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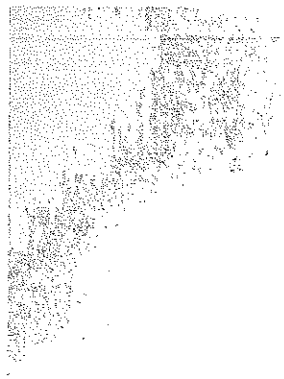

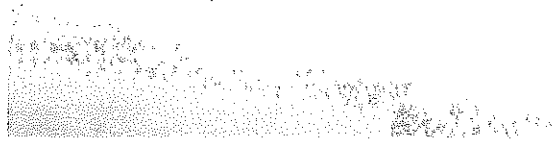

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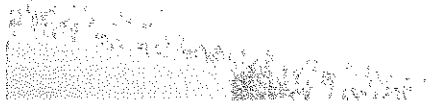

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The Rule of Law: Our Debt to Justinian and the Italian Communes (Eleventh to Twelfth Century).

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Lecture, April 10, 1996, before the Justinian Law Society of Rhode Island and the Brown University Friends of Italian Studies, The Anmary Brown Memorial, Brown University.

I. INTRODUCTION

The Italian communes of the twelfth century are well known as pioneers of democratic self-government. One of these communes, the city of Bologna, is also known as the seat of the first university founded in the early twelfth century on the study of a great law book, the *Corpus Juris Civilis*. This collection of laws and legal opinions was compiled at the order of the late Roman emperor Justinian in the sixth century at Constantinople, the then remaining capital of the all-Mediterranean Roman Empire, (today better known as the Turkish city of Istanbul). Oddly, while the democratic experience of the Italian communes faded into authoritarian and, in part, foreign governments on the Italian peninsula, the *Corpus Juris Civilis*, spread by Bologna students and by the students of other schools patterned after Bologna, became the law of most of the European continent. Down to the French Revolution and Napoleon, the *Corpus Juris Civilis* even retained its characteristic of being the law of the Roman Emperors in the hands of their self-styled heirs, the Habsburg emperors residing at Innsbruck or Vienna. The standard Gothofredus edition of 1688 has the effigy of the Habsburg emperor Leopold I as its frontispiece.[1] These were two very

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1. *Corpus Juris Civilis In Quatuor Partes Distinctum* [hereinafter "Corpus Juris Civilis"], Dionysius Gothofredus JC. Auctor, cum privilegio sacrae caesareae majestatis. (Frankfurt, 1688). Gothofredus was the French humanist Denis Godefroy (1549-1621), leader among the *culti jurisprudentes*. This group of learned jurists reconstructed ancient law texts using the methods of philological criticism of the Italian Renaissance and particularly of the Milanese scholar Andrea Alciato (1492-1550). Godefroy prepared a dependable edition of the *Corpus Juris Civilis* and the laws added in later centuries. His work would be frequently republished for the use of European legists. *See also* Ugo Gualazzini, La 'Constitutio Pacis Constantiae' quattro secoli dopo la sua emanazione nelle chiose di Denis Godefroy (1583), *in* Studi sulla Pace di Costanza 119-120 (Piero Castignoli, ed., Milan, 1984). JOHN MOOREHEAD, JUSTINIAN 33-35 (London, 1994) (discussing Justinian and Roman law). *See gener-*

different and separate historical fortunes that began in the late eleventh and early twelfth centuries, each starting on its own and going its own way.

But were they really that different and that separate, or were they at the outset intimately related and interdependent? The answer to this question will be sought in this article. Finding this answer is vital for understanding the interdependence between a free society and law. In our century filled with random violence, terrorism, atrocities, and mass-killings, this is no mean concern. Necessarily, there are three stages in which we must approach the question. We must first understand the historical background, how the communes first appear in it, and how the *Corpus Juris Civilis* resurfaces at the end of the eleventh century. We must second, trace how historical scholarship since the Second World War has deepened our understanding of the rise of the communes and the return to Roman Law. Finally, we must search for links in this deepened historical perspective between the communes and the return to Roman Law, and recognize the implications of these links for an understanding of a free society under the rule of law.

II. ELEVENTH CENTURY TOWNS TORN BY SOCIAL AND RELIGIOUS STRIFE: THE COMMUNES AND THE *DIGEST* OF JUSTINIAN

The frame for our investigation is a political entity which no longer exists: the early Kingdom of Italy. It was created by a Germanic tribe from north of the Alps, the Lombards, who in 568 invaded Italy, then still part of the Roman Empire. Compared with present day Italy, the Lombard kingdom was much more compact, comprising only the north and center of the peninsula. The Po Valley, the heart of the Lombard Kingdom, is one of the most fertile regions of Europe. The kings ruled from a capital at the center of the valley, Pavia. But this changed after 950 when the crown passed to royal houses outside Italy, the German Saxon and Salian kings. These absentee rulers had to delegate their powers to important noblemen and bishops, who governed their regions or cities as representatives of a distant king. From the start, the Saxon and Salian rulers tried to compensate for their absence by an increase in prestige, having themselves crowned in Rome by the pope as emperors, successors of the ancient Roman Emperors. This pattern, begun by Emperor Otto I in 962, did not work too well in the eleventh century. Population increased rapidly in town and country and pressed for new opportunities in land reclamation and improvement and in manufacture and long distance trade from cities like Pisa, Genoa, Venice, Piacenza, Cremona, Milan, and Asti. The cavalrymen, the knights, who were needed by the magnates and bishops to enforce their delegated royal authority, were dissatisfied with holding the farms which were given to them for their

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ally DANIEL WALEY, THE ITALIAN CITY-REPUBLICS (London, 3d. ed., 1988) (chapter 1: The legacy of power; chapter 3: The government, and chapter 7: The failure of the republics).

support only for the length of their service, and they wanted their position and their landholdings to become hereditary. The townspeople chafed under the exactions of their bishop for the use of the town-pastures, the roads and gates, and the port and the water rights usually granted to him by the king.

The prosperous Cremona on the Po river is typical. Apparently taking advantage of the young Emperor Otto III, age 17, on his first trek to Italy in 996, the citizens of Cremona persuaded him to grant them the port on the river and other rights which earlier rulers had given to their bishop. The bishop, of course, protested proving his prior right, and Otto III, angered by the "diabolic fraud" of the citizenry, reconfirmed the bishop in his rights. But the matter did not end there. The citizens allied themselves with the knights and continued for half a century to fight their bishops and the higher nobility, the major leaseholders of church lands and rights, driving them at times out of the city.[2]

As much as their obligations across the Alps would permit, the emperors tried to deal fairly with the contending forces. Their chanceries, on the move with them, would renew privileges on the basis of earlier charters, and they themselves or their special envoys would hold judicial court-sessions according to the laws recognized in the region. Local men with legal experience advised on these laws as assessors. The laws varied a good deal from region to region and were also different according to the parties in the court-action. For the old Roman population, the laws were the surviving Roman customs, here and there briefly touched by the *Corpus Juris Civilis* introduced by Justinian in the 6th century, but then swept away by the Lombard invasion. For the immigrant population, the law was that of the Lombard tribe, written down in compilations of Lombard kings at Pavia. Other Germanic newcomers were entitled to their own tribal custom and usually declared themselves in the court-sessions as of Frankish, Alemannic, Burgundian, or Saxon law. By the eleventh century, the variety of applicable laws were compiled in written legal guides, the chronological compilation known as the Book of Pavia, the *Liber Papiensis*, and the topical compilation, the *Lombarda*.[3]

With the eleventh century and rapid social change, the emperors realized that more was needed than their seeing to the equitable application of customary law and the confirmation of existing rights. A successor of Otto III, Conrad II, took the bold step of securing the rights of the knights by declaring the heredity of the lands held for service, their fiefs, the *Constitutio de Feudis* of 1037.[4] But

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2. REINHOLD SCHUMANN, AUTHORITY AND THE COMMUNE, PARMA 833-1133, 177-180 (Parma, 1973). *See also* Robert Holtzmann, Geschichte der sächsischen Kaiserzeit 180-183, 190-200, 332-334 (Munich 1941). *See also* O.C. MITCHELL, TWO GERMAN CROWNS. MONARCHY AND EMPIRE IN MEDIEVAL GERMANY (Bristol, 1985).

3. MANLIO BELLOMO, THE COMMON LEGAL PAST OF EUROPE 1000-1800, 83 (Washington, D.C., 1995).

4. Cinzio Violante, La società milanese nell'età precomunale 245-251 (Bari, 2d. ed., 1974). *See also* Karl Hampe, Deutsche Kaisergeschichte in der Zeit der Salier und Staufer 16-18 (Leipzig, 1945).

such legislation, while necessary, fanned the hostility of those who were left out, some magnates and townspeople. In Milan, the chief leaseholders of church lands, the *capitanei*, sided with their bishop, Aribert, in an on-going revolt against Conrad II. In Parma, the people rose against Conrad while he was celebrating Christmas in the bishop's palace. It was hazardous for the emperors to steer an even handed course between vital interests in conflict. Conrad's exclamation, "If Italy thirsts for law, I shall give it its fill of law," was less a solution than a foreboding.[5]

Under Conrad II's son and grandson, the emperorship itself would enter a major crisis. This crisis was related to the heightened religious awareness of populations already restless in economic and social matters in Italy and across the Alps. Religious men must be free from material ties to serve God and the eternal salvation of their flock. Starting with perfectionist teaching at the abbey of Cluny in Burgundy, three practices were sharply condemned at mid-eleventh century: a married clergy, the buying of religious offices, and the appointment to them by lay-lords. These practices were not necessarily the signs of the worldly corruption of the church seen by the reformers but had grown from practical needs. A married lower clergy existed in the Greek Church, neighboring on the Kingdom of Italy in the south, still governed until the mid-eleventh century from Constantinople. An important part of the kingdom, the Romagna, belonged to the Greek emperors until the eighth century. Bishops would in part finance their diocese with payments for the appointment of the lower clergy from the latters' land rents. Lay lords who donated such lands for the service of the church would reserve the right to select suitable candidates for them. At the highest level, the emperors would appoint, that is invest, bishops. Under Henry III, the son of Conrad, the popes became reformists, and religious strife was added to social conflict. The grandson, Henry IV, confronted a Cluniac monk, Pope Gregory VII, who excommunicated him for appointing bishops and incited the reformist populace against his appointees. Riots in the towns, atrocities against the married clergy and their 'concubines' and retaliations in kind by arch-conservatives escalated in about 1075 in the Investiture Conflict.[6]

As these troubles reached their climax, a new citizen organization appeared, the *comune* or the commune. The word *comune* is related to the Latin plural *communia*, designating what was used in common by the townspeople, common pasture lands and other civic rights and properties. The *communia* usually were granted by the emperors to the bishops, and the bishops in turn controlled their

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5. *See* Violante, *supra* note 4, at 249 (citing Wipo, Gesta Chuonradi chapter 34 (Scriptores Rerum Germanicarum, III) "si Italia modo esurit legem, concedente Deo, bene legibus hanc satiabo"). Schumann, *supra* note 2, at 204-205.

6. *See generally* GERD TELLENBACH, THE CHURCH IN WESTERN EUROPE FROM THE TENTH TO THE EARLY TWELFTH CENTURY (Cambridge, England, 1993) (for information on the church movement and its political implications).

use by the townspeople. This was one of the earthly cares which the reformers objected to. The commune was a corporate creation that took over from the churchmen these earthly possessions. We find "men of trust," *boni homines*, administering the *communia*, on behalf of the commune. Since the turn of the twelfth century, these men of trust were called by the ancient Roman title, consuls, and were responsible to the townspeople in their meetings on the cathedral square or in a similar traditional locale. There is no record, though, of the original mechanism by which the communes, the men of trust, and the consuls came into being and with what official sanction they entered on their tasks. It was not possible to derive this mechanism from existing legal practice because the *Liber Papiensis* and the *Lombarda* were the fixation of customs from an earlier period of tribal immigration into Italy. True, the German emperors considered themselves the successors of the Roman emperors, but their experience in the German kingdom was equally the custom of the different tribes of which the kingdom was composed. The law enforcement which Conrad II vowed to bring to Italy was this experience of customary law. The resurfacing, in the time of the Investiture Conflict of the law book of Justinian from a still earlier age remained to be seen as a completely separate innovation from the appearance of the communes.[7]

It is generally accepted that the return to the study of Roman Law had its start in this time of strife through the discovery of a major part of the *Corpus Juris Civilis*, the *Digest*, and the study of this compilation of the legal opinions of Roman jurists by a teacher of rhetoric at the cathedral school of Bologna, Irnerius. By commenting on, or glossating, the writings of the Roman legists, Irnerius himself became a jurist. Between 1112 and 1115, he received imperial approval for a law school, the *studium* of Bologna, with an association, an *universitas*, of students, the beginning of the University of Bologna. The Roman Law trained jurists did not replace the practice of the *Liber Papiensis* and the *Lombarda* with Roman Law but penetrated and transformed this practice through the logic of their training in the reasoning of the Roman legists in the *Digest*. As the communes grew to form the major components of the Kingdom of Italy in the course of the twelfth and thirteenth centuries, the Roman Law trained lawyers became the essential professional component as judges, as advocates, and as formulators of the binding enactments regulating the life of the cities and their territories, the *Statuti*, the new form of statutory rather than customary law. This Roman Law professionalism was necessarily tied to the formal training of the law school and could not have existed before Irnerius and

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7. *See* Paul Joachimsen, *The Investiture Contest and the German Constitution in* 2 MEDIEVAL GERMANY 911-1250, 101-104 (Geoffrey Barraclough ed., Oxford, 1938) (on Conrad II enforcing law). *See* SCHUMANN, *supra* note 2, at 242-249 (on the appearance of the commune).

his official *studium*.[8] But this did not preclude the legists before Irnerius turned to Roman Law to find solutions for the urgent problems of their day.

III. THE ELEVENTH CENTURY ANTECEDENTS OF THE COMMUNES AND OF THE STUDY OF ROMAN LAW

An answer to the question whether the appearance of the communes and the return to the study of Roman Law were related and interdependent was not possible as long as scholarship had not progressed in two directions: (1) it had to penetrate more deeply into the origins of the communes, not just at the turn to the twelfth century but throughout the eleventh century; and (2) it had to probe into the renewal of Roman Law before Irnerius in a wider ark than the search for the origins of the University of Bologna. Both directions of scholarship were born out of the agonies of the Second World War and the mortal danger in which western democracy, and with it freedom under law, had found itself.

Part of the first direction was my own investigation of the pre-communal history of Parma, a bishop's city on the Via Emilia from the Po to the Adriatic. My guide was a great Italian scholar, Gaetano Salvemini, then at Harvard University. Salvemini believed that Parma would prove a good case study because it was a very 'normal' city of the Kingdom of Italy. My scrutiny of all the extant documents from the early ninth to the end of the twelfth century - the first remaining charter was from 833 - revealed a town population which gathered before the cathedral, apparently in continuation of a Roman tradition. They listened to the enactments of the count or bishop, apportioned public burdens among themselves and determined every family's share in the common pastures and other public rights, the already mentioned *communia*. In Parma, as elsewhere, these *communia* were royal property granted by the king-emperor to the bishop and did not become the basis of civic self-government in the ninth and tenth centuries. There was still a further limitation. The *communia* consisted of different 'packages' to which different groups — the old Roman population, the Lombard newcomers, the dependents of the bishop — had different rights.[9] Among the social pressures of the early eleventh century, it would become very difficult for the bishop to remain even-handed. The already mentioned attack of the people on Conrad II in the bishop's palace may very well have been an outburst against Conrad having favored the dependents of the bishop in his *Constitutio de Feudis*.

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8. Manlio Bellomo, Una nuova figura di intellettuale: il giurista, *in* Il secolo XI: Una svolta, Istituto storico italo-germanico 246 (Cinzio Violante and Johannes Fried eds., Bologna, 1993). *See also* Giorgio Speciale, La memoria del diritto comune: Sulle tracce d'uso del 'Codex' di Giustiniano (secoli XII-XV) (Rome, 1994).

9. REINHOLD SCHUMANN, A CRITICAL HISTORY OF THE GOVERNMENT OF PARMA AND ITS TERRITORY IN THE EARLY MIDDLE AGES (ABOUT 850-1133), 178, 211, 274-276, 289, 291 (Harvard University Doctoral Dissertation, October, 1950); SCHUMANN, *supra* note 2, at 182-190.

Under the stress of the religious reform movement, a far-seeing bishop, Cadalus (1045-1072; Antipope Honorius II 1061-1064), renewed the loyalty of the Parmese to the emperor by granting them autonomy within their city-walls. He transferred his residence, which was also the royal palace, outside the walls. Henceforth, the citizens would hold their own judicial court. By 1070-1080, the People of Parma, as an entity, became the chief owner jointly with the emperor and the bishop of the common lands, granting leases from them. Men of trust administered these and other *communia*. By 1119, the Commune of Parma, represented by consuls elected in the civic assembly, ruled the city and its surrounding territory. By the second half of the twelfth century, the commune was recognized as the highest judicial and military authority in the entire county of Parma.[10]

In 1949, Salvemini returned to his chair at the University of Florence. In Italy, rebuilding its democracy since the fall of Mussolini in 1943 and the end of the war in 1945, a deeper understanding of the communes was an urgent task. At the Istituto Italiano Per Gli Studi Storici, founded and directed by Benedetto Croce, the great philosopher who had been consistently critical of fascism, a young scholar, Cinzio Violante, devoted himself to a detailed documentary study of the precommunal society of Milan. He began his work in 1947, shortly after his release from a military hospital, and published his findings in 1953 as *La società milanese nell'età precomunale* (Milanese Society in the Precommunal Age). Violante showed the city as the focus of the restless pushing of social groups from below and from above: Serfs shed their dependence and acquired the lands they had labored on; knights acquired estates of their own; merchants invested their huge profits in civic and landed properties; the higher nobility played a game of long term royal and episcopal leases to build vast dominions; married ecclesiastics passed their ecclesiastical benefices on to children whom they married into the nobility; and the episcopal church first failed and then under Aribert, it succeeded in protecting and enlarging its landed wealth.[11]

The study of Violante revealed a complicated game of legal enactments for the acquisition and transfer of properties in the city and in the countryside. At the heart of the rise and fall of shifting classes and groups, there were traditional Roman contracts, 29 year leases, or *libelli*, and so called emphyteutic leases for three generations that were adapted for the goals of aggrandizement and recovery.[12] Other scholars contributed further technical and city-investigations, and a younger generation of searchers tackled the problem of pre-communal history on a broad regional basis. Among these, Renato Bordone, working on Piedmont, was particularly significant. In his book "The Society of Asti from the

10. SCHUMANN, *supra* note 9, at 301-307; SCHUMANN, *supra* note 2, at 206-210.
11. Violante, *supra* note 4, at 200-206.
12. *Id.* at 285-287.

Dominion of the Franks to the Assertion of the Commune" he analyzed the economic and power structure of both the city and the county of Asti.[13]

Many of the citizens of Asti were traders, preoccupied with the safety of the roads to France, to Genoa, and into the Lombard plain. Their bishop protected their long distance traffic, and, in 1037, Conrad II issued an imperial safeconduct on the road to Susa towards France.[14] As the upheavals of the Investiture Conflict subsided in the city and county of Asti, the consuls of Asti appeared for the first time. In 1095, the pro-imperial bishop of Asti granted them a castle, Annone, of which he was lord, protecting the road into the Po valley.[15] The consuls and the commune were technically the vassal of the lord-bishop in the act. But it was followed by ever more autonomous dealings of the commune and consuls with magnates in the county and in other parts of Piedmont. Without any participation of the bishop, these powerful men became the vassals of the commune through contractual arrangements for which notaries and judges, who were also consuls, were essential.[16]

In all three studies, Parma, Milan, and Asti, the time of Conrad II (1024-1039) appeared as a time of great ferment, in which the city-populations, unfree and free peasants, knights, and ecclesiastics all strove to better themselves. A new collective legal form was building up as the lord of civic common land, rights, revenue, and jurisdiction, who was usually the bishop, detached himself from these *communia* in favor of their users, the citizenry. The process was long-term and could expand beyond the *communia* to other properties of importance to the citizens. It could be confrontational as well as cooperative and was accelerated by the religious reform movement. Bishops were divesting themselves of properties not essential for their religious office but of great importance for the citizenry, like the autonomous jurisdiction of the Parmese within the city-walls and like the castle of Annone for the traders of Asti. The new term "commune" and its administration by consuls, elected by the civic assembly for a term of office, were prompted by this process. Commune and consuls were, in turn, the start of a new process by which they became, in the course of the twelfth century, the highest authority in the city and the county, independent of the bishop or count and, in their own estimation, only under the supreme authority of the emperor. The legal formulations of notaries and judges were essential for this long evolution. As Bordone put it, "From its very origin the commune . . . possesses within itself the tools to define itself, for all contingen-

13. Renato Bordone, Città e territorio nell'alto medioevo: La società astigiana dal dominio dei Franchi all'affermazione comunale (Deputazione subalpina di storia patria, Biblioteca storica subalpina, Turin, 1980).

14. Bordone, *supra* note 13, at 277-311.

15. *Id.* at 259, 351, 356-357.

16. *Id.* at 357-359, 359 n. 330.

cies, as a public authority on the same level as the bishop."[17] Where did these "tools," the new legal thought and formulations, originate at the start of the commune and consulate?

