REPORT OF THE NEW YORK STATE SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS

MEMORANDUM CONCERNING CERTAIN ASPECTS OF THE 2014-2015 NEW YORK STATE EXECUTIVE BUDGET DATED JANUARY 20, 2014

The New York State Society of Certified Public Accountants, through its Estate Planning Committee (the "NYSSCPA"), respectfully submits this memorandum concerning certain aspects of the 2014-2015 New York State Executive Budget dated January 20, 2014, as amended (the "Budget Bill").[1] The Budget Bill's proposals (each a "Proposal") include the following:

A. A Proposal to reform the New York estate tax (i) by raising the New York estate tax exemption from $ 1 million to $ 5.25 million, subject to further indexing, and (ii) by reducing the maximum New York estate tax rate from 16% to 10%. Both the increased exemption and the decreased rates would be phased in over four years with the State estate tax exemption to be approximately equal to the Federal estate tax exemption, indexed for inflation, beginning in 2019. ***We support this Proposal, although we would suggest elimination of the "cliff" that would result for estates that are above the estate tax exemption amount.***

B. A Proposal to reform the New York estate tax by permitting a separate state qualified terminable interest property ("QTIP") election to be made where no federal estate tax return is required to be filed. ***We support this Proposal, although we would suggest that the statutory language be modified to clarify that a separate QTIP election can be made where no federal estate tax return is required to be filed because the estate is under the filing threshold, although a federal estate tax return may in fact have been filed. We also suggest that the separate state QTIP election apply irrespective of whether a federal estate tax return is required to be filed***.

C. A Proposal to eliminate the New York generation-skipping transfer ("GST") tax, which applies to taxable distributions and taxable terminations from a trust to a "skip person" for GST tax purposes. ***We support this Proposal.***

D. A Proposal to provide for an "addback" of taxable gifts under IRC[2] § 2503 that are made on or after April 1, 2014 if the decedent was a resident of New York at the time such gift was made. ***We oppose this Proposal, particularly in light of its omission from S. 6359-C. If, however, it becomes necessary to include such legislation, this Proposal should be modified to clarify (i) that such "addback" would not apply to gifts of real or tangible personal property located outside of New York State, (ii) that the addback would only apply to gifts***

---

[1] We comment only on the issues addressed herein and do not take a position on other aspects of the Budget Bill.

[2] All references to "IRC" are to the Internal Revenue Code of 1986, as amended.

made within one year of the decedent's death, (iii) that the addback would not apply to gifts that are included in the decedent's gross estate, and (iv) 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 specially allocated to the residuary estate (unless the governing instrument provides otherwise) through an amendment to EPTL § 2-1.8. We also have concerns with the Proposal's implementation of this addback in N.Y. Tax Law § 960(b) in the case of a nonresident decedent, and oppose its application to lifetime taxable gifts of "intangible personal property employed in a business, trade or profession carried on in this state."

E. A Proposal to subject "incomplete gift nongrantor trusts" ("ING Trusts") to New York income tax by treating such trusts as grantor trusts for New York income tax purposes. ***We support the objectives of this Proposal, although we would suggest that it would be more consistent with the way that trusts are taxed in New York, as well as a more finely-targeted remedy, to modify the statutory safe harbor from New York resident trust income taxation (Tax Law § 605(b)(3)(D)) so that such incomplete-gift trusts do not qualify for this exception.***

F. A Proposal to subject to New York income tax on a "throwback tax" basis "accumulation distributions" to New York resident beneficiaries from nongrantor trusts (other than "ING Trusts") that are currently exempt from New York income tax under the "New York Resident Trust Exception," or as nonresident trusts that do not have any New York source income. ***We oppose this Proposal on the grounds that the proposed legislation, as currently drafted, is technically flawed, and would be unduly burdensome upon trustees and New York resident beneficiaries, as well as upon practitioners.***

Our positions on these Proposals, together with our additional recommendations (including in support of a portability election for New York estate tax purposes), are further discussed below. We note that we endorse and expressly adopt each of the positions that have been taken on these matters by the New York City Bar Association in its March 2014 Report (the "City Bar March 2014 Report"), except that we oppose the addback of taxable gifts.

A. We Support the Budget Bill's Proposal to Reform the New York Estate Tax (i) by Raising the New York Estate Tax Exemption from $ 1 million to $ 5.25 million, subject to further indexing, and (ii) by Reducing the Maximum New York Estate Tax Rate from 16% to 10%, with Both the Increased Exemption and the Decreased Rates to be Phased in over Four Years.

The Budget Bill proposes to reform the New York estate tax (i) by raising the New York estate tax exemption from $ 1 million to $ 5.25 million, subject to further indexing, and (ii) by reducing the maximum New York estate tax rate from 16% to 10%. Both the increased exemption and the decreased rates would be phased in over four years, with the state estate tax exemption to be approximately equal to the federal estate tax exemption, indexed for inflation, beginning in 2019.

We applaud the Budget Bill's efforts to enhance New York's competitiveness vis-à-vis other states by increasing the New York estate tax exemption and decreasing the New York estate tax rate. As succinctly stated by Governor Cuomo in his State of the State address:

"New York is one of only fifteen states [with] an estate tax and our exemption levels are among the lowest and our rates are among the highest. Let's eliminate the "move to die tax" w[h]ere people literally leave our state, move to another state to do estate planning. We propose raising New York's state tax threshold and lowering the rate to put it into line with other states."[3]

We fully agree with the Governor's position and support the Budget Bill's Recommendation with respect to the New York estate tax.

