expresses milk in the workplace. The proposed bill will also make breastfeeding in public lawful and exempt from indecency laws, and will make it unlawful to intimidate or interfere with a mother breastfeeding her child.

Interestingly, Massachusetts is behind the curve in considering this kind of legislation. Forty-five other states already have laws protecting breastfeeding mothers and their babies. Thirty-seven allow mothers to breastfeed in any public or private location, 19 exempt nursing mothers from public indecency laws, and 11 states specifically have laws related to nursing mothers in the workplace.

The bottom line: At this point, nursing mothers do not have any specific rights in the workplace but given the court’s recent decision in the Carrier case and the pending legislation, it appears that nursing women will soon be protected by law.
A recent decision by the National Labor Relations Board, *Dana Corporation*, 351 NLRB No. 28 (Sept. 29, 2007), balances employees’ rights to free choice about unionization under the National Labor Relations Act against the increasing use of voluntary recognition agreements in lieu of a Board-sponsored secret-ballot election. Altering its long-standing recognition bar doctrine, the board concluded in *Dana Corp.* that employees have the right to file a decertification petition within 45 days after receiving notice of their employer’s grant of voluntary recognition to a union.

While the terms of voluntary recognition agreements vary, the common feature is that an employer and a union contractually agree to a private process to determine whether the union should be the exclusive bargaining representative of a group of employees. A typical provision is a card check, in which the employer agrees to voluntarily recognize the union upon a showing of signed authorization cards from at least a majority of employees. This provision often is combined with a “neutrality” clause, in which the employer waives its free speech rights under § 9(c) of the Act and agrees not to campaign against the union.

Neutrality and card check agreements have become the “bread and butter” of union organizing. A comparison of union success rates under the traditional board election process and those under card check agreements demonstrates why. For the six-month period ending in September 2007, unions were successful in about 59 percent of all board-sponsored elections for new organizing efforts. While the board does not maintain union success rates under voluntary recognition agreements, one study suggests that the union success rate under card check agreements is 78 percent. That rate increases to 86 percent when a card check is combined with employer neutrality.

Critics complain that those success rates reflect the fact that voluntary recognition agreements undermine employees’ rights under Section 7 of the Act to freely vote for or against unionization or choose a different union. Unlike a secret-ballot election, the card check process is not secret. Employees often are asked to sign authorization cards — the “ballot” — in the presence of both co-workers and union organizers, risking that employees will sign cards because of peer pressure or even coercion. Plus, employees may be given false or misleading information about unionization or the purpose of the cards, which may go uncorrected if the employer remains “neutral.” Employees who do not support the union can be cut out of the process altogether. Because the union needs only a majority of signed cards, it can ignore those employees in the unit who are against unionization, leaving those employees without any opportunity to have their voices heard. These concerns become magnified when the union obtains voluntary recognition, because — at least until *Dana Corp.* — the union becomes the beneficiary of the recognition bar. Under that doctrine, the union is insulated from a decertification petition for a reasonable period of time after voluntary recognition.

Although the board has long recognized the legality of voluntary recognition agreements, including neutrality and card check agreements, *Dana Corp.* presented an opportunity for the board to consider the impact of those agreements on employees’ Section 7 rights. The case involved two companion cases, one involving employees of Dana Corporation and another involving employees of Metaldyne Corporation. In both cases, the employers had entered into separate neutrality and card check agreements with the International Union, United Automobile, Aerospace and Agricultural Implement Workers, and both employers...
voluntarily recognized the union upon a showing of signed authorization cards from a majority of employees in each unit. In neither case was there a claim that the authorization cards were the product of coercion or that the grant of recognition constituted unlawful employer assistance.

Nonetheless, within weeks of the grant of recognition, employees in each unit filed petitions with the Board for Elections to decertify the union. Each of the decertification petitions were supported by the requisite 30 percent showing of interest among the unit employees. The Metaldyne petition was supported by over 50 percent of the unit employees, while the Dana petition was supported by 36 percent of the unit employees. The regional directors for Regions 6 & 8 dismissed the petitions pursuant to the recognition bar doctrine, and the petitioners requested board review of those dismissals.

In 2004, the board granted the petitioners’ requests for review. In its order granting review, a majority of the board signaled an intent to question the increased use of voluntary recognition agreements. It explained, “[a]lthough no party here challenges the legality of voluntary recognition, the fact remains that the secret-ballot election remains the best method for determining whether employees desire union representation.” It thus concluded that “the increased usage of recognition agreements, the varying contexts in which a recognition agreement can be reached, the superiority of board supervised secret-ballot elections, and the importance of Section 7 rights of employees, are all factors which warrant a critical look at the increased use of voluntary recognition agreements.”

On Sept. 29, 2007, three years after granting review, a majority of the board decided the merits of the requests for review. Although the board had suggested that it might disallow neutrality and card check agreements altogether, it refused to do so. It held that “[w]e do not question the legality of voluntary recognition agreements based on a showing of majority support” and specifically noted that it was not addressing the legality of neutrality and card check agreements.

Instead, it decided the more limited issue of whether an employer’s voluntary recognition of a union based on a presumably valid majority showing should bar a decertification or rival union petition for some period of time thereafter under the recognition bar doctrine. As to this issue, the board concluded that the recognition bar doctrine should be modified to provide greater protection to employees’ Section 7 right to free choice and to give proper effect to the statutory preference for a board secret-ballot election. It thus concluded that no recognition bar will be imposed unless employees receive notice of the voluntary recognition and of their right to file a decertification petition or support a petition of a rival union within 45 days of their receipt of notice. The notice must be an official board notice posted in conspicuous places at the employer. Upon the posting of this notice, employees will be free to file a decertification petition or support a petition by another union. If no petition is filed within the 45-day window, then the union will enjoy the benefit of the recognition bar doctrine for a reasonable period of time.

The majority justified its new rule on the grounds that employees’ Section 7 rights are better realized through a secret-ballot election than a card check. It explained that card signings are susceptible to group pressure, misinformation and present a murkier picture of employee voter preference. However, it refused to apply the new rule retroactively, affirming the regional directors’ dismissal of the decertification petitions.

The dissent criticized the new rule as failing to recognize that voluntary recognition “honors the free choice already exercised by a majority of unit employees.” It argued that the 45-day period serves only to undermine the bargaining relationship at its formative stage. While conceding that a secret-ballot election is preferable, the dissent disagreed with the majority’s concern that a card check is less reliable.

Since the issuance of the decision in Dana Corp., the Office of the General Counsel has issued a memorandum regarding the new notice requirements. Either the employer or the union must notify the appropriate region of the grant of voluntary recognition. The region is expected to obtain a copy of the voluntary recognition and then to prepare the notice form to be posted. This process should be expedited. At the end of the 45-day period, the employer will be required to file a certificate that the notice was in fact posted.

The board’s new approach to neutrality and card check agreements strikes the appropriate balance between enforcing voluntary recognition agreements between an employer and a union and protecting employees’ Section 7 rights of free choice. Employees sign authorization cards for many reasons unrelated to a clear preference for unionization, and allowing them to file a decertification petition within 45 days of notice of recognition ensures that a union truly enjoys majority support. This is not to say that the board will blindly enforce neutrality and card check agreements or grants of recognition pursuant to such agreements in the future. While the board in Dana Corp. recognized the legality of these agreements, it will continue to police the card check process for unlawful coercion or for unlawful employer assistance to a union.

End notes

1. Section 9 of the National Labor Relations Act provides that the National Labor Relations Board is empowered to determine an appropriate unit for bargaining and then direct a secret ballot election among the employees in that unit. See 29 U.S.C. § 159.

2. See Dana Corp., 351 NLRB No. 28, p. 1 n.7 (Sept. 29, 2007).

3. Id.


5. See U.S. Senate Republican Policy Committee, Labor Unions Seek to End Secret-Ballot Elections, the Cornerstone of Democracy, p.9 (citing to testimony of Daniel V. Yager before the House Subcommittee on Workforce Protections of the Committee on Education and the Workforce).

6. Id.

8. See, e.g., Verizon Information Systems, 335 NLRB 558, 559 n.7 (2001).
10. Id., p. 3. Compare Dairyland USA Corp., 347 NLRB No. 30 (May 31, 2006).
11. Dana Corp., 351 NLRB No. 28, p. 2.
13. Id.
14. Dana Corp., 341 NLRB No. 150 (June 7, 2004).
15. Id., p.1.
16. Id.
17. Id.
18. Dana Corp., 351 NLRB No. 28, p. 3.
19. Id., p. 3.
20. Id., p. 4.
21. Id., p. 4.
22. Id., pp. 1 & 8.
23. Id., p. 1 n.6.
24. The majority disagreed about whether the bar should be for a “reasonable period” or for a fixed amount of time. Id., p. 4 n.11.
25. Id., p. 5.
26. Id., p. 6.
27. Id., p. 11.
28. Id., p. 12.
30. Id., p. 15.
31. See General Counsel Memorandum OM 08-07 (Oct. 22, 2007).
32. Id., p. 2.
33. Id.
34. Id.
35. Id.
More than 60 years after the passage of the Labor Management Relations Act, both the National Labor Relations Board and the courts have fundamental disagreements over the extent to which the board may interpret provisions contained in collective bargaining agreements to determine whether an unfair labor practice involving a change to employee terms and conditions of employment has occurred. This conflict stems in part from tension between the oft-cited principle flowing from the passage of Section 301 of the LMRA — that mere breaches of a collective bargaining agreement do not constitute unfair labor practices — and Section 8(d) of the act, which prohibits mid-term modifications of a collective bargaining agreement without the union’s consent.

How should the board go about analyzing whether there has been an unlawful contract modification if, as has been argued, the courts and arbitration, not the board, are the proper forum for parties seeking interpretation of their collective bargaining agreements? In recent years, particularly in *Bath Iron Works Corp.*, 345 NLRB 499 (2007), the board has attempted to resolve this tension by applying two different standards to analyze claims in which an employer raises a defense that it was contractually privileged to take unilateral action. In cases alleging an unlawful refusal to bargain under §8(a)(5) of the act, the board analyzes the contract language at issue to determine whether the union has clearly and unmistakably waived its right to bargain over the change. However, in §8(d) contract modification cases, the board applies the less stringent “sound arguable basis” test, in which the board will find no violation of the act if the employer’s interpretation of the contract is plausible and the employer’s actions are otherwise untainted by union animus. *Id.*

However, in an apparent effort to rectify what it viewed as the inconsistent approaches used to analyze these types of cases, the First Circuit, in *Bath Marine Draftsmen’s Association v. N.L.R.B.*, 475 F.3d 14 (2007), rejected the board’s use of the two different tests, and instead adopted a hybrid analysis that combined elements of the contract coverage standard used by both the 7th and D.C. Circuits, and the sound arguable basis standard to all cases involving allegations that the employer has unilaterally changed terms and conditions of employment without regard to its statutory obligation.

To understand the reasoning and import of *Bath Marine*, it is necessary first to examine the policies and reasoning underlying the three possible analytical frameworks: clear and unmistakable waiver, sound arguable basis and contract coverage. A discussion of the board and First Circuit decisions and their implications will follow.
The waiver, contract coverage and sound arguable basis standards

Waiver

The clear and unmistakable waiver standard is based on the long-established proposition that the duty to bargain created by §8(a)(5) of the act continues during the term of a collective-bargaining agreement. Provena Hospitals, 350 NLRB No. 64 at 4 (2007). Unions therefore have a statutory right to require an employer to bargain before making a unilateral change with respect to a mandatory subject of bargaining. Because a waiver of statutory rights will not be lightly inferred, the Supreme Court and countless board cases have held that an employer can act unilaterally only if the union has clearly and unmistakably waived its right to bargain. Metropolitan Edison Co. v. NLRB, 460 U.S. 693, 708 (1983), citing Mastro Plastics Corp., 370 U.S. 370, 380 (1956) (declining to infer from a general contractual provision that the parties intended to waive a statute-protection right unless the undertaking is “explicitly stated.”); C & C Plywood Corp., 148 NLRB 414, 416-18 (1964) (enf’d denied 351 F.2d 224 (9th Cir. 1965), aff’d sub nom. NLRB v. C & C Plywood, 385 U.S. 421 (1967); Provena Hospitals, supra, at 5 n. 19 (citing string of cases applying waiver standard). This standard reflects the longstanding policy determination that favors collective bargaining as a means of maintaining labor peace in the face of unilateral changes in working conditions.

