

Spring 2007

The Conflicting Rights of Creditors and Beneficiaries in a Decedent's Estate: An Examination of The Laws of New York, New Jersey and Connecticut

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Recommended Citation

Marcuccio, Elizabeth and Kukol, Albert B. (2007) "The Conflicting Rights of Creditors and Beneficiaries in a Decedent's Estate: An Examination of The Laws of New York, New Jersey and Connecticut," *North East Journal of Legal Studies*: Vol. 13 , Article 1.

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**THE CONFLICTING RIGHTS OF CREDITORS AND
BENEFICIARIES IN A DECEDENT'S ESTATE:
AN EXAMINATION OF THE LAWS OF NEW YORK,
NEW JERSEY AND CONNECTICUT**

by

Elizabeth A. Marcuccio* and Albert B. Kukul**

I. INTRODUCTION

“A man must be just before he is generous.”¹
This ancient equitable maxim comes to mind when examining the rights that creditors have in a decedent's estate. Probate assets of a decedent-debtor are generally available to creditors. Probate systems developed to gather the decedent's assets, pay creditors' claims out of these assets, and distribute what is left to the designated beneficiaries. This system is in alignment with one of society's important policies: creditors should be paid. However, this policy sometimes conflicts with an equally important policy: the right of decedents to dispose of their property as they see fit. The purpose of this article is to examine the laws of New York, New Jersey and Connecticut to

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determine what rights creditors have in the assets of a decedent who died a resident of one of these states.

The laws of these three northeastern states make it clear that both the real and personal property of a decedent, if subject to probate, is chargeable with the payment of the decedent's debts.² However, more and more people are opting out of the probate system to avoid the delays and expenses of probate administration. Creditors need to be aware of this shift and, more important, know what non-probate assets are available to pay their claims.

II. JOINT ACCOUNTS

Jointly-held stocks, bonds, mutual funds, and bank accounts are very common, and are established for a variety of reasons. When a deposit of cash, securities or other property is made in the name of a depositor and another person in a joint account, it is presumed that the depositor intends to establish a joint tenancy with survivorship rights.³ So when a father opens a joint account in his name and the name of his daughter, it is *prima facie* evidence that he intends that his daughter have survivorship rights in that account.⁴ But to what extent is this account available for the payment of creditors after the father's death?

The test used by New York Courts to determine creditors' access to non-probate assets is whether the decedent maintained the power to dispose of the asset during his lifetime.⁵ In New York, the daughter receives a gift of a moiety, or one-half, of the value of the property on deposit.⁶ Although one-half of the value of the account is considered "vested" in the daughter, or gifted to her, at the time the account is opened, the other moiety clearly remains the father's property and is subject to attachment by his creditors during his

lifetime. The father is regarded as its absolute owner until he dies because he had unrestricted power to dispose of his moiety during his lifetime. This allows creditors to reach his one-half interest in the joint account after his death, even though he had named his daughter to succeed to his interest.⁷

Under certain circumstances, creditors of a New York decedent can reach the entire balance of a joint account. This would be the case if the father opened the joint account solely to give his daughter easier access to the funds. If there is clear and convincing evidence that the father did not intend to make a gift to his daughter, but added her as a signatory for his own convenience, the opening of a joint account does not affect title, and the entire account is available to creditors.⁸ The total account can also be reached if our depositor was rendered insolvent either when he initially opened the joint account with his daughter, or if upon his death his estate was ultimately rendered insolvent by the establishment of the joint account.⁹ Any creditor having a claim against the father's estate can maintain an action to set aside the conveyance as fraudulent, regardless of whether or not the father actually intended to defraud his creditors.¹⁰

Would the result be different for creditors of a decedent domiciled in either New Jersey or Connecticut? In New Jersey, when a father opens a joint account in his name and the name of his daughter, the *inter vivos* rights of the parties are not affected.¹¹ The father can insist that the account remain his sole property during his lifetime, and that his purpose in opening the account was only to achieve a gift to his daughter upon his death. The father's right to control the entire account makes the total account available to the father's creditors both during his lifetime and upon his death, whether or not he actually retains control over the account.¹²

