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Fighting the Good Fight for New York Estate Tax Reform

What Happened (and Did Not Happen) with the New York Estate Tax in the 2015-2016 New York State Fiscal Year Budget, and Next Steps

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The estate tax provisions that were signed into law by Governor Andrew Cuomo on April 1, 2015 as part of the 2015-2016 New York State fiscal year budget (the "Budget Bill") leave much to be desired. While the Budget Bill's estate tax provisions fill in some gaps left in the wake of last year's substantial revisions to the New York estate tax, they completely fail to address the substantive areas that the New York State Society of Certified Public Accountants (the "NYSSCPA") identified as warranting reform in the report that it issued in December 2014. Thus, among other things:

(i) wealthy New Yorkers in their golden years still have to contend with a confiscatory estate tax cliff that at certain levels will push the marginal New York estate tax rate far in excess of 100%;

(ii) there's no New York State portability for the deceased spouse's unused exclusion amount;

(iii) no separate state qualified terminable interest property ("QTIP") election is available in the case of an estate that files a federal estate tax return solely to make a portability election; and

(iv) no significant adjustment has been made to the 3 year addback of post-March 31, 2014 (and pre-January 1, 2019) gifts of real or tangible personal property located in New York State -- which effectively penalizes New York decedents for federal estate tax deduction purposes.

What The New Law Does

The Budget Bill included the following minor technical amendments to the New York estate tax laws:

- It removes a "lapse provision" that mistakenly would have caused no New York estate tax rates to apply to persons dying on or after April 1, 2015;

- It confirms that the 3-year addback for gifts made by a New York resident between April 1, 2014 and December 31, 2018 does not apply to gifts of real or tangible personal property located outside of New York State; and

- It clarifies that, in the case of non-New York resident decedents, the New York taxable estate shall not include any deduction related to any intangible personal property.

What the New Law Fails to Do

Unfortunately, the Budget Bill's amendments affecting the New York estate tax do little more than scratch the surface. The NYSSCPA submitted the following proposals to reform the New York estate tax in its report dated December 18, 2014 (reproduced in its entirety here: http://www.nysscpa.org/docs/default-source/commentletter/proposal.pdf):

- A proposal to reform the New York estate tax by eliminating the "cliff" that applies to estates that are slightly above the estate tax exemption amount. (The New York estate tax cliff is described in greater detail below.)

- A proposal to reform the New York estate tax by permitting a separate state qualified terminable interest property ("QTIP") election to be made where a federal estate tax return is being filed solely to make a portability election for federal estate tax purposes or in any other situation in which the executor would not be subject to penalties under the Internal Revenue Code for failure to file a federal estate tax return.

- A proposal to reform the New York estate tax to prevent New Yorkers who make taxable gifts subject to addback to their New York gross estate under Tax Law § 954(a)(3) from being penalized for federal estate tax purposes due to deduction limitations for state death taxes under IRC § 2058 by providing that the amount of any increase in New York estate tax that is attributable to the addback of New York taxable gifts shall be subject to a reduced tax rate and apportioning such additional New York estate tax against the residuary estate (unless the governing instrument provides otherwise) through an amendment to EPTL § 2-1.8. (Another approach could be to amend Section 13-1.3 of the New York Estates, Powers and Trusts Law to statutorily treat the New York estate tax attributable to the taxable gift addback as a debt allocable to the residuary estate, except as may be otherwise provided in the deed of gift, Will or other governing instrument. This statutory treatment of the addback as a debt presumably should be respected for federal estate tax purposes. *See Commissioner v. Estate of Bosch*, 387 U.S. 456 (1967).)

- A proposal to permit a portability election for New York estate tax purposes so as to conform to the portability election for federal estate tax purposes.

Unfortunately, none of the NYSSCPA's proposals were enacted as part of the Budget Bill.

Where Do We Go From Here?

Although the Budget Bill represents a temporary setback, it is hardly the end of the line. Rather, I would expect advocacy efforts in tandem with the New York State Bar Association and the New York City Bar Association to continue on the above-noted items over the following year. The issue that has drawn the greatest attention is the New York estate tax cliff, and I have further described it below.