Research into this question had been prepared by a gifted Austrian scholar, Julius Ficker, in the 19th century. Ficker pointed to the use of Roman Law long before Irnerius in the region that remained part of the East Roman Empire governed from Constantinople until the eighth century, the already mentioned Romagna.[18] Nevertheless, one could not be sure that the evidence for Roman Law which he noted for the tenth and eleventh centuries were holdovers from the eighth century or a return to the *Corpus Juris Civilis*. Here the decisive insight was gained only much later by a German scholar of Roman Law in exile in England, Hermann Kantorowicz, who in 1940 discovered a manuscript in the Dean and Chapter Library of Lincoln that stated that before Irnerius, "the beginning of civil-law was reborn like a surging sunrise through Magister Pepo." Kantorowicz had been a disbeliever in Roman Law study before Irnerius. But with great intellectual honesty he reversed his position in an article entitled "An English Theologian's View of Roman Law: Pepo, Irnerius, Ralph Niger." Ralph Niger is the twelfth century English theologian, in whose treatise, the *Moralia Regum*, Pepo was mentioned. Sadly, Kantorowicz died later in the same year, and his article appeared posthumously in 1943.[19] The discovery generated numerous articles from other scholars in search of the identity of the Pepo or Pietro mentioned by Ralph Niger. Judges by those names were identified at Ravenna, Bologna, and at the court of Matilda of Canossa, the duchess of Tuscany and supporter of Gregory VII. Most importantly, there was a legist who was a "shining light of the Bolognese" and who, in 1092, was asked to participate in a literary proposal of an arbitration on the legitimacy of the Reformist Pope Urban II or his imperial opponent, Antipope Clement III. This legist, in turn, was identified by a 15th century humanist commentator as the imperialist Bishop Pietro of Bologna.[20] Regardless of whether the disparate sources mentioned a law-man by the name of Pietro or Pepo, with the discovery in 1940-1943, the study of Roman Law before Irnerius became a certainty.

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17. *Id.* at 358. "Fin dal suo sorgere, il comune . . . possiede in sé gli strumenti per definirsi, a tutti gli effetti, come autorità pubblica alla stessa stregua del vescovo." *Id.*

18. 4 Julius Ficker, Forschungen zur Reichs- und Rechtsgeschichte Italiens, III 103-106 (Innsbruck, 1868-1874).

19. HERMANN KANTOROWICZ, *An English Theologian's View of Roman Law: Pepo, Irnerius, Ralph Niger, in* I MEDIEVAL AND RENAISSANCE STUDIES 237-252 (Beryl Smalley ed., 1943) (quoted by KANTOROWICZ, p.252, from Moralia Regum, Chapter XIX: "Cum igitur a magistro Peppone velut aurora surgente iuris civilis renasceretur initium et postmodum propagante magistro Warnerio iuris disciplinam religioso (s)cemate traheretur ad curiam Romanam. . .").

20. Carlo Dolcini, Velut aurora surgente' Pepo, il Vescovo Pietro e l'origine dello 'studium' bolognese 5 n.12 (". . .et cum Pepone claro Bononiensium lumine. . ."), 6 n.13 (Istituto storico italiano per il medio evo, Studi storici, Rome,1987).

What was lacking was information on the content and purpose of the Roman Law study of Magister Pepo. Here, a further discovery yielded a telling insight. In 1972, Ludwig Schmugge, who reexamined the *Moralia Regum* in connection with his doctoral dissertation on Ralph Niger, noted a more detailed mention of Magister Pepo as a participant in a major gathering of judges and dignitaries of the Kingdom of Italy called by Henry IV in 1084. Part of the agenda was to decide on the penalty for a murder of a serf by a freeman. The other judges proposed to fine the murderer in accordance with Lombard Law. But Pepo, "as guardian of the Code and the Institutes of Justinian," insisted that whoever "annihilated a man in the tribe of men had injured the universality of all men, so that whoever destroyed a man in the universality of men should himself be taken out of their midst, and the murderer should be killed, because he had violated the *consorcium* of natural relationship." He said that the judgment should be the same whether the victim was a serf or a freeman because falling into servitude "could not delete the communion of the nature of the human condition."[21]

Pepo made use of two further parts of the *Corpus Juris Civilis*. Pepo's *Institutes* is the first part, or textbook, of the *Corpus*. His *Code* is the third part consisting of the collection of the laws down to the early laws of Justinian. The second part of the *Corpus* is the already mentioned *Digest* taught by Irnerius. Pepo's insistence that the punishment must fit the crime was based on Book Nine of the *Code*, in which this principle was proclaimed.[22] His insistence that the murderer had offended the "tribe of men," "the universality of all men," and "the *consorcium* of natural relationship" was reflected in the introductory chapter of the *Institutes*, of which the second subsection dealt with the natural law of peoples and civilization.[23] Pepo brought to bear, on a problem of his day, principles of law reflected in the *Code* and the *Institutes* in a much richer and clearer way than in the *Digest*. He also made his emperor accept these principles of his ancient Roman predecessors. Ralph Niger informs us "that the judgment was firmed through the laws and the sacred constitutions of the emperors,

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21. *Id.* at 3-4, 4 n.10, 28 n.97. *See also* BELLOMO, *supra* note 8, at 243 n.23; Ludwig Schmugge, 'Codicis Iustiniani et Institutionum baiulus.' Eine neue Quelle zu Magister Pepo von Bologna, *in* VI Ius Commune, 1-9 (1977) (Moralia Regum, Chapter X, 6, quoted from Dolcini, *supra* note 20, at 4 n.10: "Surrexit autem Magister Peppo in medium, tamquam Codicis Iustiniani et Institutonum baiulus. . .Quippe allegavit eum, qui exemisset hominem de grege hominum, universitati fore iniuriam adeo, ut qui hominem ademisset universitati hominum, quia violasset naturalis communionis consortium, ipse pariter de medio tolleretur et homicida occideretur. Sive enim servus sive liber foret, idem ait esse iudicium, quoniam addictio servitutis delere non poterat communionem nature humane conditionis").

22. *Codex*, IX, x1viii, 22: Sancimus ibi esse poenam, ubi et noxia est". The modern edition of the *Corpus Juris Civilis* was begun by Theodor Mommsen with his publication of the *Digest* in 1870 and completed by his associates: *Institutiones*, ed. Paul Krüger; *Digesta*, ed. Th. Mommsen, rev., Paul Krüger; *Codex*, ed. Paul Krüger; *Novellae*, ed. R. Schöll, G. Kroll, (Berlin, 11/1908). Anastatic reprints after 1945.

23. *Institutiones*, I, ii: De iure naturali, gentium et civili.

this Magister Pepo obtained from the emperor, the other judges receding in confusion."[24] It was well known before the discoveries of Kantorowicz and Schmugge that judges and notaries would supplement the *Liber Papiensis* and the *Lombarda* whenever they did not cover a case with precepts of Roman Law of whatever derivation.[25] Henceforth, Emperor Henry IV reversed the relationship giving Pepo and the *Corpus Juris Civilis* priority over the judges following Lombard Law. In relating this outcome, Ralph Niger made still a further important point — the firming of the case through the laws (the *Code*) and "the sacred constitutions of the emperors." The latter is a reference to a further part of the *Corpus Juris Civilis*, the compilation of the later laws of Justinian and his successors, the "New Constitutions" or *Novellae Constitutiones* or fourth part of the *Corpus*, more briefly referred to as the *Novellae*.

With this recognition, the return of Roman Law can be put in its correct perspective. Before Irnerius tackled the difficult task of glossating the intricate material of the *Digest* and the diverse opinions of Roman jurists it contained for his students, the judges, or at least Magister Pepo, had become familiar with the introductory and brief law textbook, the *Institutes*, and the straightforward and well arranged compilations of the ancient Roman laws themselves in the *Code* and the *Novellae*. Irnerius and his *studium* was not the beginning of a return to the *Corpus Juris Civilis* but its climax as the intensive training of jurists in Roman Law, after this law had proven its superior rational force in the strife of the day.

IV. THE LINKUP OF COMMUNAL ORIGINS AND ROMAN LAW, AND WHAT IT MEANT FOR SELF-GOVERNMENT AND THE RULE OF LAW

In forging a link between the pre-communal development and the return to Roman Law before Irnerius, an article which a highly gifted scholar, Carlo Guido Mor, published in 1973 on "an abbreviated version of the *Epitome Juliani*" gains significance. This *Epitome* or condensation of 125 of the *Novellae* had been originally prepared by a professor of law in Constantinople in about 556 as a guide for the lawyers of his day. The *Epitome Juliani* came to the western part of the Roman Empire with the *Corpus Juris Civilis*, and Mor was able to show through a detailed analysis of the surviving manuscripts that, since the beginning of the eleventh century, parts of the *Epitome* were copied that would have particular use for the legal business of the time. The abbreviations of the *Epitome* generally omitted laws concerning the eastern portion of the Roman Empire. In their selection, they emphasized those aspects of family and inheritance law that differed from the Germanic customs, especially concerning

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24. Schmugge and Dolcini, *supra* note 21 ("Legibus igitur et sacris constitutionibus imperatorum firmato iudicio optinuit Magister Peppo coram imperatore aliis iudicibus in confusione recedentibus").

25. CHARLES M. RADDING, THE ORIGINS OF MEDIEVAL JURISPRUDENCE: PAVIA AND BOLOGNA 850-1150, 112 and n. 46 (New Haven, 1988).

the greater independence of women and the legitimation of children. The enactments concerning law officers, the quaestors and judges, and also the *curiales* or town managers were included from the administrative law of the Empire. Particular attention was paid to the rules governing notaries and the preparation of written documents and the laws concerning the clergy and ecclesiastical property.[26]

The appearance of these abbreviations is an indication of the greater use of documentation on the basis of Roman Law in the socially agitated, and mobile eleventh century. Violante noted the importance of long term, emphyteutic leases for the building of landed wealth. Epitome VII, Title 3, regulated the *emphyteusis* of ecclesiastical property.[27] The same Epitome VII protected ecclesiastical property from being alienated in any way in a total of 12 Titles. This meant that the *communia* held by a bishop could pass to the citizenry only with the recognition of a continuing co-ownership or superior lordship with the people. This limitation was adhered to in 1070-1080 when the bishop remained co-owner with the People of the common lands of Parma, or in 1095, when the consuls of Asti acquired the castle of Annone under the overlordship of the bishop.[28] These two formulations at Parma and at Asti illustrate the skill with which notaries and judges knowledgeable in Roman Law made possible the formation of the commune.

The rules governing the judicial magistrates in the Roman Empire contained in the abbreviated *Epitome* enhanced the position of notaries and judges in the Italian cities until they became part of the government of the budding communes. Cinzio Violante analyzed very diverse contracts for Milan, in which the notaries distinguished between the overlordship of the ecclesiastical owner, the *eminent domaine*, and the use right, the *dominium utile*, of the buyer since the first third of the eleventh century.[29] The mobile wealth of Milan as a great merchant city required a very significant group of judges and notaries for its legal business. More agriculturally oriented cities, like Parma, had first rate legists judging from the fact that a Parmese judge Armannus acted as expert jointly with the Bolognese Irnerius in a case between two non-Parmese monasteries.[30] At Asti, notariat, judicature and commune were closely linked. According to Bordone, an eminent judge of the city, Berardo, was consul in 1096 and probably a member of a family group of high officials that would remain

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26. Carlo Guido Mor, Una Forma 'Abbreviata' dell'Epitome Juliani, *in* Miscellanea in Memoria di Giorgio Cencetti, Università degli studi di Roma, Scuola speciale per archivisti e bibliotecari 679-693, 698-699, 700-703 (Turin, 1973). *See generally* Gustavus Haenel, Epitome latina Novellarum Iustiniani (Leipzig, 1873).

27. Haenel, *supra* note 26 at 32-33. *See also* Violante, *supra* notes 4 and 12.

28. Haenel, *supra* note 26, at 32-36. *See also* SCHUMANN, *supra* note 10; Bordone, *supra* note 15.

29. Violante, *supra* note 4, at 279-290.

30. SCHUMANN, *supra* note 2, at 239.

prominent throughout the twelfth century.[31] Generally, in the twelfth century, there will be the "consuli de placitis," the consuls qualified to hold court-sessions, in the Italian communes.

The abbreviated epitome of the *Novellae* was important for the legal formation of the early commune. The *Novellae*, used by Magister Pepo in about 1084,[32] contained the key for the formation of the government of the commune, the consulate. The consuls were the chief magistrates of the commune, just as the ancient consuls had been the chief magistrates of the Roman Republic. The ancient consuls continued as the highest officials even after their executive power had passed to the Roman emperors in the first century. In January of every year, two men of the highest rank and public esteem would take office as consuls, and their names would be added to the consular list, the *Fasti consulares*, a convenience for the notaries for the dating of their documents. The annual succession of consuls rather than the succession of emperors symbolized the "eternity of Rome." In the later centuries of the empire, however, men of enormous wealth rather than merit pushed their way into the consulate as the expenses of the office, the funding of public works, games, and of distributions to the populace of the two capitals of the empire, Rome and Constantinople, increased. Against these abuses, Justinian showed himself once more as the last great reformer of the empire. After his work of legal renewal had been completed, he published in August and December of 537 two laws: the Novella 47 and the Novella 105, making the consulate again the highest reward for integrity and achievement that the emperor could bestow. Novella 47 made it obligatory for all notaries to keep their written records with the dating of the annual consuls. Novella 105 assured that the emperor could bestow the office on men of integrity rather than wealth by limiting the public expenditures required.[33] Both Novellae recall the great tradition of Rome. Novella 105 is particularly emphatic: "As we come near the thousandth year since the Roman Republic sprang forth. . .(the consulate) must remain accessible to all Roman men of trust (*bonis viris* - good men), so that we (Emperor Justinian) may propose those who are worthy of such an honor."[34]

In the late eleventh century, the judges or the *boni homines* of the budding communes could not miss the call to action directed to the "good men" of the

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31. Bordone, *supra* note 13, at 359-360 and n. 330, 366-368 (discussing that at Asti the commune colloquium of the citizens met at the same location where traditionally court-sessions were held, at the market church of San Secondo, the church of the patron-saint of Asti but not the cathedral).

32. Schmugge and Dolcini, *supra*, notes 21 and 24.

33. 3 Ernest Stein, Histoire du Bas-Empire, II, 463-464 (Paris, 1949-1959); 2 ARNOLD HUGH MARTIN JONES, THE LATER ROMAN EMPIRE, 284-602 II, 532-534 (Norman, 1964). Because the office was so prestigious, the state had at different times sold the title of consul. These consuls, the suffect and honorary consuls, were never listed in the *Fasti* but account for the random appearance of the title.

34. *Novellae*, XLVII, CV. Novella CV: ". . .ad millesimum prope annum veniens, cum Romanorum republica pullulavit. . .quatenus continua sit Romanis, omnibus autem bonis viris existat accessibilis, quoscumque hujusmodi nos dignos esse honore decreverimus. . ." (from the "Praefatio").

sixth century. Moreover, if they became consuls of their commune, they would fulfill the reform effort of Justinian. In Rome and the western part of the empire, Justinian's reform of the consulate fell on the same evil days as the *Corpus Juris Civilis*. A judge of the late eleventh century with knowledge of Roman Law could read in the *Fasti consulares*, appended to the *Corpus*, or deduct from the chronological record of the reign of Justinian that the last consul was appointed in Rome in 534. He was a certain Paulinus, chosen - *mirabilia dicta* - by a 'barbarian' regent of Italy, the Ostrogothic Amalasuntha. The soon to erupt Gothic Wars with their fighting in the peninsula, and the siege of Rome made Justinian's reform of the consulate illusory.[35] The early communal consuls were the continuators of the Roman Republican, traditionally evoked by Justinian in Novella 105. Equally significant is the impact Novella 105 would have on the conception the communal consuls had of their relationship to the emperor of their own day.

When Justinian said in 537 that "the thousandth year since the Roman Republic sprang forth," had almost come, he had in mind the time of the first written Roman law of the Twelve Tables and the renewal of the consulate after the trouble of the two Decemviri between 449 and 447 BC, rather than the founding of the city of Rome in 751 BC. For him, "the Roman Republic sprang forth" as the representative government founded on the first rule of law, the Twelve Tables. He considered himself as the guarantor of the continuation of this rule of law, the coordinator of the laws in the *Corpus Juris Civilis* and the lawgiver. Inherent in his own action, and in the history of the Roman Empire as well was the duality of law as the essence of Republican freedom and of the continuity of law-giving and law-enforcement through the emperor. This same duality remains characteristic for the Italian communal consulate throughout its history. The consuls derived their authority from the emperor, while still representing the interests of their particular city-commune. Whenever imperial and city interests clashed, and the city-leagues fought the emperor, they did so with the reservation of their ultimate loyalty to the emperor. The formula for this 'excepted the loyalty to the emperor' or 'excepted the emperor' was an expression of feudal loyalty to the overlord and the essence of the rule of law of the Roman emperor on which the communal movement stood. When in 1183, after years of fighting, the emperor and communes came to a lasting peace at Constance on Lake Constance, at the foot of the Alps; the treaty reiterated the right of the emperor, or in delegation, the bishop, to confirm the consuls of a city.[36]

On their side, the emperors accepted the duality of communal autonomy and imperial authority. In Germany, with the end of the Salian House and with the

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35. Stein, *supra* note 33, at 334.

36. Pierre Racine, La Paix de Constance dans l'histoire italienne: L'autonomie des communes lombardes, *in* Studi sulla Pace di Costanza 234-240 (Milan, 1984); REINHOLD SCHUMANN, ITALY IN THE LAST FIFTEEN HUNDRED YEARS 97 (New York, 2d ed., 1992).

death of Emperor Henry V in 1125, the struggle between rival kings terminated with the election of Emperor Frederic I of Hohenstaufen in 1152. The Italian communes had strengthened their structures and control over their territories in the intervening period, but also became embroiled in bloody intercity rivalries. In expeditions to Italy between 1154 and 1158, Frederic was successful in stopping the fighting between the cities and sorting out, in a diet held at Roncaglia, which rights belonged to him in Italy and which rights were deeded to the cities. By this time the imperial chancery had adopted the Roman Law formulations of the *Corpus Juris Civilis*, and Frederic had his own enactments, including a grant of autonomy to the professors and students of the *studium* of Bologna, added to the *Novellae* of Justinian.[37] The Italians liked their new young Roman Emperor and his Burgundian wife Beatrix. The nickname, Redbeard or Barbarossa, they fondly gave him would stick to him for all time. However, money was urgently needed by the rapidly growing cities and the costly imperial expeditions. These economic and other difficulties, which neither side was wise enough to bridge, resulted in protracted warfare. Under the grandson, Frederic II, all cooperation failed and the imperial cause ended in defeat.[38]

V. CONCLUSION

The North Italian cities of the eleventh century, in need of an objective book of law to reliably regulate their rapidly changing societies, found this book in the *Corpus Juris Civilis* of the late Roman emperor Justinian. With the aid of discerning legal minds, they derived from the Roman Republican tradition of this *Corpus* a new form of self-government, the commune and the consulate, in the troubled times of the Investiture Conflict. In line with the other, the imperial tradition of the *Corpus*, they recognized the emperor as the upholder of the rule of law and accepted the continuation of the authority of the ancient Roman Emperors by the German emperors of their day. Law enforcement on a larger scale and local self-government were briefly balanced by the middle of the twelfth century to produce justice and peace for all. When cooperation with the emperors broke down and ultimately failed, each city had to become "its own prince," in the words of a fourteenth century professor of law, Bartolus of Sassoferrato, and continue the law making and enforcing authority of Emperor Jus-

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37. H.-G. Walther, Die Anfänge des Rechtsstudiums und die kommunale Welt Italiens im Hochmittelalter, *in* Schulen und Studium im sozialen Wandel des hohen und späten Mittelalters, Konstanzer Arbeitskreis für mittelalterliche Geschichte, Vorträge und Forschungen, 150 (Johannes Fried ed., Sigmaringen, 1986).

38. Marcel Pacaut, Frédéric Barberousse 134-139, 263-268 (Paris, 1967) (discussing Frederic I); *See also* PETER MUNZ, FREDERICK BARBAROSSA 165-172 (London, 1969); Hampe, Staufer 107-140. 2 E. Kantorowicz, Kaiser Friederich der Zweite 406-416, 418-424 (Munich, 1936) (Chapter VII: Caesar und Rom and Chapter VIII: Dominus Mundi). This classic work, published also in English translation and photostatic reprints, must be consulted in connection with more up to date biographies like Thomas Curtis Van Cleve, THE EMPEROR FREDERICK II OF HOHENSTAUFEN: IMMUTATOR MUNDI (Oxford, 1972).

tinian or Emperors Frederic I and II.[39] The cities did this through their own city law books, the *Statuti*, composed by professionally trained legists and given the force of law through the approval of the civic assembly. In continuing the Roman Republican tradition of the *Corpus Juris Civilis* of Justinian, they set an early precedent for the popular sovereignty of today. The rest of Europe went to school in the *studia* at Bologna and elsewhere and at first emphasized the other tradition of the *Corpus Juris Civilis*, the law making and enforcing authority of the emperor or prince, in the building of national monarchies and the formulation of royal absolutism.

