

REPORT BY THE ESTATE AND GIFT TAXATION COMMITTEE

**PROPOSED AMENDMENT TO THE ESTATES, POWERS AND TRUSTS LAW
REGARDING THE INTERPRETATION OF CREDIT SHELTER BEQUESTS IN
TESTAMENTARY DOCUMENTS**

The New York City Bar Association, through its Estate and Gift Taxation Committee (the “Committee”), respectfully proposes adding a new section to the Estates, Powers and Trusts Law (the “EPTL”) as Section 2-1.12-A. The suggested legislation, if enacted, would govern the interpretation of credit shelter bequests in testamentary documents in order to avoid unintended consequences caused by changes to New York tax law. Specifically, the statute would provide a presumption that credit shelter bequests be construed to set aside the maximum amount that may be shielded from both federal and New York state estate taxes.

I. BACKGROUND

New York State taxes estates at different amounts and different rates than the federal government. Currently, New York’s estate tax exemption is less than the \$5,490,000 federal estate tax exemption. Section 952(c)(1) of the New York Tax Law (the “NYTL”), enacted in 2014, will raise the New York estate tax exemption amount periodically over the next few years, eventually eliminating the disparity with the federal exemption. Specifically, the law will increase the state’s exemption amount from \$4,187,500 to \$5,250,000 (effective April 1, 2017), and ultimately to the then federal exemption on January 1, 2019. For all subsequent years, the New York State exemption will equal the federal exemption, indexed for inflation. Under NYTL Section 952(c)(1), individuals with taxable estates less than or equal to the applicable New York State exclusion amount will pay no state estate tax. However, the New York exemption is phased out rapidly for estates valued between 100% and 105% of the state exclusion amount, with individuals whose taxable estates exceed 105% of the exemption amount effectively taxed on the entire estate.

At the federal level, it is common for married testators to take advantage of the federal estate tax exemption by including dispositions in their testamentary documents intended to transfer the remaining federal exemption to individuals other than the surviving spouse without intending to trigger any estate tax upon the first spouse’s death. These bequests are typically drafted with a formula designed to capture the full federal exemption amount effective and available at the time of the first spouse’s death. Such “credit shelter bequests” remain prevalent in estate planning documents despite the introduction of portability at the federal level by which the second spouse to die may use the predeceased spouse’s remaining federal exemption. Indeed,

many testators still include these bequests in order to utilize any remaining generation-skipping transfer tax exemption, provide creditor protection, direct the ultimate disposition of the devised property or capture the appreciation on such property free of federal estate tax.

Unfortunately, recent changes to the NYTL may create unintended consequences for decedents whose estate plans have not been updated. The inclusion of a credit shelter bequest now often triggers a state-level tax that exceeds both the effective tax rate under portability as well as, in some cases, the difference between the state and federal exemption amounts. The Committee believes that the addition of EPTL 2-1.12A will solve this issue.

II. DISCUSSION

A. Recent Changes to New York Tax Law Have Created Unintended Consequences for Certain Decedents Whose Estate Plans Include Formula Bequests of the Federal Exemption Amount.

As a result of the recent changes to NYTL Section 952(c)(1), the federal exemption amount will continue to exceed the New York exemption amount through 2019. Coupled with dramatic phase-outs of the state exemption for estates exceeding 105% of the applicable state exemption amount, this system inadvertently leads to a very substantial state estate tax for certain decedents whose testamentary plans include a disposition of the full federal exemption amount.

For example, the New York exemption will be \$5,250,000 for decedents who die between April 1, 2017 and December 31, 2018. Assuming the current federal exemption amount, an individual whose testamentary plan includes a standard credit shelter bequest tied to the federal exemption amount would set aside \$5,490,000; yet, the resulting New York tax would be more than \$500,000. Thus, a bequest in an amount fully sheltered by the federal exemption—and only \$200,000 above the New York exemption—would result in estate tax in excess of \$500,000.

For decedents dying after March 31, 2017, the effective state-level tax is so high that it is unlikely that an individual would ever intentionally set aside the full federal exemption amount, particularly when portability is an option. However, because many testators' estate planning documents have not been (and may not be) revised to account for the recent change to NYTL Section 952(c)(1), a significant number of New York estates may be subject to this unintended consequence.

B. New York Has a Strong History of Permitting Reformation of Testamentary Documents to Avoid Unanticipated Tax Effects.

There is rich history in the New York courts of reforming testamentary documents to avoid unintended adverse tax consequences. Specifically, the courts have demonstrated a robust policy of permitting reformation to take full advantage of available tax deductions and exemptions where there has been a change in the tax law.¹ Indeed, the presumption that testators

¹ See, e.g., *Matter of Choate*, 141 Misc.2d 489 (Sur. Ct. 1988).

intend to minimize taxes has been applied consistently by the courts to secure specific tax advantages through reformation where the intent of the testator is apparent.²

To avoid an influx of reformation actions in the courts, the state legislature has enacted remedial legislation to address unexpected consequences arising from changes in tax law. For example, in the year 2000, in light of the elimination of the state death tax credit, the legislature enacted EPTL Section 2-1.12. Under this EPTL Section, certain testamentary documents executed prior to February 1, 2000 containing formula bequests which reference the credit for state death taxes are construed without regard to the reference. Further, in response to the 2010 repeal of the federal estate tax and the generation-skipping transfer tax, the legislature enacted EPTL Section 2-1.13 to require interpretation of certain formula bequests as if they were made pursuant to the Internal Revenue Code provisions in effect prior to the repeal.