In Connecticut, statutory law requires a surviving account owner to pay from a joint account the following claims against the deceased account owner's estate: funeral expenses, expenses of settling the estate, debts owed for the last illness of the decedent, and any debt due to the state of Connecticut for the aid and care of the decedent.¹³ Connecticut case law further expands creditors' rights in joint accounts. Co-holders of a joint account are considered owners of the total account and have access to the entire account balance.¹⁴ When a father adds his daughter's name as a joint owner to his account, either the father or daughter can withdraw all of the funds.¹⁵ As a result, Connecticut Courts have ruled that the entire account is available for the payment of any valid claim against the father, either during his lifetime or upon his death.¹⁶

III. TOTTEN TRUST ACCOUNTS

When a father opens a savings account "in trust" for his daughter, there really is no trust, but merely a bank account that is payable to the daughter upon the father's death. A tentative trust exists that is revocable at the will of the father until he dies or completes the gift during his lifetime. There is only a presumption that an absolute trust will arise in favor of the daughter upon the father's death. As a result, in all three states when probate assets of the father are insufficient to pay his valid debts, the presumption is rebutted to the extent necessary to make up the deficiency.¹⁷ The estate representative has the authority, and maybe even the duty, to set aside Totten trust accounts to the extent necessary to protect creditors when probate assets are insufficient to pay their claims.¹⁸

IV. U.S. SAVINGS BONDS

Let's turn to the situation where the father purchases a U.S. savings bond and designates his daughter as either the co-owner or beneficiary of the bond. Can the father's creditors look to the bond for payment of their claims? The passage of title to U.S. savings bonds is governed by the regulations of the Treasury Department, and not by the rules of property law of the individual states.¹⁹ Therefore, the result would be the same whether the father died a resident of New York, New Jersey or Connecticut. Even if the father's probate assets are insufficient to pay his obligations, the bond may not be used to pay the father's creditors.²⁰ The estate representative is entitled to recover from the daughter only the ratable amount of estate tax imposed as a result of the bond being included in the father's taxable estate.²¹ The creditors of this insolvent probate estate can look to the savings bond for payment only if the father purchased the bond with the actual intent to defraud his creditors.²² Actual fraud cannot be presumed, it must be proven.²³

V. LIFE INSURANCE

The primary purpose of life insurance is to protect the dependent beneficiaries of an insured by providing them with funds to live on after the insured's death. The insurance laws in New York, New Jersey and Connecticut clearly recognize this purpose, even though life insurance is purchased for many different reasons.²⁴ If a father names his daughter as the beneficiary of the death benefit payable under his life insurance policy, these proceeds are generally exempt from the claims of the father's creditors in all three states.²⁵ Only if the father intends to defraud his creditors can his creditors reach these proceeds. In New York, the father must actually intend to defraud his creditors at the time he names his daughter as the

beneficiary.²⁶ Under New Jersey law, the daughter is entitled to the proceeds against all creditors, but she is not entitled to the amount of premiums her father paid with the intent to defraud his creditors.²⁷ Pursuant to Connecticut law, the daughter is entitled to the proceeds unless her father intended to defraud his creditors either when he purchased the policy, or when he named her as beneficiary.²⁸ What if the father does not want the death benefit paid directly to his daughter, but instead wants these proceeds to be poured into a testamentary trust established for her benefit?

In all three states, whether or not the father's creditors can attach these proceeds depends on the specific language used by the father on the beneficiary designation form. If the father names "...my estate..." as the beneficiary, the proceeds are treated like any other probate asset, and are available to pay his creditors' claims.²⁹ However, in all three states if the father names "...the Trustee of the trust established under Article X of my Last Will and Testament..." as the beneficiary, these proceeds remain exempt from the claims of the father's creditors to the same extent as if the proceeds were payable directly to his daughter.³⁰ In the alternative, what if the father names the trustee of an inter vivos trust? In all three states, the proceeds remain exempt from the claims of the father's creditors, but in New York there is one very important exception.