Contract coverage

The clear and unmistakable waiver standard is not without its detractors. Both the Seventh and D.C. Circuits, and now the First Circuit to a certain degree, apply the contract coverage standard when analyzing cases where an employer raises a contractual defense to an unfair labor practice charge, regardless of whether the case is a §8(a)(5) unilateral change or a §8(d) contract modification. In those cases, instead of inquiring whether the union has explicitly waived its right by contract to bargain over the issue, the courts first examine whether or not there is a contract provision covering the clause. If there is, the courts reason that it is “incorrect to say that the union has ‘waived’ its statutory right to bargain; rather, the contract will control and the ‘clear and unmistakable’ intent standard is irrelevant.” Chicago Tribune Co. v. NLRB, 974 F. 2d 933, 937 (7th Cir. 1992) (citations omitted). If contract coverage is found, the court will interpret the language of the collective bargaining agreement de novo to determine whether it permitted the employer’s unilateral action. Thus, in NLRB v. U.S. Postal Service, 8 F.3d, 832, 836 (D.C. Cir. 1993), the court interpreted a broadly worded management rights clause to permit service reductions and reversed the board’s determination that the union did not clearly and unmistakably waived its right to bargain over those reductions.

Sound arguable basis

As noted previously, in cases in which an unlawful modification of a contract has been alleged under §8(d) of the act, where the employer has a sound arguable basis for its contract interpretation and is not otherwise motivated by bad faith, union animus or attempting to undermine the union’s status as collective bargaining representative, the board has from time to time since 1965 declined to enter the dispute to “serve as an arbitrator” to determine which party’s interpretation of the agreement is correct. NCR Corp., 271 NLRB 1212, 1213 (1984), citing Vickers, Inc., 153 NLRB 561, 570 (1965). This standard reflects the policy determination, which finds some support in §301’s legislative history, that mere contract breaches are better suited for resolution by arbitrators and courts, not the board. Bath Iron Works, 345 NLRB at 502, citing NLRB, 271 NLRB at n.6; C & C Plywood, 385 U.S. at 427-28.

The board’s decision in Bath Iron Works Corp.

Facts

In 1998, Bath Iron Works (respondent) decided to merge its pension plan into the larger pension plan of its corporate parent, General Dynamics. The respondent had three different bargaining agreements with each of the charging parties. All three agreements referenced its pension plan documents, but none of them expressly incorporated the plan’s terms into the collective bargaining agreement. The plan, but not the collective bargaining agreement, contained language reserving the respondent’s right to modify, amend or terminate the plan. The respondent discussed its decision to merge the plan with each of the three unions, but did not reach agreement. It ultimately implemented the merger without bargaining to impasse or resolution or obtaining the three unions’ consent. The respondent defended its action on the grounds that the plan’s terms, which were incorporated into the collective bargaining agreements, privileged it to implement the merger unilaterally.

Decision

In deciding whether the respondent had acted lawfully, the board, in a 2-1 decision (with member Liebman dissenting), first analyzed whether the case was properly analyzed as a unilateral change or §8(d) contract modification claim. Without much discussion, the board concluded that the general counsel’s sole allegation was an unlawful modification of the contract within the meaning of §8(d). Citing NCR Corp., supra, it then proceeded to analyze whether the contract had been unlawfully modified under the sound arguable basis standard. The majority dismissed the complaint, concluding that because both the respondent and the unions had presented reasonable interpretations of the applicable contract language, the contract had not been unlawfully modified. The board therefore refrained from deciding which of those interpretations was superior, on the grounds that arbitrators and the courts were better equipped to deal with those issues.

The dissent strenuously disagreed with most aspects of the majority’s decision. Citing a number of contrary precedents, the dissent challenged the majority’s basic premise that it was required to undertake two distinct analyses depending on the type of unilateral change alleged. The dissent contended that this “rigid” approach created the “anomalous result” that unions who have bargained and secured contractual provisions over mandatory subjects of bargaining are less protected from changes than unions who have been unable to secure a bargaining provision. The dissent essentially argued that “a change is a change,” and thus, whenever an employ-
er raises a contractual defense, the clear and unmistakable waiver standard should be applied. 345 NLRB at 507.

The First Circuit’s decision

On appeal, after reviewing the procedural and factual background of the case, the First Circuit set the stage for its decision by claiming that §8(d) “was not meant to confer on the board broad powers to interpret collective bargaining agreements.” 475 F. 3d at 20-21. Rather, in enacting §301, Congress determined that the board should not have general jurisdiction over all alleged violations of collective bargaining agreements; such matters should be placed within the jurisdiction of the courts. Id. at 20, quoting C&C Plywood, supra, 385 U.S. at 427. The court conceded that under C&C Plywood, the board did have some authority to construe collective bargaining agreements in the context of adjudicating unfair labor practices, but should not be considered the “sole or primary source of authority” agreeing with the board that that role was for the courts and arbitrators. 475 F. 3d at 21.

The court then addressed the unions’ argument on appeal that the general counsel’s complaint had alleged both §8(a)(5) and §8(d) allegations, thus warranting application of the waiver standard. Finding that the complaint did contain both allegations, the court nevertheless declined to apply the clear and unmistakable waiver standard. Citing NCR Corp. and other cases in which it claimed the board had applied the sound arguable basis standard in the context of a §8(a)(5) claim, the court stated that the board’s “historic vacillation” over which standard to apply justified a less deferential than usual approach to the board’s expertise. Id. at 25. Accordingly, the court announced that it was adopting the contract coverage test to determine whether the unions had already exercised their rights to bargain. In the very next sentence of the decision, however, the court stated, “The unfair labor practice determination depends solely on the interpretation of the contract in place and the appropriate standard for the board to apply is the sound arguable basis standard.” Id. at 25. The court touted this framework as consistent with the NLRB line of cases and the NLRA. The court also claimed that its approach unified the board’s “vastly disparate standards” and resolved the fact that the board has never clearly articulated a test for distinguishing between §8(a)(5) and §8(d) cases.

Application of the hybrid analysis

To determine, as the court confusingly puts it, “whether a subject is covered by a cba, such that the sound arguable basis standard is appropriate,” the court first considered whether the parties had bargained over the plan. Id. Concluding that they had, the court then reviewed, de novo, the question of whether the company’s interpretation had a sound arguable basis. Holding that it did, the court next considered whether the employer had acted in bad faith, expressly deferring to the board’s determination that it had not.

The court also addressed and rejected most of the member Liebman’s dissenting arguments in the case below, including that unions with contract coverage have less protection in the face of a change than unions that do not. The court did not necessarily disagree with this assessment, but did not find it dispositive, because “parties routinely make concessions during bargaining.” Id. at 28.

Implications of Bath Marine

In Provena Hospital, supra, decided just eight months after Bath Marine, the board contended that the court’s apparent adoption of both the contract coverage and sound arguable basis test rendered the decision’s implications “unclear” because the two tests were not the same. 350 NLRB No. 64 at n. 1. This is somewhat unfair. Although the decision’s initial references to the two standards is certainly confusing, when one reads further, it is clear that the court has established a hybrid two-part test that requires faithful application of the board’s sound arguable basis standard after it has been determined that the contract covers the dispute at issue.

One troubling aspect of Bath Marine test, as with the contract coverage test, generally, is its “one size fits all” approach to the two types of change cases. For example, where the change at issue does not implicate a collective bargaining agreement provision, but the employer’s defense does, although there may still be “contract coverage,” the union could not have filed a grievance or sued in federal court under §301. Application of the waiver standard is particularly appropriate under those circumstances, since the union would have had no recourse to arbitrators or the courts. See C&C Plywood, 385 U.S. at 562-63 (where collective bargaining agreement had no arbitration clause, board’s construction of agreement to resolve the unfair labor practice was in no way inconsistent with concept that arbitration as the instrument of national labor policy for resolving contract differences).

It is beyond the scope of this article to examine merits and flaws of each of the three standards discussed above in great detail. Nevertheless, the board’s analysis of the lawfulness of the employer’s unilateral action in contract defense cases should, at a minimum, depend on whether the change could have been the subject of a grievance or suit under §301, and whether the employer defends its unilateral action on the basis of the same contract provision, a different provision, or even, as in the Bath Marine case, other documents referenced in the contract. Taking into account these different factors would adequately safeguard a union’s statutory right to require an employer to bargain or obtain its consent before making unilateral changes without usurping the role of arbitrators or courts as an instrument of national labor policy for resolving contract differences.

Conclusion

In Bath Marine, the First Circuit introduced a new way to analyze the validity of an employer’s claim that a contract provision privileged its right to make unilateral changes to working conditions. Although it is unlikely that this decision will have any impact on the board in the near future, the First Circuit’s attempt to combine the board’s sound arguable basis standard with the contract coverage standard into a single test to be applied to all contract defense cases may prove appealing to other appeals courts looking to simplify or unify its approach to these types of cases. For the reasons set forth above, this trend should be resisted.
In 2006, the Massachusetts Clients’ Security Board launched a campaign to promote adoption of a payee notification rule. This proposed rule would require insurers paying third-party liability claims to notify claimants directly at the time they disburse settlement proceeds to claimants’ attorneys. The purpose of the rule is to reduce the likelihood that an attorney will misuse or misappropriate client settlement funds. The CSB’s campaign generated considerable debate among members of the bar, including opposition by some county bar associations. Notwithstanding this criticism, in September 2006, the Massachusetts Bar Association endorsed in principle the adoption of a payee notification rule. Since then, however, the implementation of a payee notification rule in Massachusetts has received little attention.

What are the strengths and weaknesses of a payee notification rule? Will adoption of a payee notification rule benefit Massachusetts clients and improve the bar’s image? How should such a rule be implemented? Answering these questions requires a look at both the payee notification rule itself and how the rules adopted in other states have impacted attorney theft claims.

Adoption of a payee notification rule in 12 states

To date, California, Connecticut, Delaware, Georgia, Hawaii, Kansas, Maryland, Nevada, New Jersey, New York, Pennsylvania and Rhode Island have adopted rules substantially similar to the ABA model rule for payee notification, which states:

A. Upon the payment of [insert desired dollar amount] or more in settlement of any third-party liability claim, the insurer shall provide written notice to the claimant where: (1) the claimant is a natural person, and (2) the payment is delivered to the claimant’s lawyer or other representative by draft, check or otherwise. Such notice shall be required when payment is made to a claimant by the insurer or its representative, including the insurer’s lawyer.

B. This rule shall not create any cause of action for any person against the insurer, other than a government agency, based upon the insurer’s failure to provide notice to a claimant as required by this rule; nor shall this rule create a defense for any party to any cause of action based upon the insurer’s failure to provide such notice.

The model rule, adopted in 1991, allows each jurisdiction to establish a dollar amount that triggers compliance. Among those states that have adopted payee notification rules, the minimum amount triggering notice for mandatory notification ranges from any amount in Hawaii to a high of $10,000 in Connecticut. Maryland is the only state to have adopted a voluntary payee notification rule, which provides that an insurer “may” give notice to the claimant of its payment of any claim in excess of $2,000. If an insurer chooses to provide notification, the Maryland rule requires that notice be made by regular mail no sooner than five days after payment is sent to the claimant’s attorney.

In favor of a payee notification rule

Supporters of the payee notification rule in Massachusetts take a “why not” approach. They argue that the rule has already been successfully adopted in other states, that it can only help clients, and that any burden on insurance companies and lawyers is de minimus. As the former chair of the CSB wrote in April 2006, “How can we tell the public and our clients that we have passed up an opportunity to protect clients? How can we not support the Payee Notification Rule?”

In its campaign to adopt a payee notification rule, the CSB has cited multiple instances...
where attorneys’ defalcations were not discovered until after the statute of limitations had run on the underlying liability claims, thus preventing clients from filing suit and pursuing their claims. Likewise, the CSB referenced cases in which attorneys’ defalcations were discovered when it was too late to pursue UCC claims against the banks that cashed settlement checks with forged client signatures. These examples seem to support the CSB’s claim that, had clients been notified when settlement proceeds were disbursed, as through a payee notification rule, the defalcations could have been prevented or, at the very least, discovered sooner. The CSB also believes that the mere existence of a payee notification rule would discourage attorneys who might otherwise attempt to steal client funds from doing so.

Recent headlines publicizing the sordid stories of client theft seem to support the CSB’s position that action is needed:

“Disbarred Attorney Sentenced to Prison in Theft of More than $1 Million”

“Former Cape Cod Lawyer is Sentenced in Client Theft”

Who can doubt these headlines affect the bar and its image? Why, then, would anyone oppose a payee notification rule?