III. PROPOSED LEGISLATION

Consistent with New York common law and the prior practice of the New York legislature, and in the interest of judicial efficiency, the Committee respectfully suggests that proposed Section 2-1.12-A of the EPTL be enacted in order to govern the interpretation of a credit shelter bequest for a New York decedent dying after March 31, 2017, as set forth below:³

If:

(a) a decedent who is a resident of New York State dies after March 31, 2017; and

(b) by reason of the death of the decedent, property passes or is acquired from the decedent under a will, a trust or a beneficiary designation which contains a formula providing, in sum or substance, for a bequest or other disposition of the maximum amount of property that can be sheltered from federal estate tax by reason of available credits against such tax;

then unless the governing instrument specifically provides otherwise by referring to this section, such formula shall be deemed to refer to the maximum amount of property, if any, that can be sheltered from both federal estate tax and New York State estate tax by reason of the applicable credit amount allowable against each of the federal estate tax liability and the New York State estate tax liability.

(c) Notwithstanding the foregoing, nothing in this section shall be deemed to preclude a proceeding from being brought that seeks an order (i) construing the

² For instance, in the past, New York courts have (i) reformed trusts in order to qualify them for the charitable deduction under the new requirements for charitable remainder trusts after the 1969 Tax Reform Act; (ii) permitted reformation of provisions in wills to permit taking advantage of the later enacted unlimited marital deduction; and (iii) construed tax apportionment clauses in wills where literal application of the provisions would frustrate the testator's intention. *See, e.g.*, *Matter of Gottfried*, NYLJ, April 11, 1997 (Sur. Ct. 1997); *Matter of Martin*, 146 Misc. 2d 144 (Sur. Ct. 1989); *Matter of Choate*, 141 Misc.2d 489 (Sur. Ct. 1988); *Matter of Lepore*, 128 Misc. 2d 250 (Sur. Ct. 1985).

³ For ease of reference, a blackline comparing the proposed legislation to existing Section 2-1.12 is attached hereto.

decedent's intent concerning the effect of a formula bequest or other disposition contained in a will, trust or beneficiary designation or (ii) overriding the presumption set forth in subsection (b) of this section.

IV. RECOMMENDATION

The Committee respectfully recommends that the EPTL be modified to incorporate proposed Section 2-1.12-A in order to remedy the effects of NYTL Section 952(c)(1) on decedents whose testamentary documents include credit shelter bequests or other dispositions of the federal exemption amount.

Estate and Gift Taxation Committee
Evelyn M. Capassakis, Chair

January 2017

**BLACKLINE COMPARISON OF PROPOSED EPTL SECTION 2-1.12-A
TO EXISTING EPTL SECTION 2-1.12**

STATE OF NEW YORK

2017-2018 Regular Sessions

AN ACT to amend the estates, powers and trusts law to provide a presumption that credit shelter bequests be construed to set aside the maximum amount that may be shielded from both federal and New York state estate taxes.

The People of the State of New York, represented in Senate and Assembly, do enact as follows:

1 Section 1. Section 2-1.12 of the estates, powers and trusts law is amended to read
2 as follows:

3 If:

4 (a) a decedent **who is a resident of New York state** dies after ~~January thirty first,~~
5 ~~two thousand~~ _____; and

6 (b) by reason of the death of the decedent property passes or is acquired from the
7 decedent under a will ~~executed or a trust created prior to February first, two thousand,~~ **a**
8 **trust or a beneficiary designation which contains a formula providing,** in sum or
9 substance, for a bequest **or other disposition** of the maximum amount of property that
10 can be sheltered from federal estate tax by reason of available credits against such tax;

11 **then unless the governing instrument specifically provides otherwise, such**
12 **formula shall be deemed to refer to the maximum amount of property, if any, that**
13 **can be sheltered from both federal estate tax and New York state estate tax by**
14 **reason of the applicable credit amount allowable against each of the federal estate**
15 **tax liability and the New York state estate tax liability.**

16 (c) ~~such formula was not amended at any time after January thirty first, two~~
17 ~~thousand and before the death of the decedent, then, unless the instrument containing~~
18 ~~such formula specifically provides that there are non-tax reasons for taking the federal~~

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1 ~~credit for state death taxes into account, such formula shall be deemed not to include a~~
2 ~~reference to the federal credit for state death taxes.~~ **Notwithstanding the foregoing,**
3 **nothing in this section shall be deemed to preclude a proceeding from being**
4 **brought, including but not limited to (i) construing the decedent's intent concerning**
5 **the effect of a formula bequest or other disposition contained in a will, trust or**
6 **beneficiary designation, or (ii) overriding the presumption set forth in subsection (b)**
7 **of this section.**

8 § 2. This act shall take effect on April 1, 2017.