39. CECIL NATHAN SIDNEY WOOLF, BARTOLUS OF SASSOFERRATO: HIS POSITION IN THE HISTORY OF MEDIEVAL POLITICAL THOUGHT 154 (Cambridge, England, 1913).

The New Italian Pension System

CYNTHIA LICUL, ESQ.†

On August 17, 1995, the new pension reform law entered into effect in Italy.[1] For all persons and entities affected by it, this was a major change that drastically modified a pension system which was experiencing ever-increasing expenses and in financial difficulty;[2] with particular reference to individuals, the old system was disparate in treatment among the various categories of workers.[3] The new system not only changes the eligibility requirements and the method of calculating the amount of the state pension, but also fosters the use of other forms of pension savings (e.g., pension funds),[4] bringing these alternate forms to the forefront of pension planning.[5] Depending on the circumstances, either only the old system will apply,[6] only the new system will apply,[7] or the pension will be calculated using a mixture of both the old and the new system.[8]

The goal of this article is to introduce and explain the practical aspects and tax implications of the reform for both the individuals and the employers subjected to it. Particular emphasis is placed on the treatment of contributions towards the new pension system and the use of the pension funds under the reformed regime.

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1. Decree-Law No.335 of Aug.8,1995 [hereinafter Reform Law].

2. *See* Giovanni M. Ughi, Remarks at the Seminar of the American Chamber of Commerce in Italy on the New Pension Funds (Jan. 25,1996), *summarized in* ITALIAN AMERICAN BUSINESS, Feb.-Mar. 1996, at 24, 24.

3. *See Id.* The categories of workers are: (1) dependent workers, public sector; (2) dependent workers, private sector; (3) working partners of work co-operatives; (4) autonomous workers/entrepreneurs; and (5) professionals.

4. Marco Rogari, *Guida Alle Nuove Pensioni*, IL SOLE-24 ORE, Aug. 1995, at 2 (Italy).

5. CLAUDIO BAZZANO, I FONDI PENSIONE 96-97 (2d ed. 1995) (Italy). The new system is known as the "complementary" or "integrative" system.

6. Reform Law, *supra* note 1, art. 1, § 13 provides that old system applies to those employees with at least 18 years of contributions as of December 31, 1995.

7. *See* Reform Law, *supra* note 1, art. 1, § 23; *see also* Reform Law, *supra* note 1, art. 2, § 18. These sections provide that the new system applies to those employees commencing their working lives as of January 1, 1996 and those workers who meet the relevant criteria and opt to have their pensions governed by the new system.

8. Reform Law, *supra* note 1, art. 1, § 23 provides that those employees with less than 18 years of contributions as of December 31, 1995 will have their pensions calculated using both the old and new system.

I. INTRODUCTION

The mounting costs of the existing pension system[9] no longer would have permitted postponing the inevitable resulting decrease, even substantial, of the medium pension.[10] Thus, the Italian Government sought a solution which restructured the system,[11] as well as provided access to the use of other forms of pension savings.[12] The practical effect of the reform is to decrease the amount of the state pension, which decrease is compensated by the "complementary" system, i.e., contributions on the part of individuals, and in some cases employers as well, towards the pension schemes contained in the second pillar of social security.[13]

The new integrated system is more responsible, fundamentally voluntary, and of a substantially private nature. It is based on the concept that the sums contributed to the integrated social security system are destined for the future benefit of the individual workers who and, in certain cases, on whose behalf, the contributions were made.[14] Complementary contributions on the part of all the parties are spurred by the associated tax benefits.[15]

II. THE "THREE PILLARS" OF SOCIAL SECURITY

Italians, like the Japanese, are by tradition savers.[16] With particular reference to saving for retirement, this is traditionally broken down into three main types known collectively as the "three pillars of social security": obligatory (i.e., pub-

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9. Pension costs rose from 12.2% of the Gross Domestic Product in 1980, to 16.1% of the Gross Domestic Product in 1992.

10. Ottavio Di Lorteto, *Con i neoassunti dal '96 la previdenza cambia volto*, IL SOLE 24 ORE, Nov. 27, 1995, at 2 (Italy).

11. *See Id.* The revisions of the old system include: delaying eligibility for receiving pension benefits; basing the amount of the pension not on the last wages earned, as adjusted for inflation, but with reference to the amount of the contributions either made by the recipient during his/her working life or accredited to the recipient with respect to the increase of the Gross Domestic Product; and basing the amount of the pension on the age of the recipient at the time the request for the pension benefits is made. The amount of the pension entitlements from the obligatory part of the new system is determined by multiplying the amount of the obligatory contributions made during the individual's working life by a coefficient based on the age of the individual at the moment of retirement. *See* Reform Law, *supra* note 1, art. 1, section 6.

12. *See Tutte le Regole Delle Pensioni Con Il Sistema Contributivo, supra* note 10, at 2.

13. *See infra* part II. *See also* BAZZANO, *supra* note 5, at 97.

14. *See* Ughi, *supra* note 2, at 24. In the case of dependent employees, the contributions are made jointly with the employer. Autonomous workers/entrepreneurs and professionals, in addition to their personal obligatory contributions, *see infra* note 27, collect an amount from their clients/customers based on the amount of the invoices, which they in turn deposit with the relevant obligatory system. The additional voluntary contributions made by autonomous workers/entrepreneurs to the complementary pension system are done so individually. The contributions of working partners of work cooperatives may be made by the work cooperative, the individual working partner, or by both. *See infra* note 76 and accompanying text.

15. *See infra* notes 70-76 and accompanying text.

16. BAZZANO, *supra* note 5, at 3.

lic social security system); collective savings (i.e., pension funds, annuity/endowment policies); and individual savings (i.e., life insurance policies, mutual funds, mixed products).[17]

The legislative genesis of the complementary pension system[18] was enacted in 1993 for the purpose of promoting the use of the "second pillar of social security," particularly pension funds. As a result of the chaos caused by this initial legislation, which effectively blocked development with respect to pension funds, the new pension reform law[19] was enacted.[20]

III. THE NEW SYSTEM

The complementary pension system of the new Pension Reform Law defines and delineates the application, the eligibility requirements and computation of the reformed state pension, as well as rules and regulations concerning the tax treatment, management, financing, and supervision of complementary forms of pension savings.[21] Additionally, the new Ministerial Decrees, which the new Pension Reform Law provides must be enacted,[22] as well as the Supervisory Committee,[23] play a vital role in the functioning and governance of the complementary pension system.[24]

The new system has been characterized as a "flexible structure, built around setting in motion the contributive method of calculation, progressively always more distant from the pension based on seniority and always closer to the integrative system."[25] It applies principally to those individuals who first enter the work force after December 31, 1995 (and thus have no time and rights logged in the pre-existing pension system), as well as to those workers already in the workforce as of that date but who voluntarily opt to be regulated by the new system.[26]

The Reform Law changes the pension system from that of solidarity (i.e., where the amount of the pension is tied to the last wages earned by the worker), known as "retributiva," to a system known as "contributiva" where the amount

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17. BAZZANO, *supra* note 5, at 4-5.

18. Decree-Law No. 124 of Apr. 21, 1993 (Italy).

19. *See supra* note 1 and accompanying text.

20. Raffaele Rizzardi, *Fisco leggero per far volare i fondi complementari*, IL SOLE-24 ORE, Aug. 5, 1995, at 30 (Italy).

21. *See* Alberto Brambilla, Remarks at the Seminar of the American Chamber of Commerce in Italy on the New Pension Funds (Jan. 25, 1996), *summarized in* ITALIAN AMERICAN BUSINESS, Feb.- Mar. 1996, at 37, 37.

22. The purpose of the Ministerial Decrees is to define and regulate the practical aspects for which the Reform Law provides only more general guidelines. Each designated Ministry which will issue a decree shall have authority over that aspect of the functioning of the Reform Law.

23. *See infra* part IV. b.

24. *See* Brambilla, *supra* note 21, at 37.

25. Rogari, *supra* note 4, at 6.

26. Di Loreto, *supra* note 10, at 2. *See* Reform Law, *supra* note 1, art. 1, § 23.

of the obligatory pension is based on the amount contributed toward the pension system during the individuals' working lives. There is a minimum amount which must be contributed to the obligatory pension system,[27] and if the workers and employers wish to make additional contributions ("complementare") they may do so into an approved pension scheme (e.g., pension funds).

Some aspects of the old pension system remain either untouched or modified for certain categories of individuals. For those individuals who, as of December 31, 1995, had eighteen or more years of seniority, their pension will continue to be governed under the old system. For those individuals who, as of December 31, 1995, have accumulated less than eighteen years of contributions, a *pro-rata* method of calculating pension payments will be applied so that those contributions made as of December 31, 1995, will be calculated and dispersed according to the old system, while all new contributions (i.e., those made as of January 1, 1996) shall be calculated and dispersed according to the new system.[28] Moreover, individuals who have accumulated a seniority of at least fifteen years have the option to have their pensions governed entirely by the new contributory system so long as at least five of those years are spent under the new system.[29] For all persons entering the employment market as of January 1, 1996, only the new system will be applied.[30] As a result, the major impact of the pension reform is that through time the pre-existing pension based on years of service ("anzianità") will be phased out, and all pensions will eventually be calculated based on the contributions actually made during the individuals' working lives.

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27. Reform Law, *supra* note 1, art. 1, § 10. For all employees other than autonomous workers, the mandatory contribution to the obligatory state system is 33% of yearly income, while for autonomous workers registered with INPS (National Institute for Social Security), the mandatory contribution is 20% of annual income. The Reform Law draws a distinction between those professionals who are essentially subordinates and thus fall into the category of 20% contribution (e.g., attorneys working as in-house counsel in a corporate legal department), and those who are not (e.g., attorneys working in law offices in private practice). For the latter category of professionals who are registered in the appropriate roll or register for that profession, the Reform Law provides that the government must issue regulations concerning the contributions to and from management, the financing of the obligatory system to which they belong, and their complementary contributions. Reform Law, *supra* note 1, art. 2, § 25. Moreover, for those autonomous workers not covered by INPS whose activities do not fall into any of the express categories of autonomous work (i.e., free lance professionals), and who engage in these activities habitually although not necessarily exclusively, their contributions to the obligatory system are 10% of annual income. Reform Law, *supra* note 1, art. 2, §§ 26-29.

28. Rogari, *supra* note 4, at 6.

29. Reform Law, *supra* note 1, art. 1, § 23. For the individuals in question, they may exercise this option as of January 1, 2001, at which time their seniority of fifteen years is determined. In the event the option is exercised, the pension will be calculated based on the new system only for those contributions made after the option.

30. Reform Law, *supra* note 1, art. 1, § 23.

The new pension system[31] provides three eligibility requirements for the workers covered by it: (1) the conclusion of employment, (2) the worker is at least 57 years of age (or has at least 40 years of seniority), and (3) the worker has made at least five years of contributions towards retirement (under either the old or new system), and the amount of the pension is at least 1.2 times the amount of public assistance to which the worker would be entitled to under the Reform Law.[32]

IV. PENSION FUNDS

The new pension system provides substantial changes to the previously existing laws regulating pension funds.[33] The regulations primarily concern the fiscal treatment and management of the monies contributed to the subject funds, and the Reform Law delegates to certain ministries, including the Ministry of Labor and Pension and the Ministry of Treasury and Finance, the task of issuing the regulating decrees.[34]

The Reform Law also has great impact on the utilization of pension funds as an option for pension benefits. Furthermore, the Reform Law affects not only the individuals and employers, but also the various institutions involved in the pension market. For instance, the Reform Law abolishes the 15% front-end tax owed by Pension Funds for contributions made to the funds,[35] and provides that pension funds may only be managed by disinterested commercial banks, SIMs ("società intermediazione mobiliare"),[36] insurance companies,[37] and mutual fund management companies.[38] Moreover, for defined benefit pension plans,[39]

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31. The old pension system provided numerous forms of pensions with various names, e.g., pensioni "di vecchiaia", "di vecchiaia anticipata", and "di anzianità". The new system combines them all into one category known as "Pensione di vecchiaia." Reform Law, *supra* note 1, art. 1, § 19.

32. Reform Law, *supra* note 1, art. 1, § 20. *See also* Reform Law, *supra* note 1, art. 3, § 6 (addressing a worker's eligibility for public assistance).

33. *See* Decree-Law No. 124, *supra* note 18; Decree-Law No. 585 of Dec.30, 1993 (Italy).

34. *See* Reform Law, *supra* note 1. As of this writing, the relevant ministries have not enacted any regulations. This is attributed to the fact that the government has recently changed. Until such time that the government is re-established and stabilized, it is unlikely that any regulating decrees will be issued.

35. This 15% tax was never levied on the transfer of TFR ("trattamento di fine le ropporto") monies to the pension funds. BAZZANO, *supra* note 5, at 173. Indeed, those Pension Funds which in the past paid this 15% tax may now be made whole with the reform Law, which provides that those funds may now deduct the amount of the tax previously paid from their annual substitute taxes due (i.e., Lit. 5,000,000 of taxes are due in the first five years of the funds' existence, and Lit. 10,000,000 of taxes are due each year thereafter). *Id.* The Labor Ministry is charged with issuing a Ministerial Decree for the procedure to be followed for the recovery of the taxes. *Id.*

36. Investment brokerage companies were recently introduced by Decree Law No. 1 of Jan. 2, 1991 (Italy).

37. Rogari, *supra* note 4, at 8.

38. Reform Law, *supra* note 1, art. 3, § 26, (modifying Decree-Law No. 124 of Apr. 21, 1993, art. 6, § 1). The Reform Law further modified Decree-Law Number 124 of Apr. 21, 1993 to exclude public entities from the management of pension funds.

the only fund managers permissible according to both the previous law and the Reform Law are life insurance companies.[40]

Pension Funds are merely intermediaries established by collective bargaining agreements with unions, individual companies, a group of companies, or the workers themselves,[41] whose task is to collect the contributions made to the funds, and in turn give the monies to the authorized fund managers for investment purposes.[42] Always present in all pension-related transactions is the depository bank, which must maintain the assets of the pension funds, although title to the assets always remains with the Pension Funds.[43] The depository bank, first established as a concept and fact by the 1993 pension law,[44] is the instrument of protection for the individual investors in the pension funds.[45]

Dependent workers[46] in both the private and public sectors who are hired after December 31, 1995 or who voluntarily opt to be covered by the new pension system,[47] working partners of work cooperatives,[48] autonomous workers/entrepreneurs,[49] and professionals[50] are eligible for pension funds.[51] Moreover, autonomous workers/entrepreneurs and professionals may maintain both defined contribution and defined benefit plans, while all other categories of workers are eligible for only defined contribution plans.[52]

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39. Defined benefit plans may only be maintained by autonomous workers/entrepreneurs and professionals. *See infra* note 52 and accompanying text.

40. Reform Law, *supra* note 1, art. 3, § 26; Decree-Law No. 124, *supra* note 18, art. 6, § 3. *See also* BAZZANO, *supra* note 5, at 95.

41. Reform Law, *supra* note 1, art. 9. *See also* BAZZANO, *supra* note 5, at 99-101. In the case of work cooperatives, working partners and employees may jointly establish and be part of a pension fund. Reform Law, *supra* note 1, art. 3, § 26. Autonomous workers/entrepreneurs and professionals may establish pension Funds with other members of their category, and their grouping may be broken down by geographic area or by profession. *Id.*

42. BAZZANO, *supra* note 5, at 98.

43. Reform Law, *supra* note 1, art. 3, § 26.

44. Decree-Law No. 124, *supra* note 18, art. 6-bis., *modified by* Decree-Law No. 335 of Aug. 8, 1995, art. 7.

45. *See* Fabio Carniol, Remarks at the Seminar of the American Chamber of Commerce in Italy on the New Pension Funds (Jan. 25, 1996), *summarized in* ITALIAN AMERICAN BUSINESS, Feb. - Mar. 1996, at 34, 35.

46. Dependent workers, or employees, are defined in the Italian Civil Code, articles 2094 and 2095, as well as various other specific laws which include as part of this category, apprentices. C.c. 2094-95.

47. *See supra* notes 7 and 29 and accompanying text.

48. This group of workers was not previously part of the obligatory pension scheme. They were introduced by Reform Law, supra note 1, art. 4, § 1 (amending Decree-Law No. 124 of Apr. 21, 1993, art. 2, § 1b-bis).

49. Defined by the Italian Civil Code, article 2222, as those workers who perform a certain job without further obligations and thus are not considered subordinates (i.e., free-lance, independent contractors). C.c. 2222.

50. Defined by the Italian Civil Code, article 2229, as those persons of "intellectual professions" who must be registered in the appropriate registry for that profession. *Id.* at 2229.

51. Reform Law, *supra* note 1, art. 2.

52. *Id.* at art. 3, § 26(2). *See also* BAZZANO, *supra* note 5, at 101-102. Defined contribution plans establish the amount of the contribution without guaranteeing any final payment, whereas with defined

A. AMOUNT OF CONTRIBUTION

The Reform Law sets a maximum amount of deductible yearly contributions. In the event that contributions exceed this set amount, they are subject to double taxation, i.e., both in the year of the contribution and in the year of the distribution.[53]

Sums which may be contributed towards the pension funds may derive from three sources: the yearly amount contributed to the TFR ("trattamento di fine rapporto") fund for and by the individual workers;[54] contributions other than those destined for the TFR fund made by the employers; and contributions other than those destined for the TFR fund made by the employees.[55]

Either a portion or the entire amount of the TFR fund matured annually for those employees already in the workforce as of April 28, 1993[56] may be contributed to the employees' pension funds,[57] whereas for those employees entering the workforce after that date, the entire amount set aside for purposes of the TFR fund must be deposited into the employees' pension funds.[58] By contributing some or all of the monies previously destined for the TFR account to the employees' pension funds, the employers no longer have to concern themselves with managing these monies or for liquidating the accounts at the time the employees leave the employers.[59] This is also a benefit to the employees as the Fund managers obtain higher returns for the money invested in and by the

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benefit plans the amount of the contribution may vary in order to guarantee the final payment provided for by the plan.

53. *See* Alvise Donà dalle Rose, Remarks at the Seminar of the American Chamber of Commerce in Italy on the New Pension Funds (Jan. 25, 1996), *summarized in* ITALIAN AMERICAN BUSINESS, Feb.-Mar. 1996, at 30, 30.

54. The TFR is only applicable to dependent workers. The yearly TFR, governed by article 2120 of the Italian Civil Code as modified by Decree-Law No. 297 of May 29, 1982, is comprised of contributions made by the employers for the future benefit of the employees. *See* C.c. 2120. The amount of the yearly TFR is established by article 2120 of the Italian Civil Code, and is calculated based on yearly gross wages earned by employees. *See Id.* This money remains in the company on its books, providing a sort of self-financing for the company as it is not distributed until the employee leaves the employer for whatever reason. The purpose of the TFR is to economically protect the employee at the moment that he/she no longer has a salary, and thus the TFR is a form of social security/pension savings. The employer can select how to invest the monies eventually owed to the employee pursuant to the TFR. This money is periodically set aside and may be invested to purchase insurance policies or annuity/endowment policies, government securities, government bonds, and other forms of investment. The monies must be kept in a highly liquid form in order to honor the requests for liquidating the individual funds at the time that the request is made by the employees when they leave the employer.

55. *See* dalle Rose, *supra* note 53, at 30.

56. The effective date of Decree-Law No. 124 of Apr. 21, 1993 (Italy).

57. Reform Law, *supra* note 1, art. 8. *See also* BAZZANO, *supra* note 5, at 137.

58. Decree-Law No. 124, *supra* note 18, art. 8, § 3. *See also* BAZZANO, *supra* note 5, at 141. Moreover, article 8 of the Reform Law provides that for those companies with 25 employees or less as of April 28, 1993, any monies destined for the TFR accounts exceeding Lit. 2,500,000 for employees hired on or after that date need not be deposited into pension funds for a period of four years. Reform Law, *supra* note 1, art. 8.

59. BAZZANO, *supra* note 5, at 137.

Funds than the returns generated from the monies set aside in the TFR account.[60]

With respect to working partners of work cooperatives, autonomous workers/ entrepreneurs and professionals, the situation is different in that there does not exist an employee-employer relationship; thus, there is no TFR fund and these individuals are alone responsible for their pension fund contributions.[61]

There is a ceiling of 132,000,000 Lire gross annual income for pension contributions for those individuals hired on or after January 1, 1996 or for those who opt to be covered by the new pension system.[62] Contributions are no longer mandatory for income exceeding this amount, which in any event is also the cap for the calculation of pension benefits. The Reform Law provides that the government must enact regulations dealing with the tax treatment of those contributions made with income exceeding the ceiling.[63] The 132,000,000 Lire gross annual income ceiling shall be revisited yearly and adjusted for inflation.[64] In the case of managers/directors of industrial companies, and those persons already enrolled in the sixteen previously privatized pension systems ("Casse") for various professionals, the ceiling of Lit. 195,000,000 remains in effect.[65]

B. POLICING THE PENSION FUNDS

One of the most interesting aspects of the Reform Law is the function of the Supervisory Committee ("La Commissione di Vigilanza"). The Supervisory Committee has the task of supervising and controlling the administration and management of the Pension Funds once instituted, as well as the proper functioning of the complementary pension system.[66] The Supervisory Committee is also charged with establishing regulations for the sales, marketing, and advertising of the pension funds in order to eliminate deceiving the public and damaging the investors.[67]

Whereas the tasks of the Supervisory Committee are of a more legal/juridical nature, semi-governmental organs supervise and oversee the managers of the pension funds. The competent organ is determined on the basis of the type of

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60. BAZZANO, *supra* note 5, at 137.