A critical eye

Critics of a payee notification rule in Massachusetts argue that any such rule would foster distrust between attorneys and their clients. They claim that requiring direct communication from an insurance company to a claimant upon the disbursement of settlement proceeds in order to deter attorney theft would signal to clients that their attorneys cannot be trusted to handle client funds. In addition, this communication would seem to alter a fundamental principle of the attorney-client relationship: no direct contact with a claimant represented by counsel. Indeed, many clients seek counsel for the express purpose of ending their direct contact with an insurance company, preferring to leave such communications in the hands of a capable attorney.

Critics of a Massachusetts payee notification rule also argue that any potential benefit of the rule would be limited to the small minority of clients that have their insurance settlement proceeds stolen. In fiscal year 2006, for example, the CSB paid roughly 19 percent of its claims related to improper settlement practices.7 This compares with roughly 57 percent for unearned retainer claims. Why not, critics argue, focus attention on adopting a rule that targets areas of even greater concern?

Others view a Massachusetts payee notification rule as a further step toward the over-regulation of attorneys. Trust account overdraft notification and mandatory disclosure of malpractice insurance are already in effect in Massachusetts. Further regulation might include adoption of the ABA model rule that imposes random audits on client trust accounts, a rule currently adopted in 11 states, as well as mandatory fee arbitration and mediation of non-fee disputes, neither of which have been adopted by Massachusetts.8

Finally, critics question how the administrative cost of such a requirement would be addressed. Would the burden of added paperwork only delay payment of claims, thereby causing more harm than good to claimants? Should insurance companies be allowed to defray the cost of complying with a payee notification rule by including advertising in their notices to claimants? How else might insurance companies ultimately pass the cost of a payee notification rule on to consumers?

An imperfect solution

Whether viewed as an obvious aid or a potential hindrance to clients and their attorneys, one thing is certain: The payee notification rule is, at best, an imperfect solution. Take Pennsylvania, for example, which implemented a payee notification rule in 1992. According to attorney Kathryn Peifer, executive director of the Pennsylvania Lawyers Fund for Client Security, while the Pennsylvania payee notification rule appears to deter defalcations of settlement proceeds, actual results are very difficult to quantify because it is not possible to track thefts that never occur.9 Interestingly, Pennsylvania has seen an increase in the conversion of settlement proceeds in recent years, despite the existence of a payee notification rule. In fiscal year 2005-2006, embezzlement of settlement proceeds accounted for approximately 22 percent of the fund’s awards.10 This represents an increase from 5 percent in 2004-2005 and 8 percent in 2003-2004. Peifer notes, however, that although these statistics appear to suggest that embezzlement of settlement proceeds is on the rise, almost 70 percent of those awards in 2005-2006 resulted from the defalcations of two attorneys who practiced in the same firm.

The payee notification rule is by no means foolproof and does not guarantee the protection of claimants’ settlement proceeds. Peifer cites to cases in which attorneys have reported false addresses for their clients to insurance companies to prevent clients from receiving notification. Similarly, attorneys have told their clients that settlement checks have to be held for an extended period of time in order for the funds to clear and be processed, thus affording the attorneys an opportunity to misuse the funds. The Pennsylvania Lawyers Fund for Client Security’s annual report notes that attorneys also circumvent the payee notification rule by misusing client funds earmarked to satisfy medical or other liens on the settlement proceeds, funds that a client would not be expecting to receive personally, but the defalcation of which obviously has severe implications for clients. The payee notification rule has no way of preventing these types of frauds. According to Peifer, “If an attorney wants to steal client funds, he [or she] will find a way around the payee notification rule.”

Guideposts for implementation

According to Karen O’Toole, CSB associate board counsel, the Massachusetts Bar Association has established a committee to review any proposed rule in order to address the many concerns of MBA members.11 O’Toole notes that the Massachusetts Bar Association has established a committee to review any proposed rule in order to address the many concerns of MBA members. What, then, should policy makers have in mind as they consider a payee notification rule for Massachusetts?

One small step

If a payee notification rule is to be adopted in Massachusetts, it is critical for policy makers to keep in mind that such a rule will, at best, only address a small percentage of those claims awarded annually by the CSB. Thus, adoption of a payee notification rule is only one small step toward reducing attorney theft.
Another way to empower clients and attempt to reduce the incidence of attorney theft is through client education. Clients need basic education about the claims process, including when and how claims are settled and the proceeds disbursed, so that they are not so easily exploited by dishonest lawyers. Organizations such as the Massachusetts Bar Association need to take the lead in educating these clients. One option would be to have the MBA Lawyer Referral Service, which has made over 450,000 referrals since its inception in 1974, educate clients about the claims process in a form similar to its current brochure entitled “Tips on Choosing a Lawyer.”

**Language of the rule**

The language of any proposed payee notification rule deserves careful consideration. While a mandatory rule would seem to go farthest in ensuring clients know when their settlement proceeds have been disbursed, a voluntary rule should not be rejected without thoughtful analysis. A voluntary rule would give insurance companies an option to avoid the administrative and other expense involved with complying with the rule. This would allow insurance companies to weigh the costs of compliance against the risk of non-compliance, and make their own decision about whether compliance makes economic sense while still affording clients a certain level of protection. However, arguably, where an insurer chooses not to notify the client and theft of the settlement funds results, claimants may attempt to assign some degree of culpability to the insurer.

Maryland’s rule requiring that notification be sent five days after settlement proceeds are disbursed might offer several benefits. This rule would seem to alleviate, at least in part, the concern that payee notification fosters distrust between lawyers and their clients. In addition, allowing attorneys to communicate with their clients in advance of a notification would seem to minimize the impact of this communication on the fundamental protections that the attorney client relationship affords to clients. If notification occurs after settlement proceeds are disbursed, attorneys can seize this opportunity to reassure their clients that their claims are in safe hands. Consider the attorney who sends the following notice to clients upon receipt of settlement proceeds:

**Dear Client:**

In the next few days you will receive notice from the insurance company that your settlement funds have been disbursed to us. We want to take this opportunity to assure you that they have been received and deposited into our client account, and will be disbursed to you promptly in the next seven days. We have enjoyed working with you to resolve this matter and hope we will be able to serve you again in the future.

This example demonstrates how a Massachusetts payee notification rule could actually strengthen, rather than weaken, attorney client relations. However, given that the payee notification constitutes a communication with a represented party, limitations on what insurance companies can include in their payee notifications, such as advertisements or other information, should be carefully considered.

**Conclusion**

A payee notification rule offers some promise to the bar and to the public as we work together to attack the problem of attorney theft. The payee notification rule is one of many options, such as increasing client education, that should be considered. If a payee notification rule is proposed, the language of the rule must be crafted carefully to maximize the rule’s potential benefit while minimizing its costs to clients and the profession. Attorney theft, however, is a sufficiently important issue to merit consideration from policy makers and members of the bar on a much broader level. The payee notification rule is aimed at reducing the window of opportunity for theft of client funds in limited circumstances. With leadership from the bar, and in the tradition of self-regulation that sets the legal profession apart, we can tackle the “cause” of the problem in order to reduce attorney theft across the board and strengthen public trust in the profession.

**End notes**

1. Payee notification is one of six model programs aimed at preventing client harm promulgated by the ABA Standing Committee on Client Protection.


3. The Maryland rule does allow notice to the claimant concurrent with the disbursement of settlement proceeds provided that the notice consists solely of a copy of the letter transmitting the funds to the claimant’s attorney.


7. Note 5, supra. This figure represents the percentage of total awards made in 2006 (8 of 42 awards granted). Unearned retainers accounted for 19 of 42 awards granted.

8. The Massachusetts Bar Association offers voluntary fee arbitration through the Legal Fee Arbitration Board.


10. This figure represents the percentage of total awards made in 2006 (28 of 125 awards granted).

The burden of proof in probate and trust litigation after Moretti

By Robert J. O’Regan

The rules for burden shifting in undue influence cases involving fiduciaries after Cleary v. Cleary & Rempelakis v. Russell may seem a bit confusing at first glance, but in Estate of Moretti, the Appeals Court recently made it clear that the initial inquiry is this: (1) What was the role of the person accused of benefiting from terms of a trust, will or conveyance in taking care of the settlor/testator’s personal or financial needs; and (2) What was that person’s role in the decision at issue? If a person receiving a benefit stood in a fiduciary or confidential relationship with the settlor or testator at the time of the questioned action and was involved in the decision, then the burden will shift to that person to prove that the challenged act did not result from abuse of the relationship. As discussed below, the impact of this burden-shifting rule was demonstrated in Moretti, in which a judgment that upheld a conveyance of valuable real estate into a trust benefiting a home companion was turned completely around on remand after the Appeals Court reversed the trial judge’s decision to not shift the burden from the challenger to the companion.

According to Moretti, it is “an overly limited reading of the Cleary-Rempelakis rule” that the fiduciary must procure the benefit at issue through the use of the fiduciary relationship before the burden will shift. However, even if a connection is established between the fiduciary and the decision, the burden can be shifted back to the challenger if the settlor or testator received independent legal advice as one method of showing the true independence of the decision from the fiduciary relationship. The fiduciary must not have any strings to pull with the “independent” attorney. As stated in Moretti, “the intervention of legal counsel and measured independence must be real, not illusory; the legal representation must be truly independent, with the lawyer’s loyalty flowing to the client testator alone.”

The continuing benefit of Cleary is its articulation of the longstanding concepts on which the rule applies, and this may be why Cleary is often cited as establishing the standard. Justice Charles Fried’s comment in Cleary, that its result to shift the burden merely applied well-established law, can be seen in a careful reading of Cleary, Rempelakis, Moretti and the cases they cite. This shows that the test for burden shifting is neither new nor ambiguous, but that the burden will shift depending on the actual role of the fiduciary in the decision making process. The facts in Cleary and Moretti fell on the side of the line for when burden shifting should occur, and because the burden did not shift in Rempelakis, it may appear not to apply the same burden-shifting standard. Nevertheless, a closer look at the three cases reveals the contours for when there should be a shift of the burden onto the fiduciary.

In Cleary, the Supreme Judicial Court reversed the lower court’s decision against assigning the burden of proof to the defendant, a nephew of the decedent, in a suit that challenged the validity of a change in beneficiaries of the decedent’s life insurance. The trial judge had relied on the usual presumption that the burden will not shift due to a family relationship between the principal and the ultimate beneficiary. Cleary focused on the defendant’s actual participation in the change of beneficiaries to himself from the decedent’s estate, where the proceeds were to be divided equally between the defendant and another nephew. This analysis identified the different relationships that existed, and how they came into play, to distinguish Cleary from cases in which natural generosity to a family member or close friend and not abuse of the fiduciary relationship is the presumed motivating factor behind a gift or bequest. In Cleary, the defendant was also a financial confidant and holder of a power of attorney for the decedent, as well as the insurance agent. He obtained signed forms, perhaps in blank, which ultimately named himself as sole beneficiary. These multiple roles and actual participation in the decision-making process easily fit the established burden-shifting rule that had been most visible in cases where attorneys benefited from transactions with their clients.

In Rempelakis, the Appeals Court upheld the trial judge’s refusal to shift the burden of proof to the defendant, a friend of the decedent who was named in a will drafted by an attorney and witnessed by persons who the friend located. The will left nothing to members of the decedent’s family. On the facts, however, the defendant was shown to take no part in the decedent’s decision. Although he had been given a power of at-
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torney a few days before the will was executed, and so a fiduciary relationship existed as a matter of law, the defendant had not used it when the will was signed and never used it to benefit himself. The attorney who drafted the will was not then representing the friend, although he had done so in the past, and the attorney insisted to all concerned that his only client at that time was the decedent. Therefore, Rempelakis holds that under Cleary the burden of proof does not shift automatically to the fiduciary in every case in which the fiduciary benefits, regardless of involvement — or lack of involvement — in the challenged acts. Rather, if no connection exists between the relationship and the challenged act, so that the challenged decision was made truly independent from the fiduciary relationship, the burden will not shift.