The New York estate tax law provisions that came into effect on April 1, 2014 significantly increased the basic exclusion amount that is used to determine the estate's filing threshold and also to determine the amount of the applicable credit (if any). The basic exclusion amount is as follows:

- $2,062,500 for decedents dying between April 1, 2014 and March 31, 2015;

- $3,125,000 for decedents dying between April 1, 2015 and March 31, 2016;

- $4,187,500 for decedents dying between April 1, 2016 and March 31, 2017;

- $5,250,000 for decedents dying between April 1, 2017 and December 31, 2018; and

- The federal basic exclusion amount for decedents dying on or after January 1, 2019.

In addition, a graduated tax rate table applies based on the New York taxable estate of the New York resident or nonresident decedent. The Budget Bill's estate tax provisions confirm that for persons dying on or after April 1, 2015, the top marginal estate tax rate is 16%, and applies to New York taxable estates in excess of $10,100,000.

The language of N.Y. Tax Law § 952(c)(1), however, creates an effective "cliff" due to the rapid phase-out of the applicable credit amount for taxable estates that are only slightly in excess of the basic exclusion amount that is inconsistent with the policy objective of eliminating incentives for wealthy New Yorkers to move to another state to avoid the New York estate tax. N.Y. Tax Law § 952(c)(1) provides (emphasis added):

> A credit of the applicable credit amount shall be allowed against the tax imposed by this section as provided in this subsection. In the case of a decedent whose New York taxable estate is less than or equal to the basic exclusion amount, the applicable credit amount shall be the amount of tax that would be due under subsection (b) of this section on such decedent's New York taxable estate. In the case of a decedent whose New York taxable estate exceeds the basic exclusion amount by an amount that

is less than or equal to five percent of such amount, the applicable credit amount shall be the amount of tax that would be due under subsection (b) of this section if the amount on which the tax is to be computed were equal to the basic exclusion amount multiplied by one minus a fraction, the numerator of which is the decedent's New York taxable estate minus the basic exclusion amount, and the denominator of which is five percent of the basic exclusion amount. Provided, however, that the credit allowed by this subsection shall not exceed the tax imposed by this section, **and no credit shall be allowed to the estate of any decedent whose New York taxable estate exceeds one hundred five percent of the basic exclusion amount.**

As indicated above, N.Y. Tax Law § 952(c)(1) provides an extremely steep slope that phases out the applicable credit amount for New York taxable estates that are between 100% and 105% of the basic exclusion amount, and eliminates the basic exclusion amount altogether for the estate of any decedent whose New York taxable estate exceeds one hundred and five percent of the basic exclusion amount. The effect of this cliff is demonstrated in guidance issued by the New York State Department of Taxation and Finance (the "New York Tax Department") on August 25, 2014 in TSB-M-14(6)M (the "Tax Department's Estate Tax Guidance"). The Tax Department's Estate Tax Guidance provides an example where an individual dies with a taxable estate of $2,100,000, which is $37,500 above the basic exclusion amount of $2,062,500 for persons dying between April 1, 2014 through March 31, 2015. This produces a New York estate tax of $49,308, which computes to a marginal estate tax rate of more than 131% on the amount of the taxable estate in excess of the basic exclusion amount ($49,308 / $37,500 = 1.3149, which rounds to more than 131%). This marginal estate tax rate gets even higher in subsequent years due to the mathematics involved as the basic exclusion amount increases from year to year, traversing into higher marginal tax rates that would otherwise be soaked up by the applicable credit amount.

The cliff is completely contrary to the policy objective of making New York a more favorable environment for New Yorkers during their golden years, and renders illusory any notion of estate tax reform for wealthy New Yorkers (who, paradoxically, are the ones most at risk from an estate tax standpoint to leave New York to move to a state such as Florida that does not impose a state estate tax). Accordingly, the cliff should be eliminated altogether by removing both the phase-out and the elimination of the applicable credit amount.

Alternatively, if New York's need for revenue is such that the complete elimination of the cliff is not practical, then the cliff should at minimum be "smoothed out" by "extending the runway" over which the phase out of the applicable credit amount occurs – say from 100% to 150% of the basic exclusion amount, instead of between 100% and 105% of the basic exclusion amount as the law currently provides. A proposal to slightly extend the phase-out runway from 100% to 110% of the basic exclusion amount was contained within the Senate's "one-house proposal" on the 2015-2016 New York State fiscal year budget, but this provision was not enacted into law. It does, however, demonstrate some legislative sensitivity to this issue (at least in the Senate), and will hopefully serve as a prelude to corrective action in the near future.

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