61. *See* dalle Rose, *supra* note 53, at 30. *See also supra* note 14 and accompanying text.

62. For those individuals who exercise their option, the ceiling is applicable only for contributions made after the date of the option, i.e., January 1, 2001. *See supra* note 29 and accompanying text.

63. Reform Law, *supra* note 1, art. 2, § 18. Although the Law provides that such regulations were to have been enacted within 120 days of the effective date of the Law, as of this writing no such regulations have been approved. Reform Law, *supra* note 1, art. 2, § 18.

64. Reform Law, *supra* note 1, art. 2, § 18.

65. G. Rodà, *Su versamenti e prestazioni arriva la scure del tetto*, IL SOLE-24 ORE, Aug. 5, 1995, at 27 (Italy).

66. Reform Law, *supra* note 1, art. 13, § 1. *See also* Carniol, *supra* note 45, at 35.

67. Reform Law, *supra* note 1, arts. 13-14.

fund manager involved: ISVAP is charged with the supervision of insurance companies; and CONSOB and the Bank of Italy ("Banca d'Italia") regulate the SIMs, banks, and mutual fund management companies.[68]

Fund managers cannot directly possess and have control over the resources of the pension funds. The monies must be deposited in a bank,[69] which must be independent from the fund manager, and which must have the credentials of a depository bank for common investment funds. The purpose of the depository banks is to control the accountability and value of the individual investment and overall value and composition of the funds.

C. TAXATION

The employer's pension fund contributions[70] are deductible by the employer for tax purposes.[71] Basing the percentage contribution on the same annual income used for the determination of the TFR fund contribution, the employer may deduct actual contributions up to two percent of the employee's annual income, but in no event more than 2,500,000 Lire.[72] Moreover, the amount of the employer's deduction is equal to the amount of the TFR fund contribution which is deposited into the employee's pension fund; thus, the deduction for pension fund contributions is directly tied to the amount of the TFR contribution deposited annually into the employee's pension fund.[73]

With respect to dependent workers' contributions to pension funds, up to two percent of the employee's annual income may be deducted so long as contributions in this amount have been made to the pension fund, but in no event may this amount exceed 2,500,000 Lire. As with the employer's contribution, the percentage is based on the same annual income used in the calculation of the TFR fund contribution.[74]

The amount of the tax deductible contribution is different for working partners of work-cooperatives, as well as autonomous workers/entrepreneurs and professionals, in which cases TFR fund contributions are not a factor. For these individuals, the maximum deductible contribution is six percent of the declared yearly income, which contribution in any event may not exceed 5,000,000

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68. *See* Brambilla, *supra* note 21, at 38.

69. The "depository bank". Reform Law, *supra* note 1, art. 7.

70. These are the contributions which are exclusive of the TFR monies deposited into the pension funds. *See supra* note 54 and accompanying text.

71. Decree of the President of the Republic No. 917 of December 22, 1986, Title 1 [hereinafter Testo Unico - Income Tax or "TUIR"] (Italy).

72. Reform Law, *supra* note 1, art. 11, § 1.

73. Reform Law, *supra* note 1, art. 11, §1. *See also* BAZZANO, *supra* note 5, at 158. For example, if the employer contributes Lit. 700,000 to the employee's pension fund, said amount may be deducted only if at least Lit. 700,000 of the TFR contribution has been deposited into the employee's pension fund. *See also* IL SOLE-24 ORE, Dec. 4, 1995, at 11, column 1 (Italy).

74. Reform Law, supra note 1, art. 11, § 1. See *supra* note 72 and accompanying text. *See also* BAZZANO, *supra* note 5, at 158-59.

Lire.[75] With respect to working partners of work-cooperatives, the Reform Law provides that their contributions may be made entirely by the working partners, by the cooperative, or by both within the established maximums.[76]

Despite these maximums for the deduction of contributions made to pension funds, individuals may avail themselves of tax benefits associated with other products aimed at retirement savings. For instance, the Testo Unico - Income Tax[77] provides for a tax deduction of up to Lit. 2,500,000 for individual life insurance policies, annuity/endowment policies, or other similar products.[78]

There are no changes to the Testo Unico - Income Tax with respect to the taxation of distributions of TFR fund monies to employees; they remain, with certain limitations, not part of the employees' yearly income. Rather, these amounts are subject to a separate, and more favorable, tax treatment in that the tax is withheld by the employers during the term of employment. Thus, the amount received by the employees at the conclusion of the employment relationship is the net of taxes and is not subject to individual (IRPEF) taxation. The tax rate applied is the medium rate of all the years of TFR contributions.[79]

The tax treatment of the income derived from the pension funds on the individual level is based on 87.5% of the income.[80] The other form of tax-deductible pension savings, i.e., life insurance policies and endowment/annuity policies, which are purchased individually and not through the pension funds, are taxed on the yield produced therefrom at the rate of sixty percent of the income. In these cases, when the policies are cashed in, the return of the original capital investment is not subject to taxation, but only interest and gains realized on the original capital/premiums invested are taxable.[81] With respect to the distribution of the capital from pension funds, the tax treatment differs depending upon the category of the worker. For dependent workers, 50% of the monies contributed are subject to taxation at the medium rate for the TFR fund. Autonomous workers/ entrepreneurs and professionals pay taxes at the medium rate for the two years preceding the distribution.[82]

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75. Reform Law, *supra* note 1, art. 11, § 1. *See also* dalle Rose, *supra* note 53, at 32. With respect to autonomous workers/entrepreneurs and professionals, the Testo Unico - Income Tax was amended to provide for this deduction.

76. Reform Law, *supra* note 1, art. 11, § 1.

77. *See supra* note 71.

78. TUIR, *supra* note 71, art. 10, § 1(m). *See supra* part II.

79. BAZZANO, *supra* note 5, at 167. TUIR, *supra* note 71, art. 17, § 2 provides that the employee's contributions are tax-free so long as the yearly contributions to the TFR fund do not exceed four percent of the employees' yearly income, received in cash or in kind, net of legally required contributions, and, moreover, so long as the by-laws of the funds or benefit agencies do not provide for periodic advances on the indemnity to which the employee will be entitled.

80. Reform Law, *supra* note 1, art. 11, § 1.

81. TUIR, *supra* note 71, art. 48, § 7. *See also* BAZZANO, *supra* note 5, at 164.

82. BAZZANO, *supra* note 5, at 166.

Transferring from one pension fund to another is a non-taxable event for the worker.[83] The individual may transfer his/her investment from one fund to another after five years of participation in that fund if it has been in existence for the same period of moment of the transfer, or after three years of participation if the fund has been in existence for more than five years.[84]

Employers may deduct up to three percent of the amount set aside for the TFR fund which is destined to the complementary forms of pension, provided that this portion of the TFR fund monies is set aside in a special reserve fund.[85] If the monies in this special reserve fund are used to cover losses sustained in the investment, those monies are never subject to taxation and may be deducted annually up to the amount of the reserve contributed to cover the loss over the span of five years.[86] On the other hand, if the monies in the special reserve fund are transferred to the capital of the company, they are taxed pursuant to article forty four, section two of the TUIR.[87] With this additional tax advantage to the company, as well as the fact that a portion of the pension fund's assets are used to acquire shares of the company, the Reform Law effectively encourages employers to deposit TFR fund monies into pension funds.[88]

The pension funds are subject to taxation as well. In addition to the normal withholding tax on profits generated by the funds' operations, the funds must also pay an annual flat tax of Lit. 5,000,000 in each of the first five years of the funds' individual existence, and thereafter Lit. 10,000,000.[89] Pension funds are also subject to a registry tax in the amount of Lit. 1,000,000 when they are established, and in the event that the funds are converted, when the Funds are split (e.g., the creation of two funds from one), or when there is a merger of funds.[90]

V. CONCLUSION

The new pension system in Italy has many implications on the individual, corporate, institutional and state levels. For the individuals subjected to the new system or who opt to have their pensions governed by it, the decrease of their state pension is compensated by the expected returns from investments made by the alternate forms of pension savings. Despite the associated tax benefits, private individuals have more personal and financial responsibility in their pension planning. On the corporate side, the employers gain from the pension reform

83. Reform Law, *supra* note 1, art. 11, § 13.
84. Reform Law, *supra* note 1, art. 10, § 1.
85. Reform Law, *supra* note 1, art. 11, § 1. *See also* BAZZANO, *supra* note 5, at 164.
86. Reform Law, *supra* note 1, art. 11, § 1.
87. *See supra* note 71.
88. BAZZANO, *supra* note 5, at 165.
89. Reform Law, *supra* note 1, art. 12 § 1. This tax is also applicable for tax years 1993 and 1994 for those funds which were then in existence. *Id.* art. 12, § 2.
90. Reform Law, *supra* note 1, art. 12.

by the numerous tax advantages associated with the contributions to both the TFR funds and the Pension Funds, and the decreased responsibility associated with managing the TFR funds. The state is relieved to some extent of the enormous expenses associated with administering a central pension system, as well as the cost of the pension payments.

The biggest advantage of the new pension system is given to the institutions which manage the pension funds, and the economy which will have more money circulating to assist in future investments.

It is hoped that the readers of this article will have a better understanding of how, and if, they may benefit from doing business in Italy.

Taxation of Qualified Retirement Plan Benefits: Structuring Trust Arrangements to Mitigate Confiscation

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I. INTRODUCTION

Qualified retirement plan[1] benefits are potentially subject to three different types of federal[2] taxes. These taxes include the income tax,[3] the estate tax,[4] and

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1. Congress enacted the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. §§ 1001-1461 (1994), in an attempt to regulate the establishment, operation, and administration of retirement plans, and to protect the interests of employees under retirement plans and their beneficiaries. *See id.* § 1001. "To encourage compliance with ERISA, Title II of [ERISA] is composed almost entirely of amendments to the Internal Revenue Code . . . , providing tax benefits to both employers and employees." *In re Orkin*, 170 B.R. 751, 753 (Bankr. D. Mass. 1994) (citing 29 U.S.C. §§ 1201-42).

"Qualified" retirement plans are eligible for various tax benefits and are defined under the Internal Revenue Code. *See, e.g.*, I.R.C. § 401(a). The principal tax benefits available to a qualified retirement plan are as follows: an employer is allowed a deduction in the year in which the employer makes a contribution to the plan, I.R.C. § 404(a); investment earnings within the plan accumulate tax-free, *see* I.R.C. § 501(a); and benefits under the plan are not taxed until actually received by employees under the plan, I.R.C. § 402(a). *See also infra* note 17.

The two basic types of qualified retirement plans are defined contribution plans and defined benefit plans. REGIS W. CAMPFIELD, ESTATE PLANNING AND DRAFTING 989 (2d ed. 1995). A defined contribution plan is "a pension plan which provides for an individual account for each participant and for benefits based solely upon the amount contributed to the participant's account," as well as any gains, losses, and expenses related to the amount contributed. 29 U.S.C. § 1002(34) (1994). A defined benefit plan is a pension plan where the amount of benefits to be distributed to participants in the plan is actually set forth in the plan. CAMPFIELD, *supra* at 989; *see also* 29 U.S.C. § 1002(35) (1994) (providing that a defined benefit plan is a pension plan which is not a defined contribution plan). For a more thorough discussion of the types of qualified retirement plans, *see generally* 1 MICHAEL J. CANAN, QUALIFIED RETIREMENT AND OTHER EMPLOYEE BENEFIT PLANS §§ 3.1-.111 (1996 practitioner ed. & Supp. 1996).

2. Qualified retirement plan benefits are subject to state taxes as well. *See, e.g.*, N.Y. TAX LAW §§ 952(a), 953, 954, 955 (McKinney 1987 & Supp. 1997); FLA. STAT. ANN. §§ 198.01, 198.02 (West 1989 & Supp. 1997). However, state tax consequences generally follow federal tax consequences. *E.g.*, Sanford J. Schlesinger, *Charitable Estate Planning with Retirement Benefits and Related Life Insurance Planning*, N.Y. ST. B.J., Jan. 1997, at 14, 16; *see also* 2 JEROME R. HELLERSTEIN & WALTER HELLERSTEIN, STATE TAXATION ¶¶ 20.02, 21.01[2], 21.11 (1992). This article, therefore, discusses only the federal tax implications with respect to qualified retirement plan benefits.

3. I.R.C. § 1(a)-(e) imposes a tax on income. I.R.C. § 402(a) requires that a distribution of qualified retirement plan benefits be taxed under I.R.C. § 72. I.R.C. § 72 generally includes in income any amount received as an annuity. *See infra* note 32 and accompanying text. In addition, I.R.C. § 691(a)(1) requires that amounts received as an annuity in respect of a decedent, and not included in the income of the decedent, be included in the income of a recipient who receives the annuity by reason of the decedent's death. *See infra* notes 32, 36-40 and accompanying text.

the generation-skipping tax.[5] Therefore, with regard to those taxpayers whose wealth is primarily held in untaxed[6] qualified retirement plan benefits,[7] the resulting tax bill can be astounding. For instance, with income tax rates as high as 39.6 %,[8] estate tax rates as high as 55 %,[9] and the generation-skipping tax at a rate of 55%,[10] it is conceivable that upon death as little as 12% of a decedent's undistributed qualified retirement plan benefits will pass to the decedent's beneficiaries and not to the Internal Revenue Service.[11]

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4. I.R.C. § 2001(a) imposes a tax on the transfer of a decedent's estate. I.R.C. § 2039 includes in a decedent's estate the value of an annuity formerly payable to the decedent and presently payable to any beneficiary by reason of surviving the decedent. *See infra* notes 32, 36-40 and accompanying text.

Technically, qualified retirement plan benefits are subject to the gift tax as well. *See infra* note 52. However, I.R.C. § 2001(a), (b) imposes *one* unified transfer tax on the sum of the taxable estate of a decedent and all taxable gifts made by the decedent during life. That is, the gift tax is essentially the *estate* tax imposed on a decedent's lifetime property transfers by gift. Accordingly, the label "estate tax" as used here encompasses the gift tax.

5. I.R.C. § 2601 imposes a tax on every generation-skipping transfer. Basically, a generation-skipping transfer is a transfer of wealth (such as qualified retirement plan benefits) to a beneficiary at least two generations younger than the transferor. *See* I.R.C. §§ 2611(a), 2612, 2613; *see also* Treas. Reg. § 26.2612-1(f) (providing examples of generation-skipping transfers).

The purpose of the generation-skipping tax is to tax each successive generation on a transfer of family wealth. H.R. REP. No. 94-1380, at 46-47 (1976), *reprinted in* 1976-3 (Volume 3) C.B. 735, 780-81; *see also* H.R. REP. No. 99-426, 99th Cong., 1st Sess. 824 (1985), *reprinted in* 1986-3 (Volume 2) C.B. 824. The tax has been sharply criticized, however, because its statutory scheme does not replicate the result of taxing each successive generation on a transfer of family wealth. *See* W. LESLIE PEAT & STEPHANIE J. WILLBANKS, FEDERAL ESTATE AND GIFT TAXATION (2d ed. 1995). For example, the generation-skipping tax applies to outright transfers that skip a generation, *see* I.R.C. §§ 2611(a), 2612, 2613, is imposed up-front on the transferor, I.R.C. § 2603(a)(3), and in every case is assessed at the maximum marginal estate tax rate of 55% under I.R.C. § 2001(c), *see* I.R.C. §§ 2601, 2602, 2641. Based on these characteristics, the tax is considered punitive in nature. PEAT & WILLBANKS, *supra* at 267. Furthermore, given the punitive nature of the tax, it appears that in the overwhelming majority of cases the tax is avoided. *See* Martha Britton Eller, *Federal Taxation of Wealth Transfers, 1992-1995,* STAT. INCOME BULL., Winter 1996-97, at 8, 42, 47. For example, only .3% of *all* federal estate tax returns filed in 1995 claimed that generation-skipping tax was owed. *See id.* This article does not, therefore, discuss the generation-skipping tax implications with respect to qualified retirement plan benefits.

6. *See supra* note 1.

7. Forty-four percent of all estate tax returns filed in 1995 showed some type of annuity (e.g., a retirement-plan annuity) as part of the decedent's gross estate. *See* Eller, *supra* note 5, at 42, 44. Moreover, 20% of all income tax returns filed for tax year 1994 showed either an individual retirement account, some type of pension, or some type of annuity providing a portion of income. *See* IRS STAT. INCOME- INDIVIDUAL INCOME TAX RETURNS 1994, at 36.

While these statistics do not indicate on average how much wealth taxpayers have in *qualified* retirement plan benefits, they seem to suggest that many taxpayers do, in fact, have some wealth in retirement plans generally. *See also* CAMPFIELD, *supra* note 1, at 1013 (observing that the current generation of taxpayers have most of their wealth in *qualified* retirement plan benefits).

8. I.R.C. § 1(a)-(e).

9. I.R.C. § 2001(c).

10. *See* I.R.C. §§ 2602, 2641, 2001(c).

11. *Cf.* CAMPFIELD, *supra* note 1, at 1013. I.R.C. § 4980A(d)(1) (repealed 1997) imposed an excise tax equal to 15% of an individual's excess retirement accumulation at death. The imposition of this tax, in addition to the income tax, estate tax, and generation-skipping tax, created the possibility that upon death *every dollar* of a decedent's undistributed qualified retirement plan benefits would pass to the

Part II of this article sets forth the relevant, basic rules that apply under the Internal Revenue Code with respect to the distribution of qualified retirement plan benefits.[12] As will be revealed, these rules were designed consistent with the objective of Congress to provide income for the retirement of an employee under a qualified retirement plan.[13]

Part III of this article examines the use of trusts in the context of distributing an employee's qualified retirement plan benefits. The focus of Part III is on the federal tax implications with respect to the distribution of these benefits, both before the death of the employee,[14] and after the death of the employee.[15] Specifically, Part III presents three possible trust arrangements and analyzes how each allows taxpayers to avoid,[16] or at least defer,[17] liability for federal taxes.[18]

Part IV of this article concludes that despite the fact that an employee's choice to use trusts in the context of the distribution of the employee's qualified

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Internal Revenue Service. *See supra* notes 3-5, 8-10 and accompanying text; *cf.* CAMPFIELD, *supra* note 1, at 1013.

12. *See infra* notes 29-43 and accompanying text.

13. *See infra* notes 22-28 and accompanying text.

14. *See infra* notes 52-63.

15. *See infra* notes 64-75, 79-106, 113-40 and accompanying text.

16. The Supreme Court of the United States long ago expressly recognized "[t]he legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether *avoid* them, by means which the law permits." Gregory v. Helvering, 293 U.S. 465, 469 (1935) (emphasis added). On the other hand, any willful attempt by a taxpayer to *evade* taxes is prohibited by the Internal Revenue Code and will subject the taxpayer to criminal sanctions. I.R.C. § 7201.

17. The deferral of tax occurs when tax is postponed from one year to a later year. An example of the deferral of tax is inherent in the provisions of the Internal Revenue Code concerning qualified retirement plans. *See supra* note 1. Specifically, an employer is allowed an immediate deduction for contributions made to a plan (i.e., the contributions are tax-free), I.R.C. § 404(a), although no tax is paid with respect to those contributions until employees under the plan actually receive benefits from the plan, *see* I.R.C. §§ 402(a), 501(a), which may not be until several years later.

Generally speaking, the deferral of tax can be advantageous for three reasons. The principal reason is a concept known as the time value of money, which maintains that a dollar in hand today is worth more than a dollar in hand in the future. *See, e.g.,* Daniel Q. Posin, FEDERAL INCOME TAXATION OF INDIVIDUALS, 5-8 (2d ed. 1993). Applied in the context of the deferral of tax, a tax dollar saved today can be invested to produce a return worth more than a dollar in the future. *See id.*

Somewhat related to the concept of the time value of money is the idea that deferred tax is, in effect, an interest-free loan from the government to a taxpayer. WEST'S FEDERAL TAXATION 3-30 (Eugene Willis et al. eds., 1993 ed.). When a taxpayer saves tax in one year with the expectation of paying the same tax in a later year, the government is giving the taxpayer unrestricted use of the amount saved (much like a loan) until the tax is paid. *See id. But cf.* I.R.C. §§ 453A(c), 1291(a), (c) (providing for instances where a taxpayer is required to pay interest on deferred tax).

Lastly, there is the possibility that when deferred tax actually becomes due in a later year, the applicable tax rate may be lower due to a change in the law, *compare* I.R.C. § 1 (1988) (amended 1990) (providing for a maximum marginal income tax rate of 28% for individuals) *with* I.R.C. § 1 (providing for a maximum marginal income tax rate of 39.6% for individuals), or simply because a taxpayer is in a lower tax bracket than before, CAMPFIELD, *supra* note 1, at 987-88.