When the father names the trustee of his testamentary trust as the beneficiary, it does not matter whether the will containing the trust is executed before or after this designation is made.³¹ However, if the beneficiary is the trustee of an inter vivos trust, the trust agreement naming the trustee must be in existence on the date that the beneficiary designation is made and the trust agreement must be identified in the designation.³²

Otherwise, the proceeds are available to pay the creditors of this New York decedent.³³

VI. RETIREMENT PLANS (ERISA COVERED PLANS)

Many employers provide retirement and death benefit plans for their employees. Additionally, many employees who do not have employer-provided plans, as well as self-employed individuals, set up their own retirement accounts. The Employee Retirement Income Security Act (ERISA) is the federal law governing most employer sponsored plans.³⁴ ERISA supersedes all state laws that "relate to any employee benefit plan" governed by ERISA in an effort to provide protection to employees.³⁵

The primary purpose of a pension is to ensure that the retired employee will have enough money to live on, free from creditors' claims. Under ERISA, retirement plans must have an "anti-alienation" clause, prohibiting assignment of the interest under the plan.³⁶ This makes it clear that these plans are protected from creditors while in the hands of the plan administrator, but are the monies protected once they are paid out to the beneficiary?

Let's assume that a retired father names his daughter as the beneficiary of his pension plan. During his lifetime the father receives periodic payments from this plan. It is clear that once these funds reach his hands, they are subject to attachment by his creditors.³⁷ Both New York and New Jersey courts have specifically looked at ERISA covered plans, holding that ERISA's anti-alienation clause protects funds while in the pension plan, but permits attachment once received by the pensioner.³⁸

But can the father's creditors reach the ERISA pension plan proceeds upon his death? What is the status of the benefits when paid to the daughter, since the father designated her as the third-party beneficiary of the plan benefits? As of yet, there is no case which specifically addresses this issue. One can argue that since the plan benefits, when paid to the father, would be available to his creditors, such should be the result here. But should the result be the same when paid to a beneficiary who is not the judgment debtor, like the daughter in our example?

VII. RETIREMENT PLANS (NON-ERISA COVERED PLANS AND ACCOUNTS)

While ERISA covers many employer sponsored plans, many similar pension plans and retirement accounts fall outside of ERISA, such as Individual Retirement Accounts ("IRAs"), Roth IRAs, 403b plans, and state and local government pension plans. Assume that the father had an IRA, again naming the daughter as his beneficiary. Since the IRA is not protected from creditors by ERISA, is there state law which steps in to do the same job? Is the IRA exempted from the claims of the father's creditors? How does each state treat these non-ERISA retirement plans and accounts after the father's death?

In New York, the IRA is exempt from the claims of the father's creditors during his lifetime.³⁹ It has also been held to be exempt from the claims of his creditors after his death, upon the subsequent payment to his daughter as named beneficiary.⁴⁰ It does not matter that the father retained all incidents of ownership and could change the beneficiary at any time during his life. The daughter is entitled to the proceeds.

Thus, in New York, even when ERISA does not apply to certain retirement plans, either statute or case law exempts virtually every type of retirement plan from claims of the decedent's creditors.⁴¹ New York State employees' retirement plans, New York State teachers' retirement plans, Individual Retirement Accounts, Federal Thrift Savings Plans, and 403(b) retirement annuities are all exempt from the claims of the employee's creditors after the employee's death.⁴² In addition, because the Federal Thrift Savings Plan is similar to 401k plans offered by private employers, there is no logical reason why 401k plans should not be protected from creditor claims after the employee's death.⁴³

What if the father had conveyed assets into his retirement plan with the intent to defraud his creditors? Can his creditors reach the plan benefits when they pass to his daughter upon his death? In New York, EPTL 7-3.1(b) allows creditors to reach fraudulent conveyances into such accounts.⁴⁴ Those assets of the account tainted by fraud are no longer exempt from creditors' claims. Creditors can look to these assets for payment when they pass to the daughter upon the father's death.⁴⁵

What if the father is a resident of Connecticut or New Jersey? What is the status of non-ERISA accounts and plans in those states? In both states, statutory and case law similarly exempt non-ERISA accounts and plans from creditors' claims during the father's lifetime.⁴⁶ In addition, New Jersey, like New York, allows creditors to attach an IRA that was fraudulently created.⁴⁷

Neither Connecticut nor New Jersey Courts have addressed the issue of whether non-ERISA accounts are exempt when paid to a daughter who was named as the deceased father's beneficiary. While their statutes and their

courts' legal analysis are similar to New York's when reviewing such non-ERISA accounts prior to the father's death, it remains to be seen whether this analysis will carry through after the father's death.