In Moretti, a home health companion for an elderly invalid was found to have instigated changes in the decedent’s estate plan within weeks of being hired to simply stay in the decedent’s apartment overnight. Otherwise, the decedent would have been left alone, which was neither safe nor something he wanted. This invalid owned the North End apartment building in which he lived, but he had no family. When he died, the building had both been deeded into a new trust for which the companion was trustee and beneficiary, and left to the companion in a new will. A prior will had left the property to a close family friend of over 40 years. Because the transfer into the trust would have adeemed any devise under either of the two wills, the validity of the deed was decided before the will contest. Trial of the validity of title in the trust produced the first of the four appeals, in which the trial judge was reversed because he did not make requested findings on the companion’s status as a fiduciary. On remand and later in a separate trial of the will contest (in which the facts were essentially the same), the companion was found to have been a fiduciary and to have participated in the decision making so extensively that he was involved in hiring and firing a series of lawyers; was represented by the lawyers who executed the will and wrote the trust; isolated his employer from long-time friends, care providers and advisors; intimidated visitors; read all of the decedent’s mail; set up all of appointments with the decedent and lawyers; and marked up at least one draft of the will. The two sets of findings issued in separate cases after the first appeal left no doubt that the companion used a power of attorney and the employer’s total dependency on him to gain control over the decedent and his property. The differences between the first and subsequent findings in Moretti, on the essentially the same facts, demonstrate the outcome-determining impact that burden shifting can have.

As stated in Moretti, “critical to the inquiry is the fiduciary’s involvement in the decision-making process regarding disposition of the decedent’s estate.” If a fiduciary’s involvement is the decisive factor, the underlying rationale for burden shifting suggests that the extent of involvement need not be very high to shift the burden. This should be the rule because the rationale for burden shifting is that the fiduciary relationship itself creates a unique opportunity for exploitation. Since the best (and sometimes only) source of information on whether exploitation occurred is the same person who has an interest benefiting from an advantage that was taken of the fiduciary’s principal, the rule shifts the burden onto the fiduciary. The appellate history of Moretti shows why trial counsel should attempt to ensure that the trial judges’ decisions carefully articulate why the burden was — or was not — shifted.

As a practical matter, practitioners should give careful consideration to the timing for raising and resolving who has the burden of proof. This timing can have significant impact on strategy and litigation expense. Partial summary judgment on this question, or on the entire case, may be appropriate if the facts are not in dispute. A preliminary evidentiary hearing solely on the burden of proof is a good tool for cases in which contested facts on this issue must be resolved first. Such hearings should not be lengthy or complicated, as they should deal only with the preliminary fact of whether the fiduciary participated in the decision making, not on how the role led to the decision itself. However it is resolved, however, the issue must be raised in a timely manner for best results in settling or trying the case, and to survive as an appellate issue.

End notes

THE MASSACHUSETTS PROBATE CODE: COMING CHANGES

By Raymond H. Young

The Probate Code, sponsored by the Massachusetts and Boston Bar Associations, has cleared the Joint Committee on Judiciary and is currently pending in the House of Representatives as House Bill 1633. Much of this bill is a codification of present Massachusetts law and practice, making the law easier to find and apply. It is a reworking of the Uniform Probate Code to conform with what is best in prior Massachusetts practice and law. This specific tailoring makes it appropriate to call this bill the Massachusetts Probate Code.

There are also significant and helpful changes and improvements included in the MPC. This article reviews for the benefit of Massachusetts practitioners some of the more important of the coming changes.

Informal probate

The greatest improvement is informal probate. Ninety-six percent of all probate filings are uncontested, 2 percent are contested, and another 2 percent have enough assets or serious enough issues to warrant formal procedure in any event. The problem of our present practice in Massachusetts is that, apart from voluntary probate for small estates, all those uncontested probates or administrations have to endure the formal procedure with the result, depending on luck and counties, of a 3 to 5-month delay before formal appointment can be obtained. The estate must get a citation with a return date, arrange service and publication, and get action after the return date. Meanwhile, due to privacy laws, collecting the basic information is not possible until there is a certificate of appointment. The procedure causes friction between clients and lawyers, and creates problems for the registries in dealing with complaints and inquiries from lawyers and petitioners. The registries get blamed for delays, but it is not their fault. The problem is the antiquated law.

The solution can be corrected with the MPC informal probate. Application may be made seven days after a decedent’s death and seven days after written notice to all interested parties. The initial filing will be reviewed by an assistant register or other person appointed by the court, much as in the present initial review by an assistant register upon filing. The difference is that upon that initial review by the authorized assistant register, the appointment can be effective immediately. The job is done. The appointed personal representative can proceed.

Where there is opposition the opportunity for contest is not lost. A request for formal procedure may be filed by any interested person with the request that the informal proceedings be terminated. Thereupon the informal appointment powers are at an end. This formal procedure request would be the equivalent of filing a contest. The Rule 16 provisions would thereafter apply.

The opportunity to contest is not lost but is protected.

Testamentary trust liberation

Massachusetts lawyers largely avoid testamentary trusts because their clients wish to avoid the continuing formality and expense required with accounts, filing fees and guardians ad litem. “Avoiding probate” has been a great slogan for the trust mills that attack lawyers and courts as enemies, and promote their boilerplate “living trusts.” The sensible approach here is to parallel the informal probate approach. Why force the formal procedure upon the 98 percent of the cases where it is not needed? The MPC follows just that approach, namely, there is no requirement for accounting to the court for testamentary trusts, but rather a requirement to account to the beneficiaries. Any party who wishes court action for protection or to challenge what has been done is free to bring a probate proceeding wherever it is necessary, where everyone’s rights can be determined and protected. But the unnecessary burden of filing and storing accounts where there is no question is avoided.

Guardianship and conservatorship

Guardianship is the area where the MPC improvements are on the side of more protection rather than less. These provisions were carefully worked out after intensive review with a committee of probate judges. Incapacitated persons are particularly vulnerable. They may not have family members or known beneficiaries who can protect them. Necessary safeguards are required to prevent railroad of elderly and incapacitated persons without adequate protection. Reforms are badly needed, have been agreed upon by all concerned for a long time, but have not as yet been adopted. They are at last provided in the MPC guardianship and conservatorship provisions.
“Payable on death” accounts

Presently in Massachusetts joint bank accounts are used as “poor men’s wills.” But we have all seen that the most disruptive, emotionally searing and expensive litigation can occur over whether the account was intended to transfer ownership at death or whether it was merely a convenience account to permit payment of bills, with no intent to transfer ownership. The unnecessary disruption and litigation is avoided by the MPC providing for the establishment of “pay on death” accounts making it clear that the intent is to transfer ownership where that is in fact the case.

Spousal elective share

There has been contention for years about determination of the share that a surviving spouse takes on election against the will of the deceased spouse. Because of that contention, the pending MPC does not contain any provisions for an elective share. Present Massachusetts law is continued until there is agreement. The MBA, the BBA and the Women’s Bar Association all agree that consideration of the MPC should not be delayed pending a resolution of spousal elective share. The good news is that there may in time be an agreement on the elective share. There is an interbar committee, including representatives of the MBA, the BBA and the WBA, which has been considering the question for close to two years. That committee is now starting an intensive analysis of resolution of this question in Massachusetts. That committee’s estimate is that it will take two more years to explore all questions and gain insights from the practical application of enactments in other states. All the bar associations agree that the consideration of the MPC should not be delayed to await this result.

Intestacy: surviving spouse

The surviving spouse under present Massachusetts law, where there is no will and no issue, takes the first $200,000 plus one-half of the balance. The MPC increases the surviving spouse’s intestate share in most cases to all of the intestate estate. This is consistent with the experience lawyers have in drawing wills. In most cases the intention is that the entire estate goes to the surviving spouse where there is no issue.

MPC applies the same rule where all issue is issue of the marriage. This is distinguished from the present Massachusetts provision that where there is issue the surviving spouse takes one-half and the issue take the other half. There is a practical reason for the MPC change: Where the children are young, the most reasonable provision is to provide everything for the surviving parent, whose interest is in taking care of those children as well as of himself or herself. This is particularly important in modest size estates. It accords guardianship for minor children with the attendant extra expense and delay. This is the provision that most clients choose to write into their will. It therefore is also the disposition that should be effected by the intestacy laws.

If either spouse has issue from a prior marriage, the rule is different. Then there is a 50-50 allocation between the surviving spouse and the issue. This protects against what could otherwise be a conflict of interest on the part of the surviving spouse.

Intestacy: issue of different generations

Lawyers learn about “per stirpes” distribution in law school and tend to believe that is the proper form of distribution. But this is a question for clients to decide. Lawyers should talk with their clients about this question before drawing the will. They may be surprised by their client’s choice. The question can be asked in terms of the client’s own family patterns of children and grandchildren. In simplified form, suppose the client has three children, child A has three children, child B has one child, and child C has two children. Suppose two of your three children, A and B, die before you but your other child C survives you. Presumably you want C, the surviving child, to take one third. Now comes the significant question. How should the property go among your four grandchildren who are descendants or your two deceased children? One-ninth each to the three surviving children of deceased child A and one-third to the child of deceased child B? Or one-sixth to each of the four grandchildren? Over 75 percent of clients questioned in a survey of American College of Trust and Estate Counsel members chose the equal sharing, “equally near, equally dear,” rather than the per stirpetal approach of per capita at each generation. One ACTEC Fellow reported [my clients] unanimously selected [per capita at each generation]. In my estate planning practice over the years all of my plans have been drawn to have a [per stirpes at the first generation] distribution . . . I have reluctantly come to the conclusion that I have been inadvertently influencing the decision, as my personal very strong preference is for [per stirpes at the first generation].

The MPC follows the wishes of most clients, as is the appropriate rule for intestacy. In the meantime, before the MPC becomes effective, lawyers should discuss this question with their clients to find out what it is they want to do, the object of drafting.

Premarital will

We all know that marriage revokes a prior will unless the will was executed in contemplation of marriage. Generally speaking, this has the beneficial effect of allowing the spouse to receive an intestate share. But that result is overbroad in some instances. A superior court malpractice action charged a lawyer should have found out his client had gotten married, and should have advised the client of the need for a new will. The factual situation was instructive. The marriage, kept private, occurred while the new wife was terminally ill. The husband had a prior will providing a substantial trust for one of his nephews with special needs. That careful provision was obliterated by the overbroad application of invalidity. The MPC to the contrary provides a more carefully tailored provision. It does not invalidate the prior will, but in the event of a subsequent marriage the surviving spouse takes an intestate share of so much of the estate as is not devised to a child of the testator by a prior marriage.

Effect of divorce

By Massachusetts statute, divorce revokes a prior will provision for the divorced spouse. This is a rule that is not broad enough. Much of wealth currently passes outside the
probate estate, by insurance beneficiary designation, by retirement plan beneficiary designation, and by funded revocable trusts. The Massachusetts statutory provision does not apply to those assets. The case of *Clymer v. Mayo*, 393 Mass. 754 (1985), allowed the revocation to extend to an unfunded revocable trust but on the limited ground that it was part of the testamentary plan. The MPC provision extends the sensible rule to all non-testamentary transfers, retirement plans, insurance and funded trusts.

**Omitted children**

Under present Massachusetts law the pretermitted child takes an intestate share unless the omission was intentional. The more narrowly tailored MPC provision is that the omitted child takes the intestate share if there is no issue living at the time of the will. If there is issue living at the time of the will then the omitted child, unless the omission is shown to be intentional, takes a proportionate share of the part devised to children. This more narrowly tailored approach prevents unnecessary disruption of the overall testamentary plan.

**Memorandum**

The precatory memorandum many lawyers use in connection with tangibles is given binding effect, provided the writing is signed, and describes the donees and the items with reasonable certainty. The writing may be referred to as one to be in existence at the time of death and may be prepared before or after the execution of the will.

**Anti-lapse**

The anti-lapse provision provides that if no other provision is made in the will, on the death of a relative, a legacy or devise to that relative passes to the surviving issue of the relative. But, that beneficial provision does not extend to trusts, to retirement plans, to insurance, or other non-probate transfers. The MPC extends the anti-lapse rule to all these non-probate transfers.

**Conclusion**

It is well that we all keep in mind the coming changes and benefits provided by the pending Massachusetts Probate Code. We also want to speed up enactment of the MPC. The members of the legislature do not feel the urgency that we do about the need for this legislation. You can help by contacting your state representative and state senators to let them know that this is legislation about which you feel strongly. Please convey to them your sense of urgency so that we will all get the benefit of this legislation sooner rather than later.
Recent decisions under the Comprehensive Permit Law

By Gary S. Brackett and Heather W. Kingsbury

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Introduction

Massachusetts Gen. Laws c. 40B, which addresses regional planning for low and moderate income housing, continues to create novel questions of interpretation nearly 40 years after its adoption. The courts are asked to resolve the tension between developers of affordable housing projects and opponents who feel that such projects infringe on the authority of a municipality to regulate use of land. Local zoning boards of appeal are responsible for balancing these interests under the regulatory framework. Recent decisions of the Supreme Judicial Court seem to resolve the tension in favor of promoting increased affordable housing in light of the statutory goal of eliminating exclusionary zoning practices.