18. *See infra* notes 44-140 and accompanying text.

retirement plan benefits allows the overall tax burden to be lessened,[19] the use of these trusts may not be in the best interest of the employee,[20] nor be consistent with the ultimate desire of the employee.[21]

II. THE LAW REGARDING THE DISTRIBUTION OF QUALIFIED RETIREMENT PLAN BENEFITS

A. THE CONGRESSIONAL OBJECTIVE

Congress granted preferential tax treatment to qualified retirement plans[22] with the objective that the benefits under these plans actually be used for the retirement of *employees* under these plans.[23] In an effort to accomplish this objective, Congress enacted legislation requiring the distribution of qualified retirement plan benefits.[24] This legislation, and the regulations amplifying it,[25] essentially govern the timing of distributions,[26] which can occur before the death of an employee,[27] or after the death of an employee.[28]

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19. The favorable tax results discussed in this article can for the most part be achieved whether the employee uses a trust in this context or not. *See infra* notes 52-56, 79-91, 113-15, 117-18, 126-27 and accompanying text; *cf. infra* notes 64-75, 137-40 and accompanying text. It is presumed, therefore, that the employee would choose to use a trust in this context because of the favorable non-tax results achieved by using a trust in general. These favorable non-tax results include: professional management of the trust property by a trustee; control over the trust property by a trustee to prevent misuse of the trust property by young, inexperienced trust beneficiaries; and protection of the trust property from the claims of those other than the beneficiaries of the trust. 33 BONNIE J. LAWLESS, ESTATE PLANNING STRATEGIES USING TRUSTS ¶ 1.02(A) (1997).

20. *See infra* notes 144-48 and accompanying text.

21. *See infra* notes 149-52 and accompanying text.

22. *See supra* note 1.

23. H.R. REP. No. 99-426, at 726 (1985), *reprinted in* 1986-3 (Volume 2) C.B. 726. The Committee on Ways and Means expressed a desire to see qualified retirement plans used for the "replacement of a participant's preretirement income stream at retirement[,] rather than for the indefinite deferral of tax on the participant's accumulation under the plan." *Id.*

24. For example, I.R.C. § 401(a)(9) provides that a retirement plan is not "qualified" unless the plan's provisions are in accordance with the distribution rules set forth under I.R.C. § 401(a)(9). If a retirement plan is not qualified, the relevant tax benefits are not available. *See supra* note 1.

25. I.R.C. § 7805(a) gives the Secretary of the Treasury Department general authority to "prescribe all needful rules and regulations for the enforcement of [the Internal Revenue Code], including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue." The Supreme Court of the United States indicated that regulations issued pursuant to this general authority have the force of law "unless unreasonable and plainly inconsistent with the [Internal Revenue Code]." Commissioner v. South Tex. Lumber Co., 333 U.S. 496, 501 (1948) (citing Fawcus Mach. Co. v. United States, 282 U.S. 375, 378 (1931)).

26. *See, e.g.*, I.R.C. § 401(a)(9)(A); Prop. Treas. Reg. § 1.401(a)(9)-1, Q.&A. B-1(a). While I.R.C. § 401(a)(9) literally applies only to retirement plans qualified under I.R.C. § 401(a), other types of qualified retirement plans incorporate by reference I.R.C. § 401(a)(9) as their general governing distribution provision. *See, e.g.*, I.R.C. § 403(b)(10).

27. *See* I.R.C. § 401(a)(9)(A); Prop. Treas. Reg. § 1.401(a)(9)-1, B.

28. *See* I.R.C. § 401(a)(9)(B); Prop. Treas. Reg. § 1.401(a)(9)-1, C.

B. THE RULES GOVERNING THE DISTRIBUTION OF BENEFITS BEFORE THE DEATH OF AN EMPLOYEE

The distribution of benefits under a qualified retirement plan must begin no later than the required beginning date of an employee under the plan.[29] The "required beginning date" generally is April 1 of the year following either the year in which an employee under a plan attains the age of 70½, or the year in which the employee retires, whichever is later.[30] On the required beginning date, all of an employee's benefits must have been distributed to the employee.[31] In the alternative, an employee may elect to receive the employee's benefits, "beginning not later than the required beginning date, . . . over the life of [the] employee or over the lives of [the] employee and a designated beneficiary (or over a period not extending beyond the life expectancy of [the] employee or the life expectancy of [the] employee and a designated beneficiary)."[32]

A limitation known as the minimum distribution incidental benefit requirement applies in certain cases, depending on the age of a designated beneficiary.[33] This limitation results in modifications to the payment stream under a qualified retirement plan when a designated beneficiary is more than ten years

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29. I.R.C. § 401(a)(9)(A).

30. I.R.C. § 401(a)(9)(C)(i). However, "in the case of an employee who is a 5-percent owner . . . with respect to the plan year ending in the . . . year in which the employee attains age 70½," the required beginning date is April 1 of the year following the year in which the employee attains age 70½. *See* I.R.C. § 401(a)(9)(C)(ii)(I). A 5-percent owner is any employee who owns more than 5 percent of the outstanding stock of the employee's corporate employer, or "stock possessing more than 5 percent of the total combined voting power of all stock" of the employee's corporate employer. I.R.C. § 416(i)(1)(B)(i)(I). A 5-percent owner is also any employee "who owns more than 5 percent of the capital or profits interest" in the employee's non-corporate employer. I.R.C. § 416(i)(1)(B)(i)(II).

31. I.R.C. § 401(a)(9)(A)(i).

32. I.R.C. § 401(a)(9)(A)(ii). For purposes of this article, it is assumed that an employee has chosen this alternative method for the distribution of the employee's qualified retirement plan benefits.

33. *See* I.R.C. § 401(a)(9)(G); Prop. Treas. Reg. § 1.401(a)(9)-2, Q.&A. 1.

younger than an employee.[34] This limitation does not apply, however, if the designated beneficiary is the employee's spouse.[35]

C. THE RULES GOVERNING THE DISTRIBUTION OF BENEFITS AFTER THE DEATH OF AN EMPLOYEE

If an employee under a qualified retirement plan dies after the employee's required beginning date,[36] but before the entire interest of the employee is distributed, "the remaining portion of [the] interest will be distributed at least as rapidly as under the method of distributions being used . . . as of the date of [the employee's] death."[37]

Alternatively, if an employee under a qualified retirement plan dies before the employee's required beginning date,[38] "the entire interest of the employee will be distributed within 5 years after the death of [the] employee."[39]

An exception to this alternative rule states, however, that if "any portion of the employee's interest is payable to (or for the benefit of) a designated beneficiary, [this] portion will be distributed . . . over the life of [the] designated

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34. The regulations effectuate these modifications in two ways. First, assume that an employee elects to receive the employee's benefits in installments over the life expectancy of the employee and a designated beneficiary who is more than 10 years younger than the employee. *See supra* note 32 and accompanying text. In this situation, the joint life expectancy of the employee and the designated beneficiary is altered in a way that forces larger distributions of the employee's benefits while the employee is likely to be alive. *Compare* Prop. Treas. Reg. § 1.401(a)(9)-2, Q.&A. 4(a)(2) (setting out a numerical table used in calculating the amount distributed to an employee when a designated beneficiary is more than 10 years younger than the employee) *with* Treas. Reg. § 1.72-9, Table VI (setting forth joint life expectancies used in calculating the amount distributed to an employee when a designated beneficiary is at most 10 years younger than the employee). The result in this situation would appear consistent with the stated objective of Congress in enacting the distribution requirements, which is to provide for an *employee's* retirement. *See supra* notes 22-23 and accompanying text.

Second, assume that an employee elects to receive benefits as a joint and survivor annuity and has a designated beneficiary who is more than 10 years younger than the employee. *See supra* note 32 and accompanying text. In this situation, the amount of the employee's benefits that are payable to the designated beneficiary "must not at any time on or after the employee's required beginning date exceed the applicable percentage of [the benefits] payable to the employee." Prop. Treas. Reg. § 1.401(a)(9)-2, Q.&A. 6(b)(1). *See also supra* note 30 and accompanying text (describing an employee's "required beginning date"). The "applicable percentage" depends on how many years of age separate the designated beneficiary and the employee. Prop. Treas. Reg. § 1.401(a)(9)-2, Q.&A. 6(b)(1). For instance, if the designated beneficiary is only 10 years younger than the employee, the amount of benefits payable to the designated beneficiary is, accordingly, 100% of the amount of benefits payable to the employee. *See id.* § 1.401(a)(9)-2, Q.&A. 6(b)(2). The result of limiting, in this fashion, the amount of an employee's benefits that a designated beneficiary may receive is that the employee receives more benefits before death than if no limitation were in effect. This result again would appear consistent with the objective of Congress in enacting the distribution requirements. *See supra* notes 22-23 and accompanying text.

35. Prop. Treas. Reg. § 1.401(a)(9)-2, Q.&A. 7(a).

36. *See supra* note 30 and accompanying text.

37. I.R.C. § 401(a)(9)(B)(i). *See also* Prop. Treas. Reg. § 1.401(a)(9)-1, Q.&A. B-5(a).

38. *See supra* note 30 and accompanying text.

39. I.R.C. § 401(a)(9)(B)(ii). *See also* Prop. Treas. Reg. § 1.401(a)(9)-1, Q.&A. B-5(a).

beneficiary (or over a period not extending beyond the life expectancy of [the] beneficiary)."[40] The distribution of benefits under this exception must generally begin no later than December 31 of the year following the year in which the employee died.[41]

Furthermore, a special rule states that if the surviving spouse of the employee is the designated beneficiary under the exception mentioned above, the distribution of benefits is not to begin at least until December 31 of the year in which the employee would have attained the age of 70½.[42] If the surviving spouse dies before the distribution of benefits to the spouse begin, the alternative rule mentioned above and its exception "shall be applied as if the surviving spouse were the employee."[43]

III. COPING WITH THE TAXATION OF QUALIFIED RETIREMENT PLAN BENEFITS WHEN USING CERTAIN TRUST ARRANGEMENTS

A. NAMING A TRUST AS A BENEFICIARY: THE INCOME TAX IMPLICATIONS

The term "designated beneficiary" is referred to throughout the rules regarding the distribution of qualified retirement plan benefits.[44] The Internal Revenue Code defines this term as "any *individual* designated as a beneficiary by the employee."[45] This definition provides somewhat little guidance, however, and one must instead look to regulations to exactly determine who may be a designated beneficiary.[46]

Although a trust may be named as a beneficiary of an employee's qualified retirement plan benefits,[47] the regulations prohibit a trust from being a "designated beneficiary" because a trust is not an individual.[48] However, the beneficiaries of a trust are treated as designated beneficiaries[49] and, furthermore, distributions of the benefits to the trust are treated as made to those benefi-

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40. I.R.C. § 401(a)(9)(B)(iii)(I), (II).

41. *See* I.R.C. § 401(a)(9)(B)(iii)(III); Prop. Treas. Reg. § 1.401(a)(9)-1, Q.&A. C-3(a).

42. *See* I.R.C. § 401(a)(9)(B)(iv)(I); Prop. Treas. Reg. § 1.401(a)(9)-1, Q.&A. C-3(b).

43. I.R.C. § 401(a)(9)(B)(iv)(II). For purposes of the special rule with respect to surviving spouses, a surviving spouse of an employee's surviving spouse is not considered a surviving spouse. Prop. Treas. Reg. § 1.401(a)(9)-1, Q.&A. C-5.

44. *See supra* notes 32-35, 40-43 and accompanying text.

45. I.R.C. § 401(a)(9)(E) (emphasis added).

46. *See supra* note 25.

47. Most qualified retirement plans are required to pay benefits in a form which guarantees that the spouse of an employee under a plan will receive some of the employee's undistributed benefits after the death of the employee. *See* I.R.C. §§ 401(a)(11), 417(b), (c). Therefore, in order for an employee to choose a non-spouse beneficiary such as a trust, the employee must waive this form of benefits. *See* I.R.C. § 417(a)(1). The employee's spouse, however, must provide written consent to the waiver by the employee. I.R.C. § 417(a)(2). The consent given by the employee's spouse, incidentally, is "not . . . treated as a transfer of property by gift for purposes of [the gift tax]." I.R.C. § 2503(f).

48. Prop. Treas. Reg. § 1.401(a)(9)-1, Q.&A. D-5(b).

49. These beneficiaries must, of course, be *individuals*. *See* I.R.C. § 401(a)(9)(E); *see also* Prop. Treas. Reg. § 1.401(a)(9)-1, Q.&A. D-2A(a).

ciaries for purposes of applying the rules regarding the distribution of qualified retirement plan benefits,[50] if the trust meets certain requirements.[51]

1. *Income Tax Deferral with Respect to the Distribution of Benefits Before the Death of an Employee.*—By electing to have a designated beneficiary,[52] an employee under a qualified retirement plan can spread the distribution of benefits out over the life expectancy of the employee *and* the designated beneficiary.[53] This means that distributions to the employee will be lower in amount than if the distribution of benefits were spread over the shorter life expectancy of the employee alone.[54] A lower distribution amount results in less taxable income for the employee and, therefore, less income tax payable.[55] Put another

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50. *See supra* notes 29-43 and accompanying text.

51. Prop. Treas. Reg. § 1.401(a)(9)-1, Q.&A. D-5(a), (b). The requirements are as follows:

> (1) The trust is a valid trust under state law, or would be but for the fact that there is no corpus.
> (2) The trust is irrevocable.
> (3) The beneficiaries of the trust . . . are identifiable from the trust instrument . . . .
> (4) A copy of the trust instrument is provided to the [retirement] plan.

Id. § 1.401(a)(9)-1, Q.&A. D-5(a).

With regard to the distribution of qualified retirement plan benefits before the death of an employee, a trust named as a beneficiary must meet the above requirements as of either the date the trust is named as a beneficiary, or the employee's required beginning date, whichever is later. Prop. Treas. Reg. § 1.401(a)(9)-1, Q.&A. D-5(a); *see also supra* notes 29-35 and accompanying text. Furthermore, the trust must meet the above requirements at all times after the employee's required beginning date. Prop. Treas. Reg. § 1.401(a)(9)-1, Q.&A. D-5(b).

With regard to the distribution of qualified retirement plan benefits after the death of an employee, but before the employee's required beginning date, a trust named as a beneficiary must meet the above requirements as of the date of the employee's death. Prop. Treas. Reg. § 1.401(a)(9)-1, Q.&A. D-6(a); *see also supra* notes 38-43 and accompanying text.

52. It is worth mentioning here that I.R.C. § 2501(a)(1) imposes a tax on the transfer of property by gift. Furthermore, if an employee makes an *irrevocable* election to have the employee's qualified retirement plan benefits payable to a particular designated beneficiary after the death of the employee, the election is considered a transfer of property by gift. *See* Treas. Reg. § 25.2511-1(h)(10); *see also* I.R.C. § 2517 (repealed 1986) (providing that an employee's election to have qualified retirement plan benefits payable to a beneficiary after the death of the employee will not be considered a transfer of property by gift). Given that the designated beneficiary does not receive the benefits until after the death of the employee, the gift is of a future interest in property. *See* Treas. Reg. § 25.2503-3(a). The value of the gift is, therefore, not eligible for the $10,000 annual exclusion from taxable gifts for gifts of a present interest in property provided for under I.R.C. § 2503(b). If the designated beneficiary is the employee's spouse, however, the value of the gift is deducted in arriving at the amount of taxable gifts made by the employee. *See* I.R.C. §§ 2503(a), 2523(a).

53. *See supra* note 32 and accompanying text. The ages of the employee and the designated beneficiary as of their respective birthdays in the year in which the employee retires or attains the age of 70½, whichever is later, are the ages used for determining the life expectancy of the employee and the designated beneficiary. Prop. Treas. Reg. § 1.401(a)(9)-1, Q.&A. E-1(a), (b).

54. *See infra* note 56.

55. I.R.C. § 1(a)-(e) imposes a tax on income. I.R.C. § 402(a) provides that a distribution of qualified retirement plan benefits is "taxable to the distributee, in the taxable year of the distributee in which distributed, under section 72" of the Internal Revenue Code. I.R.C. § 72 generally includes in income any amount received as an annuity. *See supra* note 32 and accompanying text.

way, the distribution of benefits over an extended period of time results in the deferral of income tax.[56]

Naming a trust as a beneficiary raises some important points for discussion. To begin with, assuming the trust has multiple beneficiaries, the life expectancy of the oldest beneficiary must be used to determine the period over which the distribution of benefits will be made.[57] This requirement ties in with the minimum distribution incidental benefit requirement.[58]

Applying these two requirements to a situation where the beneficiaries of a trust are an employee's children[59] will limit the deferral of income tax, but will not eliminate the deferral of income tax.[60] Specifically, if the oldest child of the employee is more than ten years younger than the employee, the minimum distribution incidental benefit requirement applies to modify the payment stream under the employee's qualified retirement plan.[61] In so doing, benefits are distributed to the employee in larger amounts than they would be if the minimum distribution incidental benefit requirement did not apply.[62] The employee will, therefore, have more taxable income and more income tax payable.[63]

2. *Income Tax Deferral with Respect to the Distribution of Benefits After the Death of an Employee.*—If an employee under a qualified retirement plan dies after the employee's required beginning date,[64] but before all of the employee's benefits are distributed, a designated beneficiary may receive distribu-

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56. For example, if $600 of benefits are distributed in equal amounts annually over a 20 year life expectancy of an employee alone, the income to the employee each year is $30. *See supra* note 55. However, if the same $600 of benefits are distributed in equal amounts annually over a 30 year life expectancy of an employee *and* a designated beneficiary, the income to the employee each year is $20. *See supra* note 55. In the latter situation, $10 of income and the corresponding income tax have been shifted to later years (i.e., the income and the tax have been deferred).

This example assumes that the amount of qualified retirement plan benefits left undistributed each year remains "frozen" in value. In reality, these benefits are allowed to grow tax-free in value each year. *See* I.R.C. § 501(a). This situation represents another advantage of the tax deferral inherent in the provisions of the Internal Revenue Code concerning qualified retirement plans. *See supra* note 17.

57. *See* Prop. Treas. Reg. § 1.401(a)(9)-1, Q.&A. D-5(b), E-5(a)(1).

58. *See supra* notes 33-35 and accompanying text.

59. Children of an employee generally are the optimal choice as beneficiaries of the trust because of their extended life expectancies, which increase the period for the deferral of tax. *See supra* note 56 and accompanying text.

60. *See infra* notes 61-63 and accompanying text.

61. *See supra* notes 33-34 and accompanying text.

62. *See supra* notes 33-34 and accompanying text.

63. *Cf. supra* note 55 and accompanying text. One might suggest making an employee's spouse who is more than 10 years younger than the employee the oldest beneficiary of the trust in the hope of increasing the period for the deferral of income tax. *See supra* notes 56-57 and accompanying text. The argument would be that the minimum distribution incidental benefit requirement does not apply if the designated beneficiary is the employee's spouse. *See supra* notes 33-35 and accompanying text. The regulations effectively disallow the use of this exception, however, in a situation where the trust has multiple beneficiaries. *See* Prop. Treas. Reg. § 1.401(a)(9)-2, Q.&A. 7(b).

64. *See supra* note 30 and accompanying text.

tion amounts "at least as rapidly as under the method of distributions being used . . . as of the date of [the employee's] death."[65] This means that if a trust is named as a beneficiary, it may receive the distribution of benefits over the remaining life expectancy of the employee and the oldest beneficiary of the trust.[66] Moreover, the minimum distribution incidental benefit requirement[67] does not apply with respect to the distribution of benefits after the death of an employee.[68] Therefore, assuming the oldest beneficiary of the trust is relatively young, the trust will receive the distribution of benefits over an extended period of time, which will result in the deferral of income tax.[69]

If an employee under a qualified retirement plan dies before the employee's required beginning date, a trust which is named as a beneficiary will be allowed to receive the distribution of the employee's benefits over the life expectancy of the oldest beneficiary of the trust.[70] Generally, the distribution of these benefits must commence no later than December 31 of the year following the year in which the employee died.[71] Since the minimum distribution incidental benefit requirement[72] does not apply with respect to the distribution of benefits after the death of an employee,[73] the distribution of benefits in this instance will be spread over an extended period of time (assuming the oldest beneficiary of the trust is relatively young upon the employee's death),[74] again resulting in the deferral of income tax.[75]

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65. I.R.C. § 401(a)(9)(B)(i). *See also* Prop. Treas. Reg. § 1.401(a)(9)-1, Q.&A. B-5(a).

66. *See supra* notes 52-53, 57 and accompanying text.

67. *See supra* notes 33-35 and accompanying text.

68. Prop. Treas. Reg. § 1.401(a)(9)-2, Q.&A. 3.

69. *See supra* notes 52-56 and accompanying text. The qualified retirement plan benefits of a deceased employee are known as income in respect of a decedent. *See* I.R.C. § 691(a)(1). When a trust receives distributions of these benefits, it must include these benefits in income. *See id.* Furthermore, I.R.C. § 1(e) imposes a tax on the income of a trust. An income tax deduction is allowed, however, for any estate tax attributable to the inclusion of the income in respect of a decedent in the estate of a deceased employee. I.R.C. § 691(c)(1)(A). *See also* Treas. Reg. § 1.691(c)-1(a); *infra* notes 76-77 and accompanying text.

Given that the *trust* must include distributions of qualified retirement plan benefits of a deceased employee in its income, it should be noted that the overall income tax cost in this context may, depending on the terms of the trust, be increased due to the higher marginal income tax rates applicable to trusts, as opposed to individuals. *Compare* I.R.C. § 1(c) *with* I.R.C. § 1(e). For the rules regarding the taxation of trusts, *see generally* I.R.C. §§ 641-83.