VIII. CONCLUSION

Probate avoidance has increased dramatically in recent years, and the law concerning creditors' rights in nonprobate assets remains fragmented and underdeveloped.⁴⁸ Creditors' claims will continue to be examined on a case by case basis because there is no comprehensive statute setting forth the rights of creditors in nonprobate assets.

ENDNOTES

¹ *Merchants' and Miners' Transp. Co. v. Borland*, 53 N.J. Eq. 282 (1895).

² N.Y. Est. Powers & Trusts Law § 13-1.3 (Consol. 2006); N.J. Stat. Ann. § 3B:22-19 (Lexis Nexis 2006); Conn. Gen. Stat. § 45a-428 (2006).

³ N.Y. Banking Law § 675(a) (Consol. 2006); N.J. Stat. Ann. § 17:161-5(a) (Lexis Nexis 2006); Conn. Gen. Stat. § 36a-290 (2006).

⁴ *Id.*

⁵ *In re Trust of Gallet*, 765 N.Y.S.2d 157, 160-61 (Sur. Ct., N.Y. Co. 2003).

⁶ *In re Granwell*, 228 N.E.2d 779, 781 (N.Y. 1967).

⁷ *Id.* at 782.

⁸ *In re Estate of Johnson*, 7 A.D.3d 959, 960 (3d Dept. 2004) *appeal denied* 818 N.E.2d 665 (N.Y. 2004). N.Y. Banking Law § 678 (Consol. 2006) also permits the father to open the joint account jointly with his daughter "for the convenience" of the depositor. Signature cards or account creation

documents with this notation would cause all the monies to be part of the father's probate estate when he died, and thus fully available to creditor's of his estate.

⁹ *Granwell*, 228 N.E.2d at 782-83; N.Y. Debt. & Cred. Law § 273 (McKinney 1990) (providing that a conveyance made without fair consideration is fraudulent as to creditors if the transferor is or will be rendered insolvent).

¹⁰ N.Y. Debt. & Cred. Law 273 (McKinney 1990).

¹¹ *Bauer v. Crummy*, 267 A.2d 16, 56 N.J. 400, 410 (1970).

¹² *Id.*

¹³ Conn. Gen. Stat. § 36a-292 (2006).

¹⁴ *Ardito v. Olinger*, 782 A.2d 698, 65 Conn. App. 295 (2001).

¹⁵ *Fleet Bank Connecticut, N.A. v. Carillo*, 691 A.2d 1068, 240 Conn. 343, 347 (1997).

¹⁶ *Id.*

¹⁷ *In re Estate of Halbauer*, 228 N.Y.S.2d 786, 788 (Sur. Ct., Suffolk Co. 1962), *aff'd* 238 N.Y.S.2d 511 (2d Dept. 1963); N.J. Stat. Ann. § 17:161-7 (Lexis Nexis 2006); Conn. Gen. Stat. § 45a-368, 369 (2006).

¹⁸ *Halbauer*, 228 N.Y.S.2d at 788; *In re Estate of LaPine*, 1 Misc. 3d 384, 768 N.Y.S.2d 966 (Sur. Ct, Dutchess Co. 2003), *rev'd in part*, 795 N.Y.S. 2d 294 (2nd Dept. 2005); N.J. Stat. Ann. § 17:161-7 (Lexis Nexis 2006); Conn. Gen. Stat. § 45a-368, 369 (2006).

¹⁹ *Franklin Washington Trust Co. v. Beltram*, 29 A.2d 854, 133 N.J. Eq. 11 (1943).

²⁰ *In re Estate of Satnick*, 537 N.Y.S.2d 464, 465 (Sur. Ct., Bronx Co. 1989).

²¹ *Id.*

²² *Id.*; *Reynolds v. Danko*, 36 A.2d 420, 134 N.J. Eq. 560, 562 (1944).

²³ *Reynolds*, 134 N.J. Eq. at 562.

²⁴ N.Y. Ins. Law § 3212(b)(1) (McKinney 1985 & Supp. 1997); N.J. Stat. Ann. § 17B:24-6 (Lexis Nexis 2006); Conn. Gen. Stat. § 38a-453 (2006).

²⁵ *In re Estate of King*, 764 N.Y.S.2d 519, 521 (Sur. Ct., Broome Co. 2003); *Keegan v. Estate of Edward J. Keegan*, 741 A.2d 134, 157 N.J. Super. 279, 292 (1978); N.J. Stat. Ann. § 17B:24-6(a) (Lexis Nexis 2006); Conn. Gen. Stat. § 38a-453(a) (2006).