Massachusetts Gen. Laws c. 40B, §20 allows a developer to obtain a permit for a project containing an affordable housing component through a streamlined process in which the applicant submits a single application to the zoning board of appeals rather than separate applications to several boards for the various approvals that would otherwise be necessary. The zoning board is authorized to grant a comprehensive permit subject to conditions that are “consistent with local needs” and may waive local requirements and regulations of its own, and of other boards, in the process. Pursuant to §20 of the act, local requirements and regulations are deemed “consistent with local needs” and, therefore, may be imposed upon a project when a community has satisfied one of three statutory minima with respect to the provision of affordable housing. For example, a community in which 10 percent of the housing units are “affordable,” as determined by the Massachusetts Department of Housing and Community Development, has satisfied its minimum requirement and may impose its zoning regulations on a project proposed pursuant to Chapter 40B. More than 50 municipalities have achieved this statutory goal, raising new questions as to the proper procedures and standards applicable to requests for comprehensive permits in these municipalities.

Recent decisions

In the recent case of Jepson v. Zoning Board of Appeals of Ipswich, the Supreme Judicial Court considered whether a zoning board may override local zoning requirements that would otherwise apply to a commercial component of a comprehensive permit project in the particular zone. 450 Mass. 91, 83 (2007). The YMCA sought to construct 48 rental housing units in two structures, one of which would also include 8,220 square feet of commercial space. The commercial use was allowed in the zoning district, but the proposed project did not conform to certain dimensional requirements that would otherwise be applicable to such a use. The zoning board waived these dimensional requirements and granted the permit. Certain abutters appealed the decision. The court focused on the legislative goals of Chapter 40B, namely, to provide flexibility in order to promote the continued development of affordable housing by offering financial incentives to developers. The court extended that flexibility to projects containing incidental commercial components and categorized its decision as another example of circumstances under which local concerns must yield to the need for affordable housing. The court’s ruling is limited, however, to affordable housing projects containing incidental commercial uses and would not permit a housing development proposed as a pretext for commercial development.

In the Town of Amherst, the question recently arose as to whether a local board of appeals may employ the “regional needs” test, or whether the zoning laws must be imposed in the usual way, once a municipality has satisfied one of the statutory minima. At issue in Boothroyd v. Zoning Board of Appeals of Amherst was the grant of a comprehensive permit for 26 units of rental housing, notwithstanding the fact that Amherst had reached the 10 percent threshold. 449 Mass. 333, 334 (2007). The zoning board found a continuing need for affordable housing in Amherst, despite satisfaction of the statutory requirement, as evidenced by the 870 families on the waiting list who would have to wait three to six years for affordable housing in town. The court conducted a thorough statutory construction analysis and held that a local board of appeals has discretion to decide whether or not to impose local zoning laws once the minimum has been satisfied. The court further held that its interpretation would not compromise local autonomy, as local boards in 10 percent communities maintain the discretion to impose zoning requirements if they choose to do so.

Pending cases

Currently pending before the Supreme Judicial Court is an application for further appellate review of the Appeals Court’s decision in the matter of Levin v. Board of Appeals of Framingham. 70 Mass.App.Ct. 1113
(2007) (unpublished opinion). This case raised the same issue as to the authority of the zoning board of appeals in a community that has reached the 10 percent threshold and was pending before the Appeals Court when Boothroyd was decided. Since the Boothroyd decision resolved that issue, the Appeals Court focused instead on the question of the plaintiffs’ standing, an issue impacted by another timely decision of the Supreme Judicial Court in Standerwick v. Zoning Board of Appeals of Andover. Standerwick enunciated the types of harm that would confer standing upon a plaintiff challenging the grant of a comprehensive permit and held that only the interests protected by Chapter 40B are legally cognizable, namely: 1) protection of the safety and health of the town’s residents; 2) development of improved site and building design; and 3) preservation of open space. 447 Mass. 20, 31 (2006). Diminution of property value in and of itself is not a legally cognizable claim. Standerwick was decided on the fifth day, but prior to the conclusion, of trial in the Levin case. Shortly thereafter, the developer filed a motion for reconsideration of the Land Court’s pre-trial decision on an earlier motion for summary judgment. The Motion for Reconsideration argued that Standerwick required a holding contrary to the Land Court’s earlier ruling as to the plaintiffs’ standing. The plaintiffs argued that the motion for reconsideration was improper because the developer had waived the issue of standing at the outset of trial. Although standing is jurisdictional and may be raised by a party at any time or by the court on its own motion, waiver of the issue is significant in a case where the plaintiffs may establish standing by virtue of a presumption that operates conclusively unless the opponent submits evidence challenging the presumption. On reconsideration the Land Court held, and the Appeals Court agreed, that the plaintiffs had failed to demonstrate standing. The plaintiffs’ petition for rehearing and application for further appellate review are pending.

The matter of Woburn Board of Appeals v. Housing Appeals Committee, pending before the Supreme Judicial Court on direct appellate review, presents another novel issue that has not been addressed by any appellate court to date. Docket No. SJC-10014. The applicant in this case originally presented a proposal to construct 640 units of housing on a 75-acre parcel. The zoning board approved the project at 300 units and included requirements for certain mitigation relating to infrastructure and traffic issues. On appeal, the Housing Appeals Committee concluded that the applicant had failed to meet its burden under the statute that the project was rendered uneconomic as a result of the limitation of units and the conditions. However, the HAC then proceeded to require that the zoning board approve the project at 420 units. Both parties appealed to the Superior Court. The Superior Court affirmed the finding that the applicant had failed to meet its burden before the HAC but held that the zoning board’s decision constituted a “de facto” denial. The court also concluded that, on the applicant’s appeal, the HAC determination of the 420 unit density was unsupported by substantial evidence. The matter was remanded to the HAC to present a number that was supported by the record of the hearing. Despite the zoning board’s objection, the HAC allowed the applicant to present two new proposals, each of which contained 540 units, during the remand proceedings, and eventually approved the project at 540 units, without specifying which of the two proposals had been approved. The Superior Court affirmed the HAC decision after remand and the zoning board appealed. The issue before the Supreme Judicial Court is whether the HAC, on appeal from a zoning board’s decision approving a comprehensive permit with conditions, or the Superior Court, on appeal from a decision of the HAC, has the authority to convert an approval with conditions to a “de facto” denial. The initial determination of whether a decision constitutes an approval with conditions or a denial affects the parties’ burdens on appeal before the HAC. When a project has been approved with conditions that render the project uneconomic, the developer may appeal the board’s decision to the HAC. The developer bears the burden of demonstrating that the conditions render the project uneconomic and, if so, the board must prove that the conditions are consistent with local needs. By contrast, on appeal from an outright denial of a project, the board bears the initial burden of proving that the denial is consistent with local needs. Oral argument was held on February 4, 2008. The SJC is expected to establish the proper allocation of burdens on appeal from an approval with conditions reducing the number of units.

On the same day as the Woburn case, oral arguments were also held before the SJC in the matters of Town of Hingham v. Department of Housing and Community Development, Docket No. SJC-10013, and Town of Wrentham Zoning Board of Appeals v. West Wrentham Village, LLC, Docket No. SJC-10066. The Hingham case involves a challenge to a determination by DHCD that only 25 percent of the units comprising a rental housing development will be included in the Subsidized Housing Inventory. The Town of Hingham argues that this determination runs contrary to existing DHCD regulations requiring 100 percent of the units in a rental development to be included in the SHI, even where only a fraction of the units are designated as “affordable.” If all of the units in the proposed project were included in the SHI, Hingham would exceed its statutory requirement for provision of affordable housing. The Wrentham case raises the issue of whether a zoning board in a community that has reached the statutory minimum must hold a hearing on the merits of an application for comprehensive permit, or whether such an application may be denied solely on the basis that the town has met its obligation.

Conclusion

Notably, a recent petition to repeal Chapter 40B failed in obtaining the required number of signatures to place the initiative on the 2008 ballot. It appears for now that communities will continue to be able to exercise broad powers to promote the development of affordable housing in accordance with the courts’ interpretation of the existing statute.

End notes

1. Set forth in DHCD’s Chapter 40B Subsidized Housing Inventory, based upon the federal census last taken in 2000.
Defining manufacturing activity in Massachusetts: Recent decisions clarify the availability of sales & use tax exemptions for entities engaged in manufacturing

By Natasha Varyani

The Appellate Tax Board has recently promulgated several decisions clarifying the activities that constitute manufacturing under Massachusetts law. Entities that are “engaged in manufacturing” are entitled to certain tax benefits in the commonwealth. The Department of Revenue has recently responded to the ATB’s opinions in Technical Information Release 08-2 and has accepted the refinements made to the group of activities that are to be considered “manufacturing.” The Supreme Judicial Court’s historically expansive view as to what constitutes manufacturing activity has been confirmed and expanded in recent case law, which reinforces that the broad purpose of the statute is the “promotion of the general welfare by inducing new industries to locate in Massachusetts and by fostering expansion and development of our own industries.”

Manufacturing Classification vs. Manufacturing Status

A corporation can apply to the commissioner of revenue to be formally classified as a manufacturing corporation pursuant to M.G.L. c. 58 §2. Such formal classification, when granted by the commissioner of revenue, entitles a corporation to tax benefits including: 1) the availability of an investment tax credit (M.G.L. ch. 63 §31A); 2) sales and use tax exemptions for certain sales related to manufacturing (M.G.L. ch. 64H §§6(r) and (s)); and 3) the ability to apportion multi-state income using single factor sales as opposed to the normal apportionment method in which sales are double weighted against property and payroll (M.G.L. ch. 63 §38(l)).

A corporation that does not formally apply for manufacturing corporation classification but that is engaged in manufacturing may be treated as having manufacturing corporation “status.” A corporation with manufacturing corporation status is entitled to most state tax benefits, but may not claim available local property tax benefits based on their status as manufacturer. It is identifying which activities entitle corporations to this status, thereby conferring on them the tax benefits mentioned above, that the Appellate Tax Board has recently addressed. Courts have historically held that even those processes which do not result in a finished product may constitute manufacturing for purposes of conferring tax benefits where the activities in question constitute “an essential and integral part of a total manufacturing process.”

Engaged in manufacturing

Historic holdings regarding manufacturing status

The standard articulated in William F. Sullivan & Co., Inc. v. Commissioner of Revenue has been relied on for many years. The court in William F. Sullivan confirmed the definition of manufacturing as “[C]hange wrought through the application of forces directed by the human mind, which results in the transformation of some preexisting substance or element into something different, with a new name, nature or use.” In more recent years, where there was no tangible or final product for sale by the taxpayer, the Houghton Mifflin case has been used as a guideline by the DOR and taxpayers alike. In that case, the Supreme Judicial Court held that the taxpayer’s activities, which included producing, editing and laying out the text in an electronic form, was considered manufacturing despite the fact that the tangible products, the books, came into physical existence, or were printed, by an unrelated third party hired by the taxpayer. In its decision,
the court refined the definition of what constitutes being “engaged in manufacturing” to include where the taxpayer “transforms ideas, art, information, and photographs, by application of human knowledge, intelligence, and skill, into computer disks, ready for use by independent printers, containing an immense amount of information in a highly organized form.” The ATB, in its most recent rulings discussed below, remain consistent with the concept set out in Houghton Mifflin and allow taxpayers manufacturing status even when there is no tangible product that contains the highly organized information or specifications for manufacture of the end product.

The First Years, Inc. v. Commissioner of Revenue, Appellate Tax Board No. C267626 Promulgated: September 17, 2007

Where The First Years’ products were mass-manufactured by unrelated third parties overseas, the ATB held that The First Years qualified as a domestic manufacturing corporation under M.G.L. c. §38C. The First Years’ activities included research, design and safety testing of prototypes, development of new products and improvements to existing products for sale. The board considered the level of involvement of employees located in Massachusetts to the overall manufacturing process, and in coming to understand that ideas, refinements to products and approval to manufacture came from third parties, that the activities of The First Years were integral and essential to the overall manufacturing process. In making its determination, the board also cited that quality and safety testing process. In making its determination, the board also cited that quality and safety testing process. While substantially all of Duracell’s receipts were derived from the sale of batteries, none of the product that came from the Massachusetts facility was sold at retail. The board concluded that because Duracell generated a large number of their products that were sent to customers for trial in their products, and because those products were substantially similar to those products that were found in stores, the taxpayer transcended the prototype stage and therefore qualified as a manufacturer. Generally, the research, design and creation of a prototype in and of itself is not considered manufacturing. In TIR 08-2, the department stated that it concurred with the findings of the board and would not seek judicial review with regard to the manufacturing status of the taxpayer. It is important to note that the other issue in this appeal related to receipts associated with research and development activities. During the tax periods at issue in the Duracell case, a certain amount of receipts from research and development were needed to qualify as a research and development corporation and, as a result, be eligible for additional sales and use tax exemptions. The commissioner accepted the ruling regarding Duracell’s manufacturing status.