70. *See supra* notes 38-40, 57 and accompanying text. The life expectancy of the oldest beneficiary of the trust is determined as of the beneficiary's birthday in the year following the year in which the employee died. Prop. Treas. Reg. § 1.401(a)(9)-1, Q.&A. E-2(a).

71. Prop. Treas. Reg. § 1.401(a)(9)-1, Q.&A. C-3(a). *But see supra* note 42 and accompanying text.

72. *See supra* notes 33-35 and accompanying text.

73. Prop. Treas. Reg. § 1.401(a)(9)-2, Q.&A. 3.

74. *See supra* note 70 and accompanying text.

75. *See supra* note 69.

B. NAMING A MARITAL DEDUCTION TRUST AS A BENEFICIARY: THE ESTATE TAX IMPLICATIONS

Qualified retirement plan benefits are included in an employee's estate upon the death of the employee.[76] These benefits are, therefore, subject to the estate tax.[77] The estate tax imposed with respect to an employee's qualified retirement plan benefits can, however, be deferred, or altogether avoided, by taking advantage of the marital deduction provided for under the Internal Revenue Code.[78]

1. *Estate Tax Deferral or Estate Tax Avoidance with Respect to Benefits upon the Death of an Employee Using the Marital Deduction.*—A deduction from a decedent's estate for the passing of property from the decedent[79] reduces the decedent's *taxable* estate.[80] Consequently, the estate tax that would have been imposed with respect to the property for which the deduction is taken[81] is avoided insofar as the estate of the decedent is not liable for the tax.[82] Two possible situations exist as to whether any estate tax will ever be paid with respect to property for which a deduction is taken.

First, property (or a portion of it) for which a deduction is taken can become part of the estate of the person to whom the property passed.[83] If included in the estate of this person, the property will then be subject to the estate tax.[84] This, nonetheless, represents an instance where the estate tax with respect to the property is deferred.[85]

Alternatively, property for which a deduction is taken can be entirely consumed or disposed of during life by the person to whom the property passed. As a result, none of the property will be included in this person's estate upon

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76. I.R.C. § 2039 includes in a decedent's estate the value of an annuity formerly payable to the decedent and presently payable to any beneficiary by reason of surviving the decedent. *See supra* notes 32, 36-40 and accompanying text.

77. *See* I.R.C. § 2001(a).

78. *See infra* notes 79-91 and accompanying text.

79. The marital deduction is available with respect to certain property which passes or has passed to the surviving spouse of a decedent. *See infra* notes 88-91 and accompanying text.

80. *See* I.R.C. § 2051.

81. *See* I.R.C. § 2001(a).

82. *See* I.R.C. § 2002; Treas. Reg. § 20.2002-1.

83. *See, e.g.*, I.R.C. § 2033.

84. *See* I.R.C. § 2001(a). It is conceivable, however, for the property to be eliminated from this person's estate by way of a deduction. I.R.C. § 2051.

85. *See supra* note 17.

death.[86] Therefore, the estate tax with respect to the property is altogether avoided.[87]

The marital deduction is a deduction allowed from a decedent's estate for "the value of any interest in property which passes or has passed from [a] decedent to [the decedent's] surviving spouse, but only to the extent that [the] interest is included in determining the value of the [decedent's] . . . estate."[88] If a decedent's surviving spouse receives a terminable interest in property passing from the decedent to the surviving spouse, however, the marital deduction generally is not allowed.[89] A "terminable interest" is defined as "an interest which will terminate or fail on the lapse of time or on the occurrence or failure to occur of some contingency."[90] An exception to the terminable interest rule allows the marital deduction with respect to qualified terminable interest property.[91]

The use of a trust when attempting to make the distribution of a decedent's qualified retirement plan benefits eligible for the marital deduction raises two issues. These issues are presented and discussed below.

2. *Qualifying the Distribution of Benefits in Trust for the Marital Deduction.*—The first issue presented when attempting to make the distribution of a decedent's qualified retirement plan benefits in trust[92] eligible for the marital deduction is whether the benefits *pass* from the decedent to the decedent's surviving spouse.[93] This issue is indirectly addressed in the Internal Revenue Code, which provides that if property (i.e., qualified retirement plan benefits) is "qualified terminable interest property[,] . . . [the] property shall be treated as passing to the surviving spouse [of a decedent]."[94]

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86. I.R.C. §§ 2033-44 provide for the value of specific property to be included in the estate of a decedent. For example, if a decedent during life transferred property while retaining for the decedent's life "the possession or enjoyment of, or the right to the income from, the property, or . . . the right . . . to designate the persons who shall possess or enjoy the property or the income [from the property]," the value of the property is included in the estate of the decedent. I.R.C. § 2036(a). It is assumed here that none of these sections apply.

87. It is further assumed here that no gift tax was payable with respect to the dispositions made during life by the person to whom the property originally passed. *See generally* I.R.C. §§ 2501-24. As stated at *supra* note 4, the gift tax is essentially the *estate* tax imposed on a decedent's lifetime property transfers by gift.

88. I.R.C. § 2056(a).

89. *See* I.R.C. § 2056(b)(1).

90. Treas. Reg. § 20.2056(b)-1(b).

91. *See* I.R.C. § 2056(b)(7)(A). This exception is discussed at *infra* notes 95-106 and accompanying text.

92. The trust would be a beneficiary and, therefore, distributions to the trust must be in accordance with the rules regarding the distribution of qualified retirement plan benefits. *See supra* notes 36-43, 64-68, 70-71 and accompanying text. Moreover, actually naming a trust as a beneficiary in this context is permitted only under certain circumstances, *see supra* note 47, which are assumed to be present here.

93. *See supra* note 88 and accompanying text.

94. I.R.C. § 2056(b)(7)(A).

The second issue presented is, therefore, whether the distribution of a decedent's qualified retirement plan benefits in trust creates "qualified terminable interest property", which is eligible for the marital deduction.[95] The Internal Revenue Service addressed this issue in Revenue Ruling 89-89.[96]

Under the facts of Revenue Ruling 89-89, a decedent had an individual retirement account ("IRA").[97] Prior to death, the decedent elected to have the date of death balance in the IRA distributed in annual installments to a trust over the life expectancy of the decedent's surviving spouse.[98] Under this distribution option and the terms of the trust, income with respect to both the IRA balance and amounts distributed to the trust from the IRA was payable annually to the decedent's surviving spouse as a matter of right.[99] Additionally, no person had the power to appoint any of the trust principal to anyone other than the decedent's surviving spouse.[100]

The Internal Revenue Service allowed the marital deduction under these facts,[101] reasoning that since the decedent's surviving spouse had a qualifying income interest for life in the decedent's IRA,[102] the decedent's IRA constituted qualified terminable interest property eligible for the marital deduction.[103]

In light of Revenue Ruling 89-89, when structuring a trust solely for the benefit of a decedent's surviving spouse to receive the distribution of the dece-

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95. *See supra* note 91 and accompanying text.

96. 1989-2 C.B. 231. A revenue ruling is an official interpretation of federal tax law by the Internal Revenue Service, as opposed to a court. *See* Treas. Reg. § 601.201(a)(6). Moreover, revenue rulings are merely issued for the purpose of advising and informing the public about certain federal tax issues. *See id.* Revenue rulings, therefore, are not binding on courts. *See, e.g.*, Sims v. United States, 252 F.2d 434, 438 (4th Cir. 1958), *aff'd*, 359 U.S. 108, 114 (1959); Stubbs, Overbeck & Assoc., v. United States, 445 F.2d 1142, 1146-47 (5th Cir. 1971); Burck v. Commissioner, 63 T.C. 556, 561-62 (1975), *aff'd*, 533 F.2d 768, 774 (2d Cir. 1976). *But see* Salomon, Inc. v. United States, 976 F.2d 837, 841 (2d Cir. 1992) ("'Revenue rulings issued by the I.R.S. . . . have the force of legal precedent unless unreasonable or inconsistent with the provisions of the Internal Revenue Code.'") (quoting Amato v. Western Union Int'l, Inc., 773 F.2d 1402, 1411 (2d Cir. 1985), *cert. dismissed*, 474 U.S. 1113 (1986)).

97. 1989-2 C.B. at 231.

98. *Id.*

99. *Id.*

100. *Id.*

101. *See id.* at 232.

102. *Id.* A decedent's surviving spouse has a qualifying income interest for life in trust property if "(I) the surviving spouse is entitled to all the income from the [trust] property, payable annually or at more frequent intervals . . . and (II) no person has a power to appoint any part of the [trust] property to any person other than the surviving spouse." I.R.C. § 2056(b)(7)(B)(ii)(I), (II).

If a decedent's surviving spouse has a qualifying income interest for life with respect to qualified retirement plan benefits that are in a trust, the surviving spouse must include the value of these benefits in the surviving spouse's estate. *See* I.R.C. § 2044(a), (b). This requirement, therefore, creates a situation of estate tax deferral with respect to qualified retirement plan benefits. *See supra* notes 83-85 and accompanying text.

103. *See* 1989-2 C.B. at 232. Qualified terminable interest property is defined in relevant part as property "(I) which passes from [a] decedent, [and] (II) in which the surviving spouse [of the decedent] has a *qualifying income interest for life*." I.R.C. § 2056(b)(7)(B)(i)(I), (II) (emphasis added).

dent's qualified retirement plan benefits, it is important that the terms of the trust make any income from the benefits, that becomes part of the trust, *payable*[104] annually to the surviving spouse.[105] If the terms of the trust do not do this, the decedent's qualified retirement plan benefits will not constitute property for which the marital deduction can be taken.[106]

C. NAMING A CHARITABLE REMAINDER TRUST AS A BENEFICIARY: THE ESTATE TAX AND INCOME TAX IMPLICATIONS

Charitable remainder trusts are broken down into two types.[107] A charitable remainder annuity trust is a trust from which only a sum certain is paid to one or more beneficiaries (at least one of which is not a charity) for a term of years ("the annuity interest"), with the property in the trust being transferred outright to a charity at the end of the term of years ("the remainder interest").[108] A charitable remainder unitrust is a trust from which only a fixed percentage of the trust property is paid to one or more beneficiaries (at least one of which is not a charity) for a term of years ("the unitrust interest"), with the property in the trust being transferred outright to a charity at the end of the term of years ("the remainder interest").[109] Naming a charitable remainder trust as a beneficiary of a decedent's undistributed qualified retirement plan benefits[110] not only allows for the avoidance of the estate tax with respect to a specific portion of the benefits,[111] but also allows for the deferral and avoidance of the income tax with respect to specific portions of the benefits.[112]

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104. In order for a decedent's surviving spouse to have a qualified income interest for life in trust property, the regulations explicitly require that the surviving spouse merely have command over any income that becomes part of the trust, whether the income is actually distributed to the surviving spouse or not. *See* Treas. Reg. § 20.2056(b)-7(d)(2), -5(f)(8); *see also supra* note 102.

105. Although Revenue Ruling 89-89 specifically involved a decedent's individual retirement account, as opposed to qualified retirement plan benefits, it would appear that Revenue Ruling 89-89 is equally applicable to a situation involving qualified retirement plan benefits. The Internal Revenue Service supported this proposition when it allowed the marital deduction under facts similar to those in Revenue Ruling 89-89, except that qualified retirement plan benefits were involved, as opposed to an individual retirement account. Priv. Ltr. Rul. 9232036 (May 13, 1992) (applying Rev. Rul. 89-89, 1989-2 C.B. 231).

106. *See supra* notes 97-103 and accompanying text. If a decedent's surviving spouse is not a citizen of the United States, the marital deduction generally is only allowed if the decedent's benefits are passed to the surviving spouse in a qualified domestic trust. *See* I.R.C. § 2056(d)(1), (2). A "qualified domestic trust" is any trust meeting the requirements set forth in I.R.C. § 2056A(a).

107. *See* Treas. Reg. § 1.664-1(a)(2).

108. I.R.C. § 664(d)(1).

109. I.R.C. § 664(d)(2).

110. If a charitable remainder trust is named as a beneficiary, distributions of benefits to the trust must be in accordance with the rules regarding the distribution of qualified retirement plan benefits. *See supra* notes 36-43, 64-68, 70-71 and accompanying text; *see also infra* note 130. Moreover, actually naming a trust as a beneficiary is permitted only under certain circumstances, *see supra* note 47, which are assumed to be present here.

111. *See infra* notes 113-27 and accompanying text.

112. *See infra* notes 128-40 and accompanying text.

1. *Estate Tax Avoidance with Respect to Benefits upon the Death of an Employee.*—A deduction from a decedent's estate for the transfer of qualified retirement plan benefits reduces the decedent's taxable estate[113] and, therefore, the estate tax imposed with respect to the benefits.[114] Moreover, this deduction allows for either the deferral or the complete avoidance of the estate tax imposed with respect to the benefits.[115] It is the latter result that is achieved when a charitable remainder trust is named as a beneficiary for the distribution of a decedent's qualified retirement plan benefits.[116]

The charitable deduction is a deduction allowed from a decedent's estate for the transfer of property "to a trustee or trustees . . . , but only if [the property is] to be used by [the] trustee or trustees . . . *exclusively* for religious, charitable, scientific, literary, or educational purposes."[117] The amount of the charitable deduction is limited to "the value of the transferred property required to be included in the [decedent's] . . . estate."[118] Where only a portion of property transferred is going to be used for the purposes mentioned above, however, the charitable deduction is not allowed unless "in the case of a remainder interest, [the] interest is in a trust which is a charitable remainder annuity trust or a charitable remainder unitrust."[119]

When a charitable remainder annuity trust or a charitable remainder unitrust is named as a beneficiary for the distribution of a decedent's qualified retirement plan benefits, the present value[120] of the remainder interest passing to a charity at the end of a term of years[121] represents the amount of the charitable deduction.[122] The annuity or unitrust interest passing to the noncharitable bene-

113. *See* I.R.C. § 2051.

114. *See* I.R.C. § 2001(a); *see also supra* notes 81-82 and accompanying text.

115. *See supra* notes 83-87 and accompanying text

116. *See infra* notes 117-27 and accompanying text.

117. I.R.C. § 2055(a)(3) (emphasis added).

118. I.R.C. § 2055(d).

119. I.R.C. § 2055(e)(2)(A). *See also supra* notes 108-09 and accompanying text (describing a "remainder interest").

120. Present value refers to the present or current worth of property that is to be received at some future date. *See, e.g.*, PEAT & WILLBANKS, *supra* note 5, at 18-20.

121. *See supra* notes 108-09 and accompanying text.

122. *See* Treas. Reg. § 20.2055-2(f)(1), (2).

ficiaries[123] generally is not deductible from a decedent's estate[124] and is, therefore, subject to the estate tax.[125]

Furthermore, since a charity is not a human, it is not subject to the estate tax.[126] As a result, the estate tax with respect to the property interest for which the charitable deduction is taken[127] is completely avoided.

2. *Income Tax Deferral and Income Tax Avoidance with Respect to the Distribution of Benefits After the Death of an Employee.*—Qualified retirement plan benefits which are distributed after the death of an employee constitute income to a recipient of the benefits.[128] A charitable remainder annuity trust and a charitable remainder unitrust are, however, exempt from the income tax.[129] Naming a charitable remainder trust as a beneficiary of a decedent's qualified retirement plan benefits, therefore, results in the benefits passing to

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123. *See supra* notes 108-09 and accompanying text.

124. If this interest passes to a decedent's surviving spouse, and if the surviving spouse is the *only* non-charitable beneficiary of a charitable remainder trust, however, the passing of this interest qualifies for the marital deduction. *See* I.R.C. § 2056(b)(8); *see also supra* notes 88-91and accompanying text.

Given that the surviving spouse in this arrangement will receive only a sum certain, or only a fixed percentage, from the trust property for a term of years, *see supra* notes 108-09 and accompanying text, the surviving spouse is not "entitled to all the income from the [trust] property" and cannot, therefore, have a qualifying income interest for life in the trust property. I.R.C. § 2056(b)(7)(B)(ii)(I). If the surviving spouse does not have a qualifying income interest for life in the trust property, the trust property does not have to be included in the estate of the surviving spouse upon death, where it would be subject to the estate tax. *See* I.R.C. §§ 2001(a), 2044(a). Accordingly, since the estate tax with respect to the remainder interest passing to a charity is completely avoided, *see infra* notes 126-27 and accompanying text, this arrangement presents an opportunity for qualified retirement plan benefits to pass to a decedent's beneficiaries entirely free of the estate tax.

125. *See supra* notes 76-77 and accompanying text. Any estate tax with respect to the annuity or unitrust interest passing to the non-charitable beneficiaries must not, however, be paid out of the charitable remainder trust property (i.e., the qualified retirement plan benefits). The Internal Revenue Service indicated that if any estate tax is paid out of this property, the trust will not qualify as a charitable remainder trust. Rev. Rul. 82-128, 1982-2 C.B. 71, 72. *But cf. supra* note 96. The Internal Revenue Code explicitly prohibits the payment of any amount, other than the annuity or unitrust amount, from the charitable remainder trust property to or *for the use of* any person who is not a charity. I.R.C. § 664(d)(1)(B), (2)(B); *cf.* Treas. Reg. § 1.664-1(a)(6), Example (3) (confirming that the payment by a charitable remainder trust of a debt owed by the transferor of the trust's property disqualifies the trust as a charitable remainder trust). The position of the Internal Revenue Service, therefore, would appear justified.

126. *See* Treas. Reg. § 20.0-1(b)(1).

127. *See supra* notes 120-22 and accompanying text.

128. *See* I.R.C. § 691(a)(1).

129. I.R.C. § 664(c) provides that "[a] charitable remainder annuity trust and a charitable remainder unitrust shall, for any taxable year, not be subject to any [income tax], unless [the] trust, for [the taxable year], has unrelated business taxable income." If a charitable remainder trust is disqualified as a charitable remainder trust, however, the resulting trust is not exempt from the income tax. *See* I.R.C. § 664(c). It becomes important, therefore, to avoid paying any estate tax imposed with respect to the annuity or unitrust interest of a charitable remainder trust from the property of the charitable remainder trust. *See supra* note 125; *supra* notes 108-09 and accompanying text.

the charitable remainder trust free of the income tax.[130] Once in a charitable remainder trust, a decedent's qualified retirement plan benefits are allowed to grow tax-free in value.[131]

When the annuity or unitrust interest of a charitable remainder trust is actually distributed to the noncharitable beneficiaries of the charitable remainder trust,[132] this interest is subject to the income tax.[133] Given that this is the first instance where the property of the charitable remainder trust is subject to the income tax,[134] naming a charitable remainder trust as a beneficiary of a decedent's qualified retirement plan benefits results in the deferral of the income tax imposed with respect to the portion of these benefits which fund the annuity or unitrust interest[135] of the charitable remainder trust.[136]

When the remainder interest of a charitable remainder trust is distributed to a charity at the end of a term of years,[137] this interest is not subject to the income tax.[138] Naming a charitable remainder trust as a beneficiary of a decedent's qualified retirement plan benefits, therefore, results in the complete avoidance

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130. If an employee under a qualified retirement plan dies before the employee's required beginning date, "the entire interest of the employee will be distributed within 5 years after the death of [the] employee." I.R.C. § 401(a)(9)(B)(ii). This rule can be avoided, however, if a designated beneficiary is utilized. *See supra* notes 38-43 and accompanying text. A charity cannot be a designated beneficiary for purposes of the rules regarding the distribution of qualified retirement plan benefits because a charity is not an individual. *See* Prop. Treas. Reg. § 1.401(a)(9)-1, Q.&A. D-2A(a). Given that a charity is a beneficiary of a charitable remainder trust, the five-year distribution rule mentioned above cannot be avoided by using a charitable remainder trust. *See* Prop. Treas. Reg. § 1.401(a)(9)-1, Q.&A. D-5(a), (b), D-6(a). This is of no consequence, however, since the five-year distribution rule only affects the income tax *deferral* possibility with respect to qualified retirement plan benefits. *Cf. supra* notes 70-75 and accompanying text. A charitable remainder trust is *exempt* from the income tax. *See supra* note 129 and accompanying text.

131. *See supra* note 129 and accompanying text

132. *See supra* notes 108-09 and accompanying text.

133. I.R.C. § 1(a)-(e) imposes a tax on income (including capital gain). An annuity or unitrust interest distributed from a charitable remainder trust is characterized to a recipient: first, as ordinary income; second, as capital gain; third, as other income; and last, as a distribution of the trust property (exclusive of undistributed income). *See* I.R.C. § 664(b); Treas. Reg. 1.664-1(d)(1)(i).

134. *See supra* notes 130-31 and accompanying text.

135. *See supra* notes 108-09 and accompanying text.

136. *See supra* note 17. Depending on the amount of the annuity or unitrust interest of the charitable remainder trust, it is conceivable for this interest to be entirely funded from the *income* generated by the property of the charitable remainder trust (i.e., the qualified retirement plan benefits). In this instance, the income tax *with respect to the qualified retirement plan benefits* technically is altogether avoided. That is, if the actual *benefits* originally distributed to the charitable remainder trust are not depleted through the funding of the annuity or unitrust interest of the charitable remainder trust for a term of years, these benefits pass to a charity completely free of the income tax at the end of the term of years. *See infra* notes 137-40 and accompanying text; *supra* notes 108-09 and accompanying text.