²⁶ *Satnick*, 537 N.Y.S.2d at 465.

²⁷ *U.S. v. Best*, 357 U.S. 51, 78 S. Ct. 1054, 2 L. Ed. 2d 1135 (1958); *Keegan v. Estate of Edward J. Keegan*, 741 A.2d 134, 157 N.J. Super. 279 (1978).

²⁸ Conn. Gen. Stat. § 38a-453(b) (2006).

²⁹ *In re Will of Knoedler*, 35 N.E. 601, 601-02 (N.Y. 1893).

³⁰ 7-13 Patrick J. Rohan & R. Mark Davis, *New York Civil Practice*, at N.Y. Est. Powers & Trusts Law § 13-3.3(c) (2005); *Keegan*, 157 N.J. Super. at 293; Conn. Gen. Stat. § 38a-451 (2006).

³¹ Rohan, *supra* at § 13-3.3(a)(2); *Keegan*, 157 N.J. Super. at 293; Conn. Gen. Stat. § 38a-451 (2006).

³² Rohan, *supra* at § 13-3(a)(1).

³³ *Id.*

³⁴ See generally 29 U.S.C. § 1002 (2005).

³⁵ 29 U.S.C. § 1144(a) (2005).

³⁶ 29 U.S.C. § 1056(d)(1) (2005); *Boggs v. Boggs*, 520 U.S. 833 (1997).

³⁷ *Robbins v. DeBuono*, 218 F.3d 197, 203 (2d Cir. 2000); *U.S. v. Jackson*, 229 F.3d 1223, *as amended* (9th Cir. 2000).

³⁸ *Lauder v. Jacobs*, 809 N.Y.S.2d 482 (Sur. Ct., Westchester Co. 2005); *State v. Pulasty*, 642 A.2d 1392, 136 N.J. 356, 361, *cert. denied*, 513 U.S. 1017 (1994). In New Jersey, even ERISA covered plan monies that are "rolled over" into a non-ERISA covered IRA lose their former exempt status under the ERISA anti-alienation clause. *Hawxhurst v. Hawxhurst*, 723 A.2d 58, 318 N.J. Super. 72 (1998).

³⁹ N.Y. C.P.L.R. 5205(c) (McKinney 1997); N.Y. Est. Powers & Trusts Law 7-3.1(b) (Consol. 2006); *Pauk v. Pauk*, 648 N.Y.S.2d 134 (2d Dept. 1996).

⁴⁰ *In re Estate of King*, 196 Misc.2d 250, 764 N.Y.S.2d 519, 521 (Sur. Ct., Broome Co. 2003); N.Y. Est. Powers & Trusts Law § 13-3.2 (Consol. 2006).

⁴¹ *King*, 196 Misc.2d at 255.

⁴² *King*, 196 Misc.2d 250, (citing N.Y. Retire. & Soc. Sec. Law § 110 (McKinney 1987); N.Y. Educ. Law § 524 (McKinney 1988); N.Y. C.P.L.R. § 5205(c) (McKinney 1997)); *In re Trust of Gallet*, 765 N.Y.S.2d 157, 163 (Sur. Ct., N.Y. Co. 2003).

⁴³ *Gallet*, 765 N.Y.S.2d at 163.

⁴⁴ *King*, 196 Misc.2d at 254-55.

⁴⁵ *Id.*

⁴⁶ N.J. Stat. Ann. § 25:2-1 (Lexis Nexis 2006); *C.P. By J.P. v. Township of Piscataway Bd. Of Ed.*, 681 A.2d 105, 293 N.J. Super. 421 (1996); Conn. Gen. Stat. 52-321a, 352b (2006); *Central Bank v. Hickey*, 680 A.2d 298, 238 Conn. 778 (1996); *Sears Roebuck & Co. v. Welker*, 2002 Conn. Super. Lexis 3176 (2002).

⁴⁷ *Gilchinsky v. National Westminster Bank N.J.*, 159 N.J. 463 (1999).

⁴⁸ McCouch, *Will Substitutes Under the Revised Uniform Probate Code*, 58 Brook. L. Rev. 1123, 1183 (1993).