Onex Communications Corp. v. Commissioner of Revenue, Appellate Tax Board No. C271834 Promulgated: September 11, 2007

In this case, the ATB found that Onex was entitled to an abatement of use tax on purchases of certain materials based on its qualification as a foreign manufacturing corporation as defined in M.G.L. c. 63 §42B. The activities of Onex included working with an abstract concept to eventually produce a piece of technology that was ready for market. Though Onex was responsible for bringing the concept of this technology to a specific blueprint, it never had the capacity to manufacture any tangible prototypes or products for commercial sale. Instead, Onex entered into an agreement with an unrelated third party to produce the technology and refined the production blueprints as prototypes were returned to Onex and examined. The third party manufacturer had no discretion or control to exercise in the production or design of the product. The board held that Onex carried out steps that were “essential and integral” steps in the manufacturing of the product, and that, akin to the Houghton Mifflin case, a transformative change occurred which produced a commodity (the blueprint and manufacturing specifications) that had never existed before. The fact that the taxpayer itself did not produce a tangible product was irrelevant.

Manufacturing moving forward

Both the Appellate Tax Board and the commissioner of revenue have demonstrated, by way of these recent rulings and associated TIR 08-2, that the expansive view of the legislature and the Supreme Judicial Court will continue to be read broadly. As the commonwealth continues to adjust its definition of manufacturing, with the technological capabilities of clients as well as increasing globalization, an environment that is increasingly palatable for foreign corporations is created.

End notes

4. Id. at 579.
Reducing the Massachusetts Estate Tax via Taxable Gifts

By Rand Hutcheson

Because of the decoupling of the Massachusetts estate tax from the federal estate tax in response to the Economic Growth and Tax Relief Reconciliation Act ("EGTRRA"), it has since 2002 been possible for the first time to reduce one’s overall estate tax burden by making gifts during lifetime that are subject to federal gift tax. While this technique has been available for six years now, it has not been as widely publicized among estate planning practitioners as it should have been. The purpose of this article is to publicize the technique and to explain why it works.

Perhaps the easiest way of introducing the technique is with an example. Take a hypothetical Massachusetts decedent, D, who dies in June of 2008 with a taxable estate of $2 million. Since the federal exemption amount for 2008 is $2 million, no federal estate tax will be due on D’s death. The Massachusetts exemption for 2008, however, is only $1 million, and so D’s estate will have to pay a Massachusetts estate tax. The Massachusetts estate tax will be levied on D’s adjusted taxable estate; the adjusted taxable estate is $1.94 million, and D’s estate will therefore pay a Massachusetts estate tax of $99,600.

If, on the other hand, D does not die owning the entire $2 million but instead gives away $1 million a month before her death, the tax result is different. This $1 million gift is an adjusted taxable gift, but since the amount of the gift is within the $1 million lifetime exemption from gift taxes under the Internal Revenue Code of 1986, as amended, § 2505, there is no gift tax due or payable. D’s federal taxable estate, moreover, is still $2 million, since for federal purposes, adjusted taxable gifts made during life are brought back into the estate for estate tax purposes. Of course, there is still no federal estate tax on this $2 million taxable estate. D’s Massachusetts taxable estate, however, is now only $1 million, since—and this is the key to the technique—adjusted taxable gifts are not brought back into the estate for Massachusetts estate tax purposes. The tax on a Massachusetts taxable estate of $1 million is $33,200. D has saved her estate $66,400 in taxes—not “chump change” by any stretch of the imagination—by making this taxable gift before her death. Note that the gift can be made up to the moment of death.

This, then, is why the technique works, in a nutshell. The important points to keep in mind are these:

- Code Section 2011 is still in effect for Massachusetts estate tax purposes;
- New Code Section 2058 is in effect for federal estate tax purposes;
- The federal estate tax is levied on the sum of the federal taxable estate and adjusted taxable gifts;
- The Massachusetts estate tax is levied on the adjusted taxable estate, period;
- The federal estate tax exemption amount for 2008 is $2 million;
- The federal gift tax exemption amount is $1 million; and
- The Massachusetts estate tax exemption amount for 2008 is $1 million, but this is totally irrelevant to the tax calculation and is only relevant in determining whether or not a Massachusetts estate tax return must be filed. Again, the question of whether a return must be filed and the question of how much tax is due are independent questions except to the extent that if no return must be filed, no tax will be due. However, the converse is not true, and sometimes—theoretically, at least—no tax will be due even though a return must be filed (in the case of, for example, a decedent who gives away $1 million and has nothing left after the gift).

Before EGTRRA, it was not possible to reduce overall estate taxes by making taxable gifts, because formerly we were under a sponge tax system. Under a sponge tax system, making taxable gifts reduces the Massachusetts estate tax for the same reason just illustrated, but the overall tax burden remains unchanged, since a decedent’s estate simply receives less of a credit for paying the lower state death taxes. In other words, the total tax was the same but it was just allocated differently, with Massachusetts getting less and the federal government getting more...
Taxation Law

if taxable gifts had been made by the decedent during his or her lifetime. All of this has now changed.

It would seem at first blush, therefore, that people who have taxable estates between $1 million and $2 million could reduce their state and federal transfer taxes at death to zero simply by making a lifetime transfer in the amount of the difference between the value of their estate and $1 million. This is not, however, the case; complications arise because of the way the Massachusetts estate tax is calculated.

It is somewhat counterintuitive, but no unified credit, 11 credit, or exemption was directly relevant to calculating the credit for state death taxes under Chapter 11 of the Code as in effect before EGTRRA was enacted. According to the tax table in 26 U.S.C. § 2011 (2000), that is, the first dollar of a decedent’s taxable estate is subject to state estate taxes under a sponge tax system. A taxable estate of $100 would, for example, without further restrictions, produce a Massachusetts estate tax of $0.80 under that tax table. The further restrictions here are crucial, and are provided by pre-EGTRRA Code § 2011(e), which limits the credit for state death taxes to the amount of the federal tax. 12 This certainly makes sense. If the credit for state death taxes could exceed the federal estate tax, then taxpayers could claim refunds from the federal government on estate tax returns, when no tax had been paid to the federal government in the first place. 12

Again, there are three essential (and all obvious and interrelated) points to keep in mind here:

1. Under 26 U.S.C. § 2001(b) (2000), the estate tax is and was figured based upon “the sum of . . . the amount of the taxable estate and . . . the amount of the adjusted taxable gifts.”

2. Under 26 U.S.C. § 2011(b)(3) (2000), the credit for state death taxes was (before it was abolished) figured upon “the taxable estate reduced by $60,000.” That is, taxable gifts are completely irrelevant for the purposes of determining the credit for state death taxes.

3. The amount of the credit for state death taxes was, in most cases, therefore, completely independent of the amount of the unified credit and of the amount of adjusted taxable gifts.

In other words, to figure the total estate tax under a pure sponge tax regime, one computed the tentative estate tax on the sum of the taxable estate and the adjusted taxable gifts, then one subtracted from that tentative tax the unified credit amount. That gave one the total estate tax. Then one figured the amount of the state death tax credit, which gave one the amount to pay to the state and to subtract from the total estate tax for federal purposes.

So much for the obvious facts. Now for the obvious-but-not-obvious conclusion: the difference between what the amount exempt from federal tax because of the unified credit would have been under year 2000 law (i.e., $1 million) and what the federal exemption amount is today (i.e., $2 million) can totally escape Massachusetts taxation if given as a gift during the decedent’s lifetime. This is because Massachusetts never has had (and (we hope) never will have a gift tax. 13

This conclusion is independent of the filing threshold. The new different filing thresholds for Massachusetts and federal estate taxes tend to muddy the waters here, because we tend to think about filing thresholds when we think about the differences between federal and state estate taxes and not about taxable gifts. These are almost entirely independent issues. Most of us are used to thinking of the exemption amount as directly relevant to the amount of estate tax due, because for federal estate tax, it is directly relevant. But in most instances, it is completely irrelevant to the amount of state estate tax due.

It is received wisdom that a tax credit is always better than a tax deduction, because a credit comes off the tax directly, whereas a deduction simply reduces the tax base. In general, therefore, a tax credit will always be preferable to a deduction. The present case is, however, one of the few where a deduction is in fact better than a credit, since if we were still under a sponge tax—i.e., tax credit—system, making taxable gifts could not reduce overall estate taxes, but under the current deduction system, it can. The table below shows the savings in Massachusetts estate tax that can be obtained by making a taxable gift of $1 million immediately prior to death: (fig. 1)

Of course, for large estates (over $2 million plus), making taxable gifts will reduce the Massachusetts estate tax and hence reduce the deduction under Code § 2058 (and thus increase the federal tax), but the federal increase will by definition not offset the Massachusetts decrease.

Note that one of the traditional tax reasons for making taxable gifts also still applies: all of the appreciation on the gifted assets between date of gift and date of death is removed from the taxable estate. This benefit may still be obtained. The other traditional tax reason for making taxable gifts is, however, less certain. In the past, it made more sense to pay some gift tax than to pay estate tax, because the gift tax is tax-exclusive whereas the estate tax is tax-inclusive. 14 That is, in an estate, the tax is also taxed, but this is not true in the gift context. Due to the difference in the federal exclusion amounts for the estate and gift taxes, however, as well as to uncertainty about what the estate tax law will look like in coming years, taxable gifts that actually incur a gift tax are no longer as attractive.

Lest the reader come away with the impression that the technique presented here

<table>
<thead>
<tr>
<th>Taxable Estate before Making Gift</th>
<th>Massachusetts Estate Tax Savings</th>
</tr>
</thead>
<tbody>
<tr>
<td>$1,500,000</td>
<td>$64,400</td>
</tr>
<tr>
<td>$2,000,000</td>
<td>$66,400</td>
</tr>
<tr>
<td>$2,500,000</td>
<td>$74,400</td>
</tr>
<tr>
<td>$3,000,000</td>
<td>$82,400</td>
</tr>
<tr>
<td>$3,500,000</td>
<td>$90,400</td>
</tr>
<tr>
<td>$4,000,000</td>
<td>$98,400</td>
</tr>
</tbody>
</table>

fig. 1
is controversial, risky, or purely theoretical, I conclude with a discussion of several of the Massachusetts Department of Revenue’s pronouncements on the subject. The Department of Revenue has issued two publications that, both individually and taken together, can be read to suggest that taxable gifts must in fact be taken into account when figuring the Massachusetts estate tax: DOR Directive 03-2 and the Instructions for filling out Form M-706, Massachusetts Estate Tax Return. A close reading of these two publications reveals, however, that this is not the case. DOR Directive 03-2, “Issues Arising from Decoupling the Massachusetts Estate Tax from the Federal Estate Tax,” simply points out that for decedents dying on or after Jan. 1, 2003, the filing thresholds are different for Massachusetts and federal estate tax purposes. This is, of course, true. This directive makes absolutely no mention of gift tax or of taxable gifts. As observed previously, moreover, for the purposes of the Massachusetts estate tax, the filing threshold has no bearing on the amount of tax due.

To see why this is the case, we need to look more closely at the DOR’s other pronouncement on the subject, which is contained in the Instructions for Filing Form M-706. At first glance, these instructions can be read to suggest that making taxable gifts will affect the amount of Massachusetts estate tax. The instructions read:

To determine whether a return must be filed for a decedent’s estate, add:

1. the adjusted taxable gifts (under section 2001(b)) made by the decedent after Dec. 31, 1976;
2. the total specific exemption allowed under section 2521 (as in effect before its repeal by the Tax Reform Act of 1976) for gifts made by the decedent after September 8, 1976; and
3. the decedent’s gross estate valued at the date of death. (M-706 Instructions, page 1; emphasis in original).

The Instructions go on to state that “Adjusted taxable gifts affect the Massachusetts filing threshold but are not added to the taxable estate.” Id.