137. *See supra* notes 108-09 and accompanying text.

138. I.R.C. § 501(a) provides that "[a]n organization described in subsection (c) . . . shall be exempt from [the income tax] unless [this] exemption is denied under [other sections of the Internal Revenue Code]." Subsection (c) includes charities. I.R.C. § 501(c)(3).

of the income tax imposed with respect to the portion of these benefits which fund the remainder interest[139] of the charitable remainder trust.[140]

IV. CONCLUSION

Given the confiscatory nature of the taxes imposed with respect to qualified retirement plan benefits,[141] one would naturally seek to defer, or altogether avoid, these taxes. It is hoped that this article demonstrates how the use of particular trust arrangements in the context of the distribution of a taxpayer's qualified retirement plan benefits allows the overall tax burden with respect to these benefits to be lessened.[142] Because this article was written from a *tax* planning perspective, it overlooks the significant nontax implications regarding the use of trusts in this context. Taxpayers who choose to use trusts in the context of distributing their qualified retirement plan benefits[143] should, however, be made aware of the nontax implications which necessarily accompany the tax implications.

When a trust is named as a beneficiary of an employee's qualified retirement plan benefits, the income tax imposed with respect to the distribution of these benefits can be deferred both before the death of the employee,[144] and after the death of the employee.[145] The way these favorable tax results[146] are achieved is by lowering the amount of benefits actually distributed to the employee, or to a trust and its beneficiaries, each year.[147] A low amount of distributed benefits may not be in the employee's *best* interest, however, if this amount is insufficient to support the employee, or the beneficiaries of the trust.[148]

Additionally, when a charitable remainder trust, in particular, is named as a beneficiary of an employee's qualified retirement plan benefits, the estate tax and income tax imposed with respect to a portion of these benefits distributed following the death of the employee can be completely avoided, while the income tax imposed with respect to another portion of these benefits can be deferred.[149] In order to achieve these favorable tax results,[150] however, a portion

139. *See supra* notes 108-09 and accompanying text.
140. *See supra* notes 130-31 and accompanying text.
141. *See supra* notes 8-11 and accompanying text.
142. *See supra* notes 52-75, 79-106, 113-40 and accompanying text.
143. *See supra* note 19.
144. *See supra* notes 52-63 and accompanying text.
145. *See supra* notes 64-75 and accompanying text.
146. *See supra* note 17.
147. *See supra* notes 52-56, 64-75 and accompanying text.
148. Saving tax is, undoubtedly, in the interest of an employee under a qualified retirement plan. However, the projected cash requirements of the employee and the employee's beneficiaries are often the primary considerations when planning for the distribution of the employee's qualified retirement plan benefits. *Cf.* CAMPFIELD, *supra* note 1, at 1030-31.
149. *See supra* notes 113-40 and accompanying text.
150. *See supra* note 17.

of the employee's benefits must ultimately pass to a charity,[151] unavailable for the use of other, noncharitable beneficiaries the employee may have. Unless the employee is charitably inclined, therefore, the use of a charitable remainder trust as a beneficiary of the employee's qualified retirement plan benefits may not be consistent with the ultimate desire of the employee, which could be to provide for the employee's noncharitable beneficiaries after the employee's death.[152]

The foregoing analysis shows that when planning for the distribution of an employee's qualified retirement plan benefits, one must not lose sight of the needs and ultimate objective of the employee, as well as the needs of the employee's beneficiaries, notwithstanding the adverse tax consequences that may fall upon the employee's benefits.

151. *See supra* notes 120-22, 126-27, 130-40 and accompanying text.
152. *See* CAMPFIELD, *supra* note 1, at 1030-31.

Selected Defenses to Damage Allegations in Products Liability Suits

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I. INTRODUCTION

A cause of action for products liability can be asserted under a number of theories. This paper will examine selected damage defenses and review the corresponding standards which must be met before recovery is allowed. The most common theories include negligence, breach of warranty, and strict liability. Negligence, as a products liability cause of action, is divided into three principle categories: (1) manufacturing defect; (2) design defect; and (3) inadequate warning. With respect to breach of warranty, product liability causes of action may be upheld on the following theories: (1) implied warranty of merchantability; (2) implied warranty of fitness for a particular purpose; and (3) express warranty.[1] Finally, strict liability may be pled as a products liability cause of action in cases where the plaintiff can prove the product was "unreasonably dangerous."[2]

Regardless of the theory relied upon, a plaintiff must prove damages if the case is to result in a monetary award. From the defense perspective, regardless of whether the case is in discovery, negotiations, or trial, a solid understanding of the damage theories alleged along with the applicable defenses is imperative to properly defend the product manufacturer. While damage defenses are many and varied, the following illustrate examples of how damage allegations can be challenged.

II. THERE IS NO RECOVERY FOR DAMAGES WHICH ARE UNCERTAIN, SPECULATIVE, OR REMOTE

Generally, recovery for loss of profits will be denied where the profits are uncertain, speculative, or remote.[3] Nevertheless, despite the fact the alleged damages may be somewhat speculative, the plaintiff, may recover for loss of

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1. *See, e.g.*, Uniform Commercial Code, Article 2.

2. Many states have developed their own approach to strict products liability. *See, e.g.* Bierman, *Strict Products Liability: An Overview of State Law*, 10 J. Prod. Liab. 111(1987).

3. *Johnson v. Central Aviation Corp.*, 229 P.2d 114, 177 (Cal. 1951).

use in addition to a claim for loss of profits upon sale, in those instances where both elements of damage are warranted.[4]

Loss of goodwill caused by the seller's breach of contract with respect to goods sold can be recoverable under the Uniform Commercial Code (UCC) § 2-715. However, as before, damages for loss of goodwill are not recoverable where the measure of damages is speculative.[5] For example, one federal case involved a plaintiff in the business of installing air conditioning equipment.[6] He sought to recover lost future profits when two of the plaintiff's customers refused to award him contracts for future projects because of late delivery and malfunctioning of the air conditioning equipment.[7] The court, applying Illinois law, held that the consequential damages claimed by the plaintiff were totally speculative and did not arise naturally from the breach of the contract itself.[8]

Damages for loss of future profits and loss of goodwill have been held by many courts not to be recoverable under UCC § 2-715 due to insufficiency of evidence.[9] Aircraft product cases fall on both sides of the fence.

One federal case involved a defective aircraft engine which resulted in lost flight days for the photographer/plaintiff.[10] The court held that lost profits were recoverable as a consequential loss from injury to property where a defective remanufactured aircraft engine caused the damages.[11] The court noted, however, that proof of lost profits must be sufficient to remove the question from the realm of speculation and conjecture.[12] As such, the court reduced plaintiff's recovery from $56,000 to $3,600, which reflected a reasonable amount of profits for the flight days lost.[13]

Another court held that while a break in a nose gear rod caused damage to an aircraft, attempts at proving the loss of income and profits were unclear and uncertain and ultimately inconclusive based on the evidence presented.[14] The court concluded that because the insurer of the airplane proved its case against the manufacturer on the issue of liability, but not as to the loss of profits allegations, plaintiffs were entitled only to the cost of repairs and certain related expenses.[15]

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4. *Johnson*, 229 P.2d at 117.
5. *Id.*
6. *Chrysler v. E. Shavitz & Sons*, 536 F.2d 743 (7th Cir. 1976).
7. *Chrysler*, 536 F.2d at 743.
8. *Id.* at 746.
9. *See, e.g. Aldon Industries, Inc. v. Don Myers & Associates, Inc.*, 517 F.2d 188 (5th Cir. 1975) (later appealed on other grounds, 547 F.2d 924); *Certain-Teed Products Corp. v. Goslee Roofing & Sheet Metal, Inc.*, 339 A.2d 302 (Md. 1975).
10. *Horizons, Inc. v. Avco Corp.*, 714 F.2d 862 (8th Cir. 1983).
11. *Horizons*, 714 F.2d at 866.
12. *Id.*
13. *Id.* at 867.
14. *Charlie Hairston Aircraft, Inc. v, Beech Aircraft Corp.*, 457 F.Supp. 364 (W.D.La. 1978).
15. *Charlie Hairston Aircraft, Inc.*, 475 F.Supp. at 369.

One federal case, applying Connecticut law, held that lost profits were not recoverable in an action based on a defective aircraft product.[16] This case involved an allegedly defective compressor hub which caused the aircraft engine to explode prior to take-off, grounding the aircraft for 42 days.[17] The airline's products liability action was brought against the company involved in the design and manufacture of the engine.[18] The airline argued that it suffered actual compensable business loss based on flights that the grounded aircraft would have flown which were subsequently cancelled, as well as added fuel costs in using less efficient aircraft to replace the grounded airplane.[19] No flight reservation records were produced at trial, and the court noted that it was the admitted policy of the airline to cancel flights carrying the lowest passenger loads.[20] The court also relied on the magistrate's finding that the low passenger loads inferred that some of the cancelled flights, had they been flown, would have resulted in losses to the company rather than gains.[21] As such, the court held that lost profits were not established and therefore not recoverable.[22]

A similar case involved defective drive shafts which caused physical damage to various aircraft.[23] While the court found that the manufacturer's negligence proximately caused the physical damage to the aircraft and granted recovery as to these damages, the court rejected the airline's lost profits allegation based on the fact that the evidence showed no interruption of normal services.[24] The court further rejected the airline's loss of use argument, i.e., that it could have profited from leasing the airplanes which were grounded.[25] The court found no evidence that supported any demand for the use of the aircraft.[26]

Another federal court, applying Georgia law, held that recovery for economic losses (including loss of profits) is not allowable under a negligence theory.[27] In defining economic loss, the court stated that such damages are to compensate inadequate value, cost of repair and replacement of a defective product, and the consequent loss of profits without any claim for personal injury or damage to other property.[28] The court held that because the injuries claimed constituted

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16. *Koninklijke Luchtvaart Maatschaapij, NV v. United Technologies Corp.*, 610 F.2d 1052 (2d. Cir. 1979) (disapproved on other grounds by *CTI International, Inc. v. Lloyds Underwriters*, 735 F.2d 679 (2d. Cir. 1984)).

17. *Koninklijke Luchtvaart Maatschaapij, NV*, 610 F.2d at 1054.

18. *Id.*

19. *Id.*

20. *Id.* at 1055.

21. *Koninklijke Luchtvaart Maatschaapij, NV*, 610 F.2d at 1058.

22. *Id.* at 1058-1059.

23. *Pan American World Airways, Inc. v. United Aircraft Corp.*, 192 A.2d 913 (Del. 1963).

24. *Pan American World Airways, Inc.*, 192 A.2d at 918.

25. *Id.*

26. *Id.*

27. *Baltimore Football Club, Inc. v. Lockheed Corp.*, 525 F.Supp. 1206 (N.D. Ga. 1981).

28. *Baltimore Football Club, Inc.*, 525 F.Supp. at 1210.

solely economic damages arising solely from damage to the allegedly negligently designed product itself, unaccompanied by other property damage or personal injury, the damages were not recoverable.[29] With respect to plaintiff's strict liability cause of action, the court concluded that a corporation does not have standing to bring such an action.[30]

Finally, recovery for economic loss may be denied even when brought under a warranty theory. Economic loss, along with claims for personal injury and property damage, are generally recoverable under a breach of implied warranty theory. Recovery for economic loss, however, can nonetheless be denied where plaintiff is not in privity of contract with the manufacturer.[31]

III. IMPROVEMENT TO PROPERTY AFTER REPAIR

Under California law, the general rule is that the measure of damages is the amount which will compensate for the detriment proximately caused by the defendant.[32] By its very terms, this law is not designed to place the injured party in a better position than he or she would have been in had the wrong not occurred.[33]

Where the improvement to the property is minimal, however, the court may nonetheless choose to award full recovery.[34] In *Creole Shipping Ltd., v. Diamandis Pateras, Ltd.*, the court considered damages to a ship's gang plank and spring lines.[35] Because the gang plank had been completely repaired only 1-1/2 months prior to the accident, the court found that the improvement in installing a new gang plank was *de minimus* and therefore awarded full recovery for the repair.[36] Conversely, the spring lines were in use for one year at the time of the accident.[37] The useful life of a spring line was calculated to be three years.[38] As such, the court reduced plaintiff's damages by 1/3 with respect to the installation of new spring lines to compensate for the extended useful life.[39]

One federal case reduced plaintiff's damages based on a peripheral benefit arising from the installation of a new water tower.[40] This case involved the replacement of a water cooling tower with a model superior to the original,

29. *Id.*
30. *Id.*
31. *Salmon River Sportsmen Camps, Inc. v. Cessna Aircraft Co.*, 544 P.2d 306 (Idaho 1975).
32. CAL. CIV. CODE § 3333.
33. *Basin Oil Co. v. Brash-Ross Tool*, 271 P.2d 122, 138 (Cal. 1954).
34. *Creole Shipping, Ltd. v. Diamandis Pateras, Ltd.*, 410 F.Supp. 313 (S.D. Ala. 1976).
35. *Creole Shipping, Ltd.*, 410 F.Supp. at 315.
36. *Id.* at 319.
37. *Id.*
38. *Id.*
39. *Creole Shipping, Ltd.*, 410 F.Supp. at 319.
40. *United States v. Ebinger*, 386 F.2d 557 (2d. Cir. 1967).

based on its reduced maintenance requirements.[41] The old tower was to be cleaned and lined every five years at a cost of $12,000.[42] Because the new tower did not require this maintenance, the Court of Appeal remanded the case, ordering the lower court to take into account the saved maintenance costs to the plaintiff.[43]

Damages are not reduced for improvement to the property where the structure in question did not appreciably deteriorate at the time of the accident.[44] One case involved a protective fender system which was made of structural steel, collapsible pipe cans and wooden timbers.[45] The system was damaged by a barge after nine years of use.[46] Defendants sought to have the damage award reduced based on a nine year depreciation of the system.[47] The court held, however, that while the timbers could be depreciated, the structural steel and collapsible pipe cans had not deteriorated in any way since the time of the accident, and therefore no reduction was appropriate for these elements.[48]

Thus in applying an improvement defense to product liability cases, it is imperative to not only allege depreciation of the original product, but also to amply support that the repairs made improved the product in some appreciable way.

IV. PLAINTIFF CANNOT RECOVER BOTH LOSS OF USE AND LOST BUSINESS PROFIT DAMAGES ARISING FROM DAMAGE TO A VEHICLE

Where a vehicle is damaged, the plaintiff must choose between recovery for loss of use or for net lost business profits.[49] Generally, the plaintiff opts to pursue a net lost business profit theory where a vehicle was used commercially.

Damages for loss of use of a vehicle are recoverable only for the period of time reasonably necessary to repair and replace the damaged or destroyed property.[50] The reasonable value of the loss of use is generally calculated by the reasonable rental value of the property.[51]

Lost business profits, on the other hand, may be recovered where the plaintiff can prove with certainty that profit would have been gained absent the injury.[52] Similar to the limitation with respect to loss of use, recovery for lost profits can

41. *Ebinger*, 386 F.2d at 561.
42. *Id.*
43. *Id.*
44. *The City of New Orleans v. American Commercial*, 662 F.2d 1121 (5th Cir. 1981).
45. *American Commerical*, 662 F.2d at 1122.
46. *Id.*
47. *Id.*
48. *Id.* at 1124.
49. *Tremeroli v. Austin Trailer Equip. Co.*, 227 P.2d 923, 934 (1951).
50. *Reynolds v. Bank of America Nat'l Trust & Sav. Ass'n.*, 345 P.2d 926 (1959).
51. *Meyers v.* Bradford, 54 Cal.App. 157 (1921).
52. *Hanlon Dry Dock & Shipbuilding Co. v. Southern Pac. Co.*, 92 Cal. App. 230, 235 (1928).

only be based on the period of time reasonably necessary to repair or replace the injured property.[53] Proof of lost business profits can be shown by records comparing income of net profits over a reasonable time period preceding the loss with records for the time period after the loss while a vehicle is being repaired.[54] If the plaintiff's losses continue, an expert may testify as to the value of future business losses based on a present value figure.[55]

As discussed previously, a plaintiff may allege loss of profit from a *planned* sale of the damaged property in addition to the aforementioned theories.[56] In *Johnson v. Central Aviation Corp.*, an airplane was damaged by a student pilot and loss of use damages were sought.[57] In addition, plaintiffs had an agreement to sell the airplane to a prospective buyer for $7,500 more than the amount the aircraft had cost them.[58] The court held that there is nothing necessarily inconsistent with a claim for damages for loss of use of the plane coupled with a claim for loss of profits upon sale, since both elements of damage might be warranted under certain circumstances.[59] The court reasoned that the time of delivery for the airplane may have been sufficiently in the future to enable the owner to use the plane for their own purposes for the period of time before the sale.[60]

Some courts limit recovery based on the question of whether a vehicle was only damaged or completely destroyed. One California case seeks to eliminate this distinction.[61] Here the court, citing Civil Code § 3333, asserted that the owner of a vehicle is entitled to recover damages to the vehicle as well as the loss sustained by being deprived of its use, limited to the time reasonably required for making the repairs.[62] The court went on to state:

> "There appears to be no logical or practical reason why a distinction should be drawn between cases in which the property is totally destroyed and those in which it has been injured but is repairable, and we have concluded that when the owner of a negligently destroyed commercial vehicle has suffered injury by being deprived of the use of the vehicle during the period required for replacement, he is entitled, upon proper pleading and proof, to recover for loss of use in order to 'compensate for all the detriment proximately caused' by the wrongful destruction."[63]

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53. *Blake v. E. Thompson Petroleum Repair Co.*, 216 Cal. Rptr. 568, 574 (1985).
54. *Blake*, 216 Cal. Rptr. at 573.
55. *Inyo Chem. Co. v. City of Los Angeles*, 55 P.2d 850, 858 (1936).
56. *Johnson v. Central Aviation Corp.*, 229 P.2d 114, 116 (Cal. 1951).
57. *Johnson*, 55 P.2d at 115.
58. *Id.*
59. *Id.* at 118.
60. *Id.*
61. *Reynolds v. Bank of America*, 345 P.2d 926 (Cal. 1959).
62. *Reynolds*, 345 P.2d at 927.
63. *Id.*

The court noted that the refusal of some jurisdictions to allow loss of use damages for a totally destroyed vehicle is based on historical limitations.[64]

V. RECOVERY FOR ECONOMIC LOSS ALONE

California law suggests that a manufacturer cannot be held liable for commercial losses under a negligence or a strict liability theory in torts.[65] *Seely v. White Motor Co.*, involved the purchaser of a truck who sought to recover damages for injury to property as well as damages for economic loss.[66] The rule approved in *Seely* essentially precludes tort liability if a defective product did not cause injury or property damage beyond the product itself.[67] The court held that such damages should be recoverable under the laws of warranty.[68]

A similar result is found in another California case.[69] This case involved a defective fuel tank support for commercial buses.[70] The plaintiff in this case failed to allege any physical injuries to the buses apart from the manifestation of the defect itself.[71] The court held that the rule imposing strict liability in tort for damage to property necessitates not only a defect, but also further damage to the plaintiff's property caused by the defect.[72]

> "When the defect and the damage are one and the same, the defect may not be considered to have caused physical injury."[73]

The court made clear that where damages consist solely of "economic losses", recovery upon a products liability theory is precluded.[74]

However, California law does support recovery of economic loss alone which is based on a breach of warranty theory.[75] Generally, for a plaintiff to prevail on a breach of implied warranty theory, there must be privity between the parties.[76] Thus, where plaintiffs are not in privity with the manufacturer, nor is there any injury to person or property, recovery for economic damages alone will be denied. In *Anthony v. Kelsey-Hayes Co.*, plaintiff sought to circumvent this limitation by forming a class action alleging that other members of the class suffered personal injury and property damage.[77] Because plaintiffs who brought

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64. *Id.* at 927-928.
65. *Seely v. White Motor Co.*, 403 P.2d 145 (Cal. 1965).
66. *Seely*, 403 P.2d at 147.
67. *Id.* at 152.
68. *Id.*
69. *Sacramento Regional Transit District v. Grumman Flxible*, 204 Cal. Rptr. 736 (1984).
70. *Sacramento Regional Transit Dist.*, 204 Cal. Rptr. at 737.
71. *Id.* at 739.
72. *Id.*
73. *Id.*
74. *Sacramento Regional Transit Dist*, 204 Cal. Rptr. at 738.
75. *Anthony v. Kelsey-Hayes Co.*, 102 Cal. Rptr. 113 (1972).
76. *Anthony*, 102 Cal. Rptr. at 116.
77. *Id.* at 114.

the lawsuit did not allege that they themselves sustained any personal injuries or physical property damages, they were not "similarly situated" to those who may indeed have suffered such losses.[78] The court held that these plaintiffs could not confer upon themselves standing to sue, by purporting to represent a class of which they are not members.[79]

Interestingly, one California case has seemingly allowed recovery for economic loss under a negligence theory.[80] While the court held that recovery for lost profits and lost business opportunities is permitted in a negligence action, this case is distinguishable in that property damage beyond the allegedly defective product occurred.[81] *Pisano* involved a defective sanding machine which allegedly failed and caused lost profits, lost future business, and loss of prospective clients, to the owner.[82] Apart from the defect itself, the wooden cabinets which were to be sanded were also damaged.[83] The court found that recovery for cost of repairs, in addition to economic losses were available under the negligence cause of action.[84] However, the court limited recovery to the damage done to the cabinets with respect to the plaintiff's product liability count.[85]

Another California case which allowed recovery for lost profits and lost business opportunities did so based on an interference with prospective economic advantages cause of action.[86] The court held that:

> "Even when only injury to prospective economic advantages is claimed, recovery is not foreclosed. Where a special relationship exists between the parties, a plaintiff may recover for loss of expected economic advantage through the negligent performance of a contract although the parties were not in contractual privity."[87]

In reaching its decision, the court noted that recovery for negligent interference with prospective economic advantage will be limited to instances where the risk of harm is foreseeable and closely connected to the defendant's conduct and not part of plaintiff's ordinary business risk.[88]

VI. CONCLUSION

While the number of possible defenses to damage allegations would be far too numerous to be included herein, the theories discussed above should spark

78. *Id.*
79. *Id.* at 116.
80. *Pisano v. American Leasing*, 194 Cal. Rptr. 77 (1983).
81. *Pisano*, 194 Cal. Rptr. at 79.
82. *Id.* at 78.
83. *Id.*
84. *Id.* at 79.
85. *Pisano*, 194 Cal. Rptr. at 79.
86. *J'Aire Corp v. Gregory*, 598 P.2d 60 (Cal. 1979).
87. *J'Aire Corp.*, 598 P.2d at 63.
88. *Id.* at 65-66.

interest in the reader and encourage early analysis of damage claims and prospective defenses. Because it is never too soon to consider the damages aspect of a lawsuit, careful and meticulous analysis and damage defense strategizing will result in thorough discovery, a sound basis for negotiations, and a more persuasive case at trial. Every meritorious lawsuit inevitably boils down to a question of damages; it is therefore imperative to take the bull by the horns and deal with this issue at the outset of any litigation in order to craft the best possible defense.

A Critique of the Prosecution in the O.J. Simpson Trial: Vincent Bugliosi's *Outrage: The Five Reasons Why O.J. Simpson Got Away With Murder*

BOOK REVIEW BY: CARIE A. NELSON†

Did O.J. Simpson get away with murder? If you are Vincent Bugliosi,[1] the answer is a resounding 'yes.' "There can be no doubt about Simpson's guilt," writes Bugliosi in the introduction of his best-seller, *Outrage: The Five Reasons Why O.J. Simpson Got Away with Murder*.[2] The proof of Simpson's guilt lies in the evidence. This in-depth analysis of the prosecution in the Simpson case has the lead prosecutors[3] bearing the brunt of Bugliosi's anger over the verdict in this case. However, no one related to the Simpson case escapes unscathed — "the conduct of virtually everyone associated with this case was deplorable."[4] Bugliosi criticizes Judge Ito for bad rulings and for being star struck. He also criticizes the jury for being biased in Simpson's favor and for lacking wisdom. Bugliosi faults the defense for introducing race into the case and for being "ordinary" attorneys; he also criticizes the prosecution for being horribly incompetent. Furthermore, Bugliosi blames the media for hyping Simpson's defense lawyers as the "Dream Team"[5] and for making uninformed statements and judgments about the lawyers and their performances.

Outrage does not try to summarize and discuss all of the evidence from the trial. It instead focuses on two things: (1) what ultimately led to the loss of the case, and (2) what the author would have done differently to obtain a guilty verdict. Ultimately, this book is about Bugliosi's outrage over the egregious manner in which the Simpson case was tried. Bugliosi devotes a separate chapter to each of the five reasons why he believes the prosecution lost the case against Simpson. The five reasons are: (1) there was a belief "in the air" before the trial began that Simpson would get off despite overwhelming evidence that

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1. Vincent Bugliosi is a former Los Angeles prosecutor who currently writes true-crime books. He is best known as the prosecutor of Charles Manson and the best-selling author of the true-crime book *Helter Skelter* based on the Manson trial.

2. VINCENT BUGLIOSI, OUTRAGE: THE FIVE REASONS WHY O.J. SIMPSON GOT AWAY WITH MURDER (1996).

3. Marcia Clark and Christopher Darden. Hank Goldberg, who handled most of the DNA testimony and evidence, also played a huge role in the prosecution.

4. BUGLIOSI, *supra* note 2, at 54.

5. *Id.* at 39-40. The defense attorneys the media hyped as the "Dream Team" were Johnnie Cochran, Robert Shapiro, F. Lee Bailey, and Alan Dershowitz. The two DNA lawyers for the defense, Barry Scheck and Peter Neufeld, had not yet appeared in court and, thus, were rarely mentioned in the media.

he committed the murders; (2) the prosecution erred in transferring the case downtown instead of filing it in Santa Monica, where the crime took place; (3) Judge Ito improperly allowed the defense to interject race into the case; (4) the prosecution was extremely incompetent; and (5) the prosecution's summation was very weak.

The "in the air" phenomenon contributed to the not guilty verdict by making it easier for the jury to give Simpson every benefit to which he was legally entitled, and then some.[6] The dynamics at play in this phenomenon were threefold: (1) Simpson's popularity; (2) the media's hype of the "Dream Team"; and (3) the "talking heads" (legal analysts on TV programs who discussed the trial).[7]

Because Simpson's lawyers were labeled the "Dream Team," jurors may have perceived them as being more effective than they actually were.[8] Bugliosi finds the suggestion that Simpson's lawyers were a "Dream Team" laughable due to the inexperience of all of the lead attorneys.[9] He believes that the label "Dream Team" is based more on the amount of money Simpson was willing to pay his legal counsel than on their actual credentials.

As for the TV "talking heads," Bugliosi points out that they too had never tried a murder case, that the majority of these commentators were not "experts," and that they did not know what they were talking about.[10] Bugliosi's main criticism seems to be that these legal analysts made negative comments about the prosecution and its handling of the case, while giving the defense more credit than it deserved for its performance.

The second chapter of the book addresses the prosecution's first major blunder — transferring the case to downtown Los Angeles from Santa Monica, where the crime took place. This mistake was probably the most critical in deciding the outcome of the case because it affected the makeup of the jury pool.[11] Had the case been filed in Santa Monica, there would have been a small

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6. *Id.* at 27-28. This phenomenon is described as the assumption that Simpson would get off despite the conclusive evidence of his guilt, unless there was a powerful prosecution. Presumably, this feeling was known to jurors before they were selected. *Id.*

7. *Id.* at 32.

8. BUGLIOSI, *supra* note 2, at 45-46.

9. *Id.* at 37-40. Shapiro was known mainly as a plea bargainer. While he previously had represented Christian Brando in a homicide case, that case ended with a guilty plea. Thus, the Simpson case was Shapiro's first murder trial. Cochran was best known as a civil trial attorney. In the one known murder case he tried before a jury, he represented a Black Panther named Elmer Pratt who was accused of murdering a white schoolteacher. Pratt was sentenced to life imprisonment. Alan Dershowitz had distinguished himself in the profession as a prominent appellate attorney, not as a trial attorney. Of the "Dream Team" members, only F. Lee Bailey had distinguished himself in several murder cases. However, his last big case was the Patti Hearst bank robbery case, which took place more than twenty years ago. Hearst was convicted, sending Bailey's career into a decline.

10. *Id.* at 51.

11. It is the practice in L.A. County to file the case in the superior court in the district in which the crime occurred. *Id.* at 58.

percentage of Blacks in the jury pool. This would have favored the prosecution, since it was believed that Blacks were anti-prosecution or sympathetic to the defendant.

Bugliosi believes that a *normal* jury in Santa Monica would have found Simpson guilty because, despite the prosecution's incompetent handling of the case, Simpson's guilt was proven beyond a reasonable doubt.[12] This raises several questions. What is a *normal* jury? What was so abnormal about the Simpson jury? Was it because it was made up of predominantly black people, or because it did not return the "right" verdict? Bugliosi suggests that the Simpson jury was disgraceful because it did not return a guilty verdict.

In chapter three Bugliosi addresses the substandard performance of Judge Ito. The main complaint Bugliosi has is that Ito allowed race to become a major issue in the case. The defense's injection of race into the case, and the prosecution's ineptness in dealing with it once it was introduced, played a considerable role in allowing Simpson to go free. Citing a number of cases, Bugliosi argues that the prejudicial effect of allowing the defense to question Detective Mark Fuhrman about his past use of the word "nigger" far outweighed any relevance this evidence might have had.[13] Thus, even if Judge Ito was not going to follow precedent he should have used common sense and prohibited this line of questioning. The rest of the chapter outlines other controversial decisions by Judge Ito. Among these were: (1) permitting Simpson to address the court; (2) shortening court days; (3) allowing cameras in the courtroom; and (4) prohibiting a guard's testimony regarding an exchange between Simpson and Rosey Grier (former NFL defensive lineman who became an ordained minister) during a jail visit.

The next two chapters of *Outrage* deal with the extreme incompetence of the prosecution, during both the trial and summations. The two lead prosecutors, Marcia Clark and Christopher Darden, bear the brunt of Bugliosi's criticism. Despite being a supporter of the Simpson prosecutors, Bugliosi calls the prosecution of Simpson the "most incompetent criminal prosecution" he has ever seen.[14] Bugliosi divides the prosecution's incompetence during the trial into three main areas.

The first area of incompetence is the prosecution's failure to introduce a large amount of incriminating evidence. Evidence of guilt that was not introduced by the prosecution included Simpson's suicide note, the slow speed Bronco chase, the items that were found in the Bronco after the chase, and the statement Simpson gave to the police — probably the most damaging piece of evidence. Bug-

12. BUGLIOSI, *supra* note 2, at 62.

13. *Id.* at 66. The California Evidence Code states: "The court in its discretion may exclude evidence if its probative value is substantially outweighed by the probability that its admission will. . .(b) create substantial danger of undue prejudice. . . ." CAL. EVID. CODE § 352(b) (West 1995).

14. BUGLIOSI, *supra* note 2, at 91.

liosi believes that he could have convicted Simpson on that statement alone, and he also believes that there is no valid reason for not introducing the statement.[15]

The second area of incompetence is the prosecution's handling of the case. Some examples in this area include inadequate preparation (e.g. the glove demonstration), failure to present unfavorable evidence (e.g. the dance recital video showing a smiling O.J. Simpson), the handling of the "missing" blood issue, and the handling of Mark Fuhrman's lying about his past use of racial epithets.

Bugliosi calls the third area of incompetence "miscellaneous ineptitude." Some examples are: (1) the failure to put on all the allowable domestic violence evidence, (2) not presenting the case in a logical chronology, and (3) failure to neutralize Simpson's celebrity.

The final chapter of the book deals with the prosecution's summations. Marcia Clark's and Christopher Darden's summations lacked passion and were too informal. The prosecutors' summations also lacked preparation. They waited until the night before they were to give their arguments to prepare, and it showed.[16]

In the end, Bugliosi uses the Simpson trial to raise a number of important issues about the American jury system. Despite its shortcomings, *Outrage* is worth reading for the insight it provides into this most "public" of American criminal trials.

15. *Id.* at 102-105.
16. *Id.* at 206.

Mario Cuomo, *Reason to Believe*

BOOK REVIEW BY: MICHAEL J. AURICCHIO†

I. INTRODUCTION

Reason to Believe,[1] by Mario Cuomo, is a reaction to the Congressional elections of 1994 which overwhelmingly placed Republicans in power in both houses of Congress. As a result, the Republicans were provided with the mandate and the means to pursue their agenda, as embodied in the "Contract with America." In his book, Cuomo states that America is at a point in her history in which economic and social crises are tearing society apart.[2] He suggests that government's inability to resolve the problems related to these crises prompted American voters to change the government by replacing many Democrats with Republicans in the 1994 elections.[3] Cuomo laments that Americans were misled into supporting the Republicans and their "Contract with America."[4] While he thinks the Contract offered a catharsis for Americans upset by "business as usual" in Washington, he believes that the Contract will do more harm than good.[5]

II. DEMOCRATIC CONTRIBUTIONS TO AMERICA

Cuomo states that trying to blame Democratic social programs for society's ills is like blaming the band-aid for the wound.[6] He acknowledges that there have been many shortcomings of the Democratic party but that overall, Democratic programs have overshadowed the party's failings and brought America into the modern era.[7] In their idealism to help the most bereft members of society, the Democrats have often forgot the working man and the middle class.[8] In the quest for a more "just" system, Democrats have appeared to be too lenient with criminals.[9] It is also conceded that the Democrats have not focused enough upon the importance of hard work, familial responsibility, and respect and duty to country.[10]

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1. MARIO CUOMO, REASON TO BELIEVE (Simon & Schuster, 1995).
2. CUOMO, *supra* note 1, at 8.
3. *Id.* at 9.
4. *Id.*
5. *Id.*
6. CUOMO, *supra* note 1, at 67.
7. *Id.* at 17.
8. *Id.* at 19.
9. *Id.*
10. CUOMO, *supra* note 1, at 19.

After pointing out the Democratic party's shortcomings, Cuomo focuses on the many successes of the Democrats which have fostered positive changes in society during his own lifetime.[11] The progress of women and minorities, public education, public health care, workers compensation and unemployment insurance are enumerated.[12]

III. AMERICA'S RISE AND DECLINE

Cuomo speaks of the United State's rise to greatness in the last 50 years, but believes a turning point was reached in the 1970's.[13] America's great successes may have spoiled us.[14] The American people, enjoying success, lost their drive, discipline, and respect for authority.[15] At the same time, U.S. business had failed to remain competitive in the world market place.[16] By the 1990's, the U.S. was experiencing the worst recession since the 1930's.[17] People were hurting and wanted change.

IV. ENTER THE "CONTRACT WITH AMERICA"

By the 1990's, the populace was generally tired of Liberal Democratic policies which seemed powerless to stop destructive trends in society and in some cases, seemed to be fostering them.[18] The Republicans and their "Contract with America" offered a panacea which would cure society's ills; the most important propositions of which include: reducing government social programs, a return to laissez-faire government in relation to business, focusing on supply side economics, achieving a balanced budget in seven years, and a devolution of federal power to the states.

It is these main propositions that Cuomo challenges in his book. He argues that Republican policies will return America to a time when there was no public education, public health care, workers compensation or unemployment insurance.[19]

Cuomo asserts that the Contract's solutions for America's problems are inadequate and misguided.[20] Instead of contracting out of government responsibility, Cuomo calls for government to move people into "a new era of productivity and progress;" getting more money in the hands of workers by raising the mini-

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11. *Id.* at 20.
12. *Id.* at 13, 20.
13. *Id.* at 23, 27.
14. CUOMO, *supra* note 1, at 23.
15. *Id.* at 24.
16. *Id.*
17. *Id.*
18. CUOMO, *supra* note 1, at 9.
19. *Id.* at 13.
20. *Id.* at 9.

mum wage, offering profit sharing plans, and increasing unemployment and disability benefits.[21] It is recommended that the poor be offered more services and facilities that will improve their lives; such as libraries, schools, health care, cultural facilities, child care, and youth recreation programs.[22] States should also be encouraged to adopt welfare reforms, such as making absent parents responsible for child support, requiring those who are able, to work in return for receiving benefits, providing training and child care so recipients can find and hold jobs, and removing perverse incentives which create cycles of dependency by discouraging welfare recipients from working.[23]

V. THE FREE MARKET

Republicans assume that government regulation is hindering the growth of American companies.[24] They believe in the old economic assumption that the greater the productivity, the greater the wealth for all.[25] Cuomo thinks that this assumption may have been true at one time, but is no longer the case. Now, the American economy is one which rewards investors but does not provide adequate protection for the average worker.[26] It is pointed out that, presently, the gap in income and in wealth is widening.[27] Cuomo does not begrudge the importance of the free market but recognizes that our society was built not only on the free market but also upon government intervention.[28]

VI. INVESTMENT IN HUMAN CAPITAL AND INFRASTRUCTURE

Cuomo is critical of the Contract because it is virtually silent on providing investment in job training, education programs, and infrastructure.[29] In order to be competitive with countries which have cheap labor and competitive technologies, both the public and the private sectors need to invest in the training of workers in new technologies.[30] It is also asserted that because infrastructure is of such vital importance to society, it must be maintained and promoted in order

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21. *Id.* at 128.
22. CUOMO, *supra* note 1, at 130.
23. *Id.* at 137.
24. *Id.* at 55.
25. *Id.* at 27.
26. CUOMO, *supra* note 1, at 27. In general, U.S. workers' incomes have dropped since the 1970's and white collar workers have had their salaries drop since 1989. Furthermore, family income has fallen seven percent from 1989 to 1993.
27. *Id.* at 27. In 1989, the bottom eighty percent of Americans controlled fifteen percent of America's wealth and the top twenty percent of Americans controlled the other eighty five percent.
28. *Id.* at 40. Cuomo supports this statement with the example of the government's bailout of Chrysler and savings and loans institutions, and the creation of the minimum wage and antitrust legislation. *Id.*
29. *Id.* at 53, 104.
30. CUOMO, *supra* note 1, at 104.

to foster growth.[31] Accordingly, the most important areas in which to invest are roads, bridges, mass transportation, harbors, ports, fiber optic communications, and high speed rail.[32]

VII. SUPPLY SIDE ECONOMICS AND A BALANCED BUDGET

By far, Cuomo's greatest criticism of the Contract is its emphasis on supply side economics and tax cuts for the middle class and the rich as the solution for a wasteful government.[33] He is against such an experiment because it was already tried under Reagan and resulted in the recession.[34]

It is asserted that the idea of balancing the budget in seven years is preposterous.[35] Cuomo believes that government economic forecasters cannot balance the budget by a specific date because of the enormous complexity of factors that effect the economy.[36] Instead, he maintains that the budget should gradually be reduced over time with sensible means to avoid shocks to society and the economy.[37]

VIII. DEVOLUTION

Cuomo addresses the Republicans' endorsement of devolution.[38] This is the processes of permitting states to take over programs on the theory that they can operate the programs less expensively and more efficiently.[39] It is maintained that we should be wary of this proposition because it inevitably means that federal responsibility as well as federal power is given away.[40] The problem with devolution is that states would receive block grants without regard to their local situation.[41]

For Cuomo, it is a question of balance. He believes that the federal government should give money to states to promote national interests, and it should ensure that the states are spending the money wisely.[42] At the same time, the states should be permitted as much leeway as possible to determine how the

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31. *Id.* at 116.
32. *Id.* at 117.
33. *Id.* at 39. Cuomo claims that this has been proven a failure under the Reagan years with the result of a greater gap between the rich and the poor, the creation of a huge deficit, and no money left to adequately invest in infrastructure and people.
34. CUOMO, *supra* note 1, at 45.
35. *Id.* at 50.
36. *Id.* at 51. On average, forecasters are off on the budget by twenty percent. *Id.*
37. *Id.* at 163.
38. CUOMO, *supra* note 1, at 61.
39. *Id.*
40. *Id.* Cuomo notes that a similar concept has already been attempted and failed under the Articles of Confederation. *Id.*
41. *Id.* at 62.
42. CUOMO, *supra* note 1, at 92.

goals are attained.[43] The fear is that if the right balance is not struck, America may regress to a "Separate States of America."[44]

IX. CULTURAL CORROSION

Cuomo addresses the cultural corrosion occurring in society. America is ranked first among the industrialized nations for murder, robbery, rape and divorce rates.[45] It is asserted that this growing incivility in America is the result of a general attitude of selfishness.[46] Cuomo is concerned that the Contract does not address the issue of cultural corrosion. Instead, it forces individuals to work their problems out themselves.[47] It gets tough by supporting the death penalty, stiffer sentences, and more prisons, but offers no plan to end drug abuse or teen pregnancies.[48] Cuomo believes what is needed is a combination of punishment and preventative measures that will get at the root causes of crime and welfare by investment in child care, health insurance, drug treatment, and education.[49]

Furthermore, Cuomo believes that we need to re-focus on instilling the societal values that are at the foundation of our nation and which are based on philosophical, cultural, and religious traditions.[50] These values are self discipline, compassion, and a willingness to help the less fortunate.[51] It is emphasized that these values are important because they are what unite our country in spite of all our differences.[52] Cuomo concludes that one of the best methods of improving the moral state of Americans is to find ways to employ more people.[53] This will provide people with the basic value of opportunity to work and to be productive in society.[54]

X. CONCLUSION

Cuomo addresses the main points of the Republicans' "Contract with America." He criticizes and offers alternatives to the propositions which he believes will further divide America: the reduction of government social programs, a return to laissez-faire government in relation to business, an emphasis on supply side economics, achieving a balanced budget in seven years, and a

43. *Id.*
44. *Id.* at 94.
45. *Id.* at 142.
46. CUOMO, *supra* note 1, at 34.
47. *Id.* at 57.
48. *Id.*
49. *Id.* at 58.
50. CUOMO, *supra* note 1, at 95.
51. *Id.* at 96.
52. *Id.*
53. *Id.* at 98.
54. CUOMO, *supra* note 1, at 97.

devolution of federal power to the states. Cuomo's alternative vision can be summed up in one word, "community." He believes it is a greater sense of community which will help America overcome its economic and social problems. The dispute remains, however, as to whether more people will find security in a world governed by the principles of the Contract or in a world governed by the principles set out by Cuomo in his book *Reason to Believe*.

National Italian American Bar Association

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