This is the key point. The problem is that it seems counterintuitive that making taxable gifts can affect one’s Massachusetts filing threshold but not the amount of tax due. To see how this can be the case, it is necessary to recall the procedure for filing a Massachusetts estate tax return for decedents dying in 2003 and later. Recall that the DOR now requires that a decedent’s estate, if it is large enough to be taxable, file not one, but at least two and in many cases three estate tax returns with the DOR, as follows: A decedent with an estate that is taxable for Massachusetts purposes—i.e., over the Massachusetts filing threshold of $1,000,000—must file not only Form M-706 but also the now outdated federal Form 706 that was in use in the year 2000. Estates must file this form because the Massachusetts estate tax is currently set equal to the credit for state death taxes as it would have been under federal law as it existed in the year 2000, and to figure out what this credit would have been, one must fill out and file with the DOR the federal estate tax return that was in use in the year 2000—using, however, not the year 2000 unified credit, but the unified credit as it would have been for the year of death under year 2000 law. It is this phantom federal return—“phantom” because it is only filled out for Massachusetts purposes and of course never filed with the federal government—that determines the Massachusetts filing threshold, according to the DOR.

If we look at the phantom federal return itself—i.e., the July 1999 revision of federal Form 706—everything should become clear. The directly relevant lines of this form are lines 3, 6, 13, and 15.

Line 3 is the taxable estate (gross estate minus allowable deductions).
Line 4 is the adjusted taxable gifts.
Line 5 is the sum of lines 3 and 4.
Line 6 is the tentative tax on the amount in line 5.
Line 13 is the allowable unified credit.

Finally, an example of how the phantom federal return would actually be filled out is in order. For example, a decedent who had a $900,000 taxable estate and had made gifts of $600,000 during lifetime would have the following (for death in 2008) filled in on the phantom federal return:

<table>
<thead>
<tr>
<th>Line</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>3</td>
<td>$900,000</td>
</tr>
<tr>
<td>4</td>
<td>$600,000</td>
</tr>
<tr>
<td>5</td>
<td>$1,500,000</td>
</tr>
<tr>
<td>6</td>
<td>$555,800</td>
</tr>
<tr>
<td>13</td>
<td>$345,800</td>
</tr>
<tr>
<td>15</td>
<td>$27,600</td>
</tr>
</tbody>
</table>

Note that line 5 is the sum of adjusted taxable gifts and the taxable estate, and since line 5 is over $1 million, a Massachusetts estate tax return must be filed, even though the Massachusetts taxable estate (line 3) is under the exemption amount. Moreover, even though the Massachusetts taxable estate is under the exemption amount, there is still a Massachusetts estate tax due (hence my earlier remark that the exemption amount has no bearing on the amount of tax due). The credit for state death taxes under year 2000 law would have been $27,600, which is less than the federal tax that would have been due in 2000 (i.e., $210,000, obtained by subtracting line 13 from line 6 above), and so the Massachusetts estate tax is equal to the credit for state death taxes under year 2000 law, or $27,600.

If on the other hand the same decedent had made no taxable gifts, the phantom federal return would have the following:

<table>
<thead>
<tr>
<th>Line</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>3</td>
<td>$1,500,000</td>
</tr>
<tr>
<td>4</td>
<td>$0</td>
</tr>
<tr>
<td>5</td>
<td>$1,500,000</td>
</tr>
<tr>
<td>6</td>
<td>$555,800</td>
</tr>
<tr>
<td>13</td>
<td>$345,800</td>
</tr>
<tr>
<td>15</td>
<td>$64,400</td>
</tr>
</tbody>
</table>

There is no 2008 federal tax due in either case because the taxable estate plus adjusted taxable gifts (line 5) is under $2,000,000. Line 15 on the phantom federal form, credit for state death taxes, again gives the Massachusetts estate tax, and here we see that by making gifts that were taxable gifts (but not taxed) for federal purposes, the decedent has saved $36,800 in Massachusetts estate taxes.
End notes

2. An informal survey I took at a recent meeting of Massachusetts estate planning practitioners revealed that not a single one of the 30 or so practitioners in attendance was familiar with the technique, even though many of us have been using it for six years now.
4. This is the exemption that would have been available in 2008 under federal law as in effect on Dec. 31, 2000 if EGTRRA had not been enacted. M.G.L. c. 65C, §2A.
5. It is important to note that the Massachusetts estate tax is levied on the adjusted taxable estate—i.e., the taxable estate minus $60,000 (26 U.S.C. § 2011(b)(3) (2000))—and not on the difference between the taxable estate and the Massachusetts exemption amount.
7. To the extent that it exceeds the annual exclusion from gift taxes available under 26 U.S.C. § 2503 (2008). The annual exclusion is $12,000 in 2008, so assuming that there is only one donee for this $1 million gift, $988,000 of the gift is taxable.
8. 26 U.S.C. § 2001(b)(1)(B) (2008). Actually, to be precise, D’s federal taxable estate is now $1,988,000 because the $12,000 annual exclusion amount included in the gift disappears into thin air for transfer tax purposes.
9. It is important to note that there is still an estate tax even though the Massachusetts exemption is currently $1 million. This is because the exemption amount/unified credit is and always was independent of the credit for state death taxes, which is what the Massachusetts estate tax is equal to. Adjusted taxable gifts must be added back in to determine whether it is necessary to file a Massachusetts estate tax return, but they have no bearing on the amount of the tax, which is calculated independently of the exemption amount. This is counterintuitive; see further below.
10. The term “unified credit” is still in widespread use and still in fact used by the Code, (26 U.S.C. § 2010 (2008)), even though of course the credit for estate taxes has, since EGTRRA was enacted, been different from the credit for gift taxes. I therefore believe that it is clearer and causes less confusion to speak in terms of an “exemption.”
11. The exemption/unified credit amount is relevant for determining this amount, of course, and hence it is also relevant for determining the pre-EGTRRA credit for state death taxes and hence the post-EGTRRA Massachusetts estate tax. But it comes in through the back door, as it were.
12. Under prior law, it was useful when envisaging the Massachusetts estate tax to think in terms of “crossover points”: i.e., points at which the tax calculation flips from one mode of calculation to another. There were two crossover points for Massachusetts estate tax calculation purposes: the upper crossover point (relevant only from 2002 through 2004), above which it didn’t matter what you gave away (because the modified sponge tax system then in effect erased the benefit of removing taxable gifts from the Massachusetts estate), and the lower crossover point, below which the credit for state death taxes was limited to what the federal estate taxes would have been under pre-EGTRRA law.

Under post-EGTRRA law, we have the anomalous (from a sponge tax perspective) situation that the credit for state death taxes under pre-EGTRRA federal law—which is, of course, the same thing as the Massachusetts estate tax as currently formulated—can in fact be higher than the federal tax under current law (this is, for example, obviously the case for any taxable estate the value of which falls in between the amount of the Massachusetts exemption and the amount of the federal exemption). This is why the Massachusetts legislature enacted the current version of the Massachusetts estate tax law: they no longer wanted the Massachusetts estate tax to have as its upper limit the amount of the federal estate tax.

The place where this stopped happening from 2002 to 2004—i.e., where the federal tax began to outstrip the Massachusetts tax—was the upper crossover point. This point is relevant under a tax credit system because at this point the actual federal tax under a credit system, which is of course equal to the tentative federal tax minus the credit for state death taxes, is zero because the credit for state death taxes is at this crossover point precisely equal to the tentative federal tax. Again, this upper...
crossover point was different from the lower crossover point only under the modified credit system in effect from 2002 to 2004; under a pure sponge tax system, there is only one crossover point because there is no estate size below which one can save overall taxes by making adjusted taxable gifts. The important point for our present purposes is that there is no longer an upper crossover point: once you are above the lower crossover point, there is no longer a point at which making adjusted taxable gifts does not reduce the overall tax burden.

13. Under a sponge tax system (i.e., pre-EGTRRA), it makes absolutely no difference in total estate taxes paid whether a taxpayer with $1.5 million gave $500,000 away before death and died with $1 million in her estate or whether that taxpayer gave nothing away before death and died with $1.5 million in her estate: Massachusetts is still getting less under the gift-giving option, but the federal government is getting just as much more.

14. For example, if the tax rate were a flat 50 percent, and one wanted to pass on, say, $500,000 to one’s children, one would need $750,000 to do so by way of an inter-vivos gift (i.e., $500,000 gift plus $250,000 tax on that gift), but a full $1 million to do so by way of a bequest in one’s will (i.e., on this $1 million, there would be a tax of $500,000, which would leave $500,000 to go to the children).

15. The unified credit in 2000 was $220,550, and in 2008 it is $345,800, because, even though there is no longer a unified credit under federal law, under federal law as it existed in the year 2000, there would have been a unified credit of $345,800 in 2008.

16. The third return that must be filed with the DOR in many cases is the actual federal return as filed—i.e., the real federal return, and not just a phantom one that represents what would have been filed with the Internal Revenue Service if the federal tax law had not changed under EGTRRA—which of course must only be filed with the DOR for estates of decedents whose taxable estates were over the federal threshold and hence were actually required to file a federal return.

17. The situation is further complicated because for the purpose of determining whether a Massachusetts estate tax return must be filed, one looks at the gross estate, and not the taxable estate. For simplicity, the above example assumes no allowable deductions. The gross estate is only relevant for determining whether a Massachusetts return must be filed and for nothing else, since all tax calculations use the taxable estate or the adjusted taxable estate as their basis. In other words, if the gross estate is over $1 million and the taxable estate is under $1 million—such as would typically be the case with standard zero-out marital deduction planning, for example—then (even if there are no adjusted taxable gifts) a Massachusetts return must be filed, but the Massachusetts estate tax return will be a purely informational return and no tax will be due. This has always been the case.
The New Tax Return Preparer’s Standards

By Lisa M. Rico

The Small Business and Work Opportunity Tax Act signed into law on May 25, 2007 (Pub. L. No. 110-28) amended section 6694 of the Internal Revenue Code by raising the standard of conduct for tax return preparers to avoid the imposition of penalties, expanding the scope of tax return preparers to which the penalties apply, and increasing the penalties on tax return preparers. At the same time the 2007 Act amended section 7701(a)(36) of the Code to remove the definition of income tax return preparer and replace it with a definition for tax return preparer.

Prior law

Prior to its amendment, Code section 6694 imposed a $250 penalty on any income tax return preparer with respect to an understatement of liability on a return or a claim for refund which the income tax return preparer knew, or reasonably should have known, was due to a position for which there was not a realistic possibility of being sustained on its merits and such position was not disclosed or was frivolous. The penalty could be avoided if the income tax return preparer acted in good faith and showed that there was reasonable cause for the understatement (the “Good Faith Reasonable Cause Exception”). If the understatement of liability was due to a willful attempt in any manner to understate the tax liability by the income tax return preparer on a return or claim for refund, or to a reckless or intentional disregard of rules or regulations by the income tax return preparer, then the penalty imposed was $1,000 reduced by the $250 penalty paid by the income tax return preparer by reason of taking a position for which there was not a realistic possibility of being sustained on its merits.

Changes made by the 2007 act

For returns prepared after May 25, 2007, Code section 6694(a) imposes a penalty on any tax return preparer who prepares any return or claim for refund with respect to which any part of the understatement of liability is due to an unreasonable position (the “Section 6694 Penalty”). A tax return position is unreasonable if (i) the tax return preparer knew, or reasonably should have known, of the position, (ii) the tax return preparer did not have a reasonable belief that the position would more likely than not be sustained on its merits, and (iii) the position was not properly disclosed on the return, or there was no reasonable basis for the position. The penalty for taking an unreasonable position is the greater of $1,000 or one-half of the income derived, or to be derived, by the tax return preparer with respect to the return or claim. The Good Faith Reasonable Cause Exception continues to apply. The standard of conduct for a willful attempt in any manner to understatement the tax liability by the tax return preparer for a return or claim for refund, or for a reckless or intentional disregard of rules or regulations have remained the same. However, the penalties for this type of conduct have been increased to the greater of $5,000 or one-half of the income derived, or to be derived, by the tax return preparer with respect to the claim or refund.

At the same time as raising the standard to an unreasonable position, the amended Code section 6694 expands the scope of those persons subject to penalties from income tax return preparers with respect to income tax returns or claims for refunds to tax return preparers with respect to any returns or claims for refund. The amended Code section 7701(a)(36) now defines tax return preparer as any person that for compensation prepares, or employs other people to prepare, any tax return or any claim for refund of tax, or a substantial portion of a tax return or claim for refund.

Lisa M. Rico is a partner at McCarter & English, LLP in Boston. She concentrates her practice on estate, gift, generation-skipping transfer and income tax planning for high net worth individuals, estate and trust administration, and the representation of nonprofit organizations and charitable trusts.
Proposed changes to circular 230

In order to conform the professional standards for practice before the Internal Revenue Service with the civil penalties for tax return preparers, the Department of Treasury issued proposed regulations to Circular 230 on Sept. 24, 2007. Under the proposed regulations, section 10.34(a) of Circular 230 has been amended to provide that a tax practitioner may not sign a tax return as a preparer, or advise a client to take a position on a tax return, unless the practitioner has a reasonable belief that the tax treatment of each position on the return would more likely than not be sustained on its merits, or there is a reasonable basis for each position on the return and such positions are adequately disclosed to the IRS.

The changes made by the 2007 Act increase the standard for tax return preparers from a realistic possibility of being sustained on the merits, which under Treasury Regulation section 1.6694-2(b)(1) requires that the income tax return preparer conclude that a position is likely to be sustained by at least a one-and-three chance, to a standard which requires a more than 50 percent likelihood of being sustained on its merits. Not only is this an increase in the tax return preparer standard, but it also imposes a higher standard on tax return preparers than for the imposition of penalties on taxpayers. Under Code section 6662(d), a taxpayer is subject to penalty for a substantial understatement of tax liability unless the taxpayer had substantial authority for the tax position, or the facts regarding the tax position are adequately disclosed and there is a reasonable basis for such position (the “Section 6662(d) Standards”). Under Treasury Regulation section 1.6662-4(d)(3), the substantial authority standard is less stringent than the more likely than not standard, which requires a 50 percent likelihood of being sustained on its merits, but more stringent than the reasonable basis standard. The substantial authority standard requires approximately a 40 percent likelihood that the tax position will be sustained on its merits. This creates a conflict of interest for tax return preparers and could create a situation where a taxpayer is required to report a position on a return that he may not have otherwise reported solely to allow the tax return preparer to avoid penalties.

These changes have raised many questions among practitioners. Who is a tax return preparer? How does Code section 7701(a)(36) apply to signing and non-signing tax return preparers? What constitutes the preparation of a return or claim for refund? What if the tax position has substantial authority but it is not more likely than not to be sustained on its merits; how does the tax return preparer advise the taxpayer? Are taxpayers better off preparing and filing their own returns? While some of these questions are not new and the regulations under Code section 6694 deal with the definition of income tax return preparer, given the increase in the penalties on tax return preparers and the broadening of the type of tax return preparers subject to penalties, the questions have become more significant.

IRS relief and guidance

In light of the questions that have arisen due to the change in the standards of conduct for tax return preparers to avoid penalties, the Treasury Department and the IRS have issued guidance on this matter, first in the form of transitional relief with the issuance of Notice 2007-54, 2007-27 I.R.B. 12, on June 11, 2007, and then with the issuance of Notices 2008-11, 2008-3 I.R.B. 279, and 2008-13, 2008-3 I.R.B. 282 on Dec. 31, 2007. The Treasury Department and the IRS issued its transitional relief so that they can prepare for the effective tax administration of the new law, which they indicated will require changes to relevant forms and publications as well as altering existing procedures in order to process disclosures with certain forms and in electronic formats.

Notice 2007-54 and Notice 2008-11

The transitional relief under Notice 2007-54 applied to all returns, amended returns and refund claims due before Jan. 1, 2008, to 2007 estimated returns due before Jan. 16, 2008, and to 2007 employment and excise tax returns due before Feb. 1, 2008. Under Notice 2007-54, the IRS will apply the law prior to the change to Code section 6694 and the current section 6694 regulations in determining whether to impose a Section 6694(a) Penalty for income tax returns, amended returns and refunded claims. For all other returns and claims for refund, the IRS will apply the reasonable basis standard in the Section 6662 regulations in determining whether to impose a Section 6694(a) penalty. No transitional relief was provided under this notice with respect to penalties relating to a willful attempt in any manner by a tax return preparer to understate tax liability or to any reckless or intentional disregard of rules or regulations by a tax return preparer. Notice 2008-11 was issued to clarify Notice 2007-54.

Notice 2008-11 clarified Notice 2007-54 in three ways. First, by providing that the transitional relief described in Notice 2007-54 applies to timely amended returns or claims for refunds, other than 2007 employment and excise tax returns, filed on or before Dec. 31, 2007, and timely amended employment and excise tax returns or claims for refund filed on or before Jan. 31, 2008. Second, Notice 2008-11 clarified that the transitional relief applies to original returns, other than 2007 employment and excise tax returns, filed on or before Dec. 31, 2007, and to original employment and excise tax returns filed on or before Jan. 31, 2008, regardless of the extension due date. And finally, the transitional relief was clarified by providing that it applies to non-signing preparers for advice provided on or before Dec. 31, 2007.

Notice 2008-13

With the issuance of Notice 2008-13, the Treasury Department and the IRS provided interim guidance regarding the application
of the new tax return preparer penalties under Code section 6694.

The notice sets forth in exhibits which tax returns or claims for refunds are covered by Code section 6694. The notice provides that a claim for refund of tax also includes a claim for credit against any tax. Exhibit 1 of Notice 2008-13 sets forth the returns or claims for refund to which Code section 6694 will apply and a tax return preparer will include a tax return preparer who prepares any returns set forth in Exhibit 1. Exhibit 1 includes, but is not limited to: Form 990-PF, Return of Private Foundation; Form 990T, Exempt Organization Business Income Tax Return; Form 1040, U.S. Individual Income Tax Return; Form 1040-A, U.S. Individual Income Tax Return; Form 1040-EZ, Income Tax Return for Single Filers and Joint Filers with No Dependents; Form 1041, U.S. Income Tax Return for Estates and Trusts; Form 1120, U.S. Corporations Income Tax Return; Form 1120S, Income Tax Return for an S Corporation; Form 706, U.S. Estate Tax Return; Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return; and certain employment tax returns - Form 940, Form 940-PR, Form 941, Form 943, and Form 944.

Exhibit 2 sets forth information returns which will be subject to Code section 6694 if such information return includes information that is or may be reported on the taxpayer's return or claim for refund to which Code section 6694 could apply if the information reported constitutes a substantial portion of the taxpayer's tax return or claim for refund. Exhibit 2 includes, but is not limited to: Form 1065, U.S. Return of Partnership Income; Form 1120S, U.S. Income Tax Return for an S Corporation; Form 8038, Information Return for a Tax-Exempt Private Activity Bond Issue; and Form 8038-G, Information Return for a Government Purpose Tax-Exempt Bond Issue.

Exhibit 3 sets forth documents that would not subject a tax return preparer to the Code section 6694 penalties unless such document was prepared so as to willfully in any manner understate the tax liability or was prepared in reckless or intentional disregard of the rules or regulations. Exhibit 3 documents include, but are not limited to: Form 1099; Form W-2; Form SS-8; Form 990, Return of Organization Exempt from Income Tax; Form 1040-ES, Estimated Tax for Individuals; Form 1120-W, Estimated Tax for Corporations; Form 2350, Application for Extension of Time to File U.S. Income Tax Return; Form 4768, Application for Extension of Time to File Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes; Form 4868, Application for Automatic Extension of Time to File U.S. Individual Income Tax Returns; Form 8868, Application for Extension of Time to File an Exempt Organization Return; Form 8892, Application for Automatic Extension of Time to File Form 709 and/or Payment of Gift/Generation-Skipping Transfer Tax. Practitioners should refer to Notice 2008-13 for a complete listing of returns and/or other documents to determine whether and how any return which a practitioner may be preparing or providing advice on is affected by the amendments to Code section 6694.

The notice then goes on to address inconsistencies between the new law and the existing regulations. Pursuant to the notice, the definition of income tax return preparer under Treasury Regulations sections 1.6694-1, 1.6694-3 and 301.7701-15 is modified to eliminate the word “income” so that the regulations conform to the current amendments made under the 2007 Act. In addition, the definition of returns and claims for refunds under these regulations have been expanded to returns of the tax and claims for refunds with respect to income taxes, estate and gift taxes, employment taxes and excise taxes. The notice also provides guidance as to the interpretation of "substantial portion" in determining what constitutes a substantial portion of a return for purposes of the definition of tax return preparer under Treasury Regulations Section 301.7701-15(b)(1). The notice provides that substantial portion means a schedule, entry, or other portion of a tax return or claim for refund that, if adjusted or disallowed, could result in a deficiency determination, or disallowance of refund claim, that the preparer knows or reasonably should know is a significant portion of the tax liability reported on the return (or, in the case of a claim for refund, a significant portion of the tax originally reported or previously adjusted). A practitioner preparing a substantial portion of a return or claim for refund is a tax return preparer for purposes of Code sections 6694 and 7701(a)(36).

Under Notice 2008-13, for purposes of Code section 6694, a tax return preparer is considered reasonably to believe that the tax treatment of an item is more likely than not the proper tax treatment if the tax return preparer analyzes the pertinent facts and authorities in a manner provided in Treasury Regulations section 1.6662-4(d)(3)(ii) for determining whether substantial authority is present and, based upon that analysis, reasonably concludes in good faith that there is a greater than 50 percent likelihood that the tax treatment of the item will be upheld on a challenge by the IRS. In making such a determination a tax return preparer may rely in good faith without verification upon information furnished by the taxpayer, by another advisor, tax return preparer or other third party. A tax return preparer is not required to independently verify or review the items reported on the tax returns, schedules or other third-party documents to determine if the items meet the standard requiring a reasonable belief that the tax position would more likely than not be sustained on the merits. However, the tax return preparer may not ignore the implications of information furnished to the tax return preparer or actually known to the tax return preparer. If the tax return preparer receives information that appears to be incorrect or incomplete, the tax return preparer must make reasonable inquiries to the provider of such information in order for the standard to apply.

The guidance further provides that the reasonable basis standard under the Section 6662(d) Standards will apply for purposes of Code section 6694. The same rules regarding good faith reliance on information furnished by a third party for the reasonable belief standard as described in the prior paragraph apply to the reasonable basis standard. Generally, the rules applicable to the Good Faith Reasonable Cause Exception continue to apply, except that the notice changes the regulations such that a tax return preparer is considered to have acted in good faith if the tax return preparer relied on the advice of a third party who is not in the same firm as the tax return preparer, which replaces “another preparer” under the existing regulations, and who the tax return preparer had reason to believe was competent to render such advice.

The interim penalty compliance rules set
forth in Notice 2008-13 provide that, for the purposes of Code section 6694, a signing tax return preparer shall be deemed to meet the requirements of Code section 6694 with respect to a tax position for which there is a reasonable basis but for which a tax return preparer does not have a reasonable belief the position would more likely than not be sustained on its merits, if a tax return preparer meets any of the following requirements:

1. The position is properly disclosed.
2. The tax return preparer provides the taxpayer with a prepared tax return that includes the proper disclosure, if the position would not otherwise meet the Section 6662(d) standards without disclosure.
3. If there is substantial authority for the tax, the tax return preparer advises the taxpayer of the difference between the Section 6662(d) standards applicable to the taxpayer and the penalty provisions applicable to the tax return preparer under Code section 6694, and contemporaneously documents in the tax return preparer’s files that this advice was provided.
4. If the Section 6662(d) standards do not apply because the position is attributable to a tax shelter, the tax return preparer advises the taxpayer of the penalty standards applicable to the taxpayer under Code section 6694(d)(2)(C) and the difference, if any, between these standards and the standards under Code section 6694, and contemporaneously documents in the tax return preparer’s files that this advice was provided.

For purposes of Code section 6694, a non-signing tax return preparer shall be deemed to meet the requirements of the amended Code section 6694 with respect to a tax position for which there is a reasonable basis but for which the non-signing tax return preparer does not have a reasonable basis that the tax position would be more likely than not sustained on its merits, if a tax return preparer meets any of the following requirements:

1. The position is properly disclosed.
2. The tax return preparer provides the taxpayer with a prepared tax return that includes the proper disclosure, if the position would not otherwise meet the Section 6662(d) standards without disclosure.
3. If there is substantial authority for the tax, the tax return preparer advises the taxpayer of the difference between the Section 6662(d) standards applicable to the taxpayer and the penalty provisions applicable to the tax return preparer under Code section 6694, and contemporaneously documents in the tax return preparer’s files that this advice was provided.
4. If the Section 6662(d) standards do not apply because the position is attributable to a tax shelter, the tax return preparer advises the taxpayer of the penalty standards applicable to the taxpayer under Code section 6694(d)(2)(C) and the difference, if any, between these standards and the standards under Code section 6694, and contemporaneously documents in the tax return preparer’s files that this advice was provided.

End notes

1. The form 1120S is actually included in both Exhibit 1 and Exhibit 2.
2. Id.