We do, however, offer the following technical comments concerning the language of the Budget Bill.

Although the language of the Budget Bill may provide parity between the federal and New York State estate tax exemption amounts during the period from April 1, 2017 through December 31, 2019, it appears that such parity would not necessarily be assured after that. A potential issue arises with the New York exemption amount due to the fact that, during the period from April 1, 2017 through December 31, 2018 (addressed in proposed Tax Law § 952(c)(2)(A)), the New York base year for indexing is slightly different from the Federal base year. The base year for the Federal indexing adjustment is 2010; while for New York it is 2012. So while New York is using the federal applicable exclusion amount for 2012 ($5,120,000), that figure is rounded down (to the nearest $10,000) from $5,121,320. Although this will generally provide parity with the federal applicable exclusion amount, it is possible that there could be a year where the federal and New York figures are slightly different.[4]

In addition, we are concerned that the language of the Budget Bill has created 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 applicable credit amount. Proposed 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**."

[3] "Transcript: Governor Cuomo's 2014 State of the State Address," *available at* https://www.governor.ny.gov/press/01092014-transcript-2014-sos.

[4] We note that the 2014-2015 Executive Budget Amendments dated February 11, 2014 (the "21 Day Amendments") contained corrections relating to this Proposal that addressed technical concerns that we had with respect to the determination of the New York State exemption amount from the year 2021 onward, which had appeared on page 495 of the original version of the Budget Bill.

As indicated above, proposed 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. Assuming a basic exclusion amount of $ 5,250,000, a decedent with a New York taxable estate of $ 5,512,500 (which is 105% of the basic exclusion amount of $ 5,250,000) would pay New York estate tax of $ 430,050. In effect, there is a New York estate tax of $ 430,050 (or a marginal New York estate tax rate of nearly 164%) on the additional New York taxable estate of $ 262,500 in excess of the basic exclusion amount of $ 5,250,000.

We do not believe that this cliff is consistent with the Governor's objectives of making New York a more favorable environment for New Yorkers during their golden years. Accordingly, we suggest that this cliff be eliminated altogether by removing both the phase-out and the elimination of the applicable credit amount.

B. We Support the Budget Bill's Proposal to Revise the New York Estate Tax by Permitting a Separate State Qualified Terminable Interest Property ("QTIP") Election to be made in circumstances where no Federal Estate Tax Return is Required to be Filed and Suggest that Language be Added to Reflect that no Federal Estate Tax Return is Required to be Filed if an Estate is under the Federal Filing Threshold (although a Federal Estate Tax Return May In Fact Have Been Filed), and also Suggest that the Proposal be further Extended to circumstances where a Federal Estate Tax Return is Required to be Filed.

The Budget Bill proposes to revise the New York estate tax law by permitting a separate state QTIP election to be made when no federal estate tax return is required to be filed. (Proposed Tax Law § 955(c)). We suggest adding language to clarify that a separate QTIP election can be made where no federal estate tax return is required to be filed "because the estate is under the filing threshold, although a federal estate tax return may in fact have been filed." This could arise, for example, where a federal estate tax return is "required" to be filed (although not technically over the filing threshold) in order to make a portability election or to commence the running of the statute of limitations for hard-to-value assets. This is in contrast to current New York law, which requires that Federal and New York QTIP elections be consistent. *See* TSB-M-11(9)M.[5]

A federal estate tax return must be filed in order to take advantage of portability for federal purposes. If an estate is below the filing threshold and a federal return is required to be filed solely for portability reasons, there would be no reason to make a federal QTIP election. There is presently no provision in New York, however, for making a New York QTIP election that is inconsistent with a position taken on a federal return. In TSB-M-11(9)M, the guidance explicitly provides that, even if a federal estate tax return is filed solely for the purpose of electing portability, then the same QTIP election reflected on the federal return must be made for New York estate tax purposes. If a QTIP election is not made on the federal return, it cannot be made for New York purposes. This may result in a dilemma for a fiduciary who is forced to choose between a separate state QTIP election and portability. Conflicting interests might cause the fiduciary dilemma to intensify.

The Budget Bill, with the suggested modification, would address these conflicting interests in the case of an estate that files a federal estate tax return solely for purposes of electing portability where a

[5] "Supplemental Information on New York State Estate Tax Filing Requirements Related to the Federal 2010 Tax Relief Act", NYS Dept. of Taxation and Finance Taxpayer Guidance Division, July 29, 2011, *available at* http://www.tax.ny.gov/pdf/memos/estate_&_gift/m11_9m.pdf.

federal estate tax return is not otherwise required to be filed. We applaud this Proposal, but believe that it would be more helpful to New York estates, executors and beneficiaries if the Proposal went even further, and allowed a separate state QTIP election to be made irrespective of whether a federal estate tax return is required to be filed. We therefore respectfully request that this Proposal be modified accordingly to encompass such circumstances as well.

In addition, we note the following technical concerns with the language of the proposed amendment:

- Proposed Tax Law section 960(c)(2) contains a list of the Code sections that may be applicable in determining the New York estate tax, and those sections are reproduced in full in Tax Law section 999-A – the "Appendix to article twenty-six." While Code section 2044 is included in that Appendix, it would seem that neither that reference nor section 954's definition of a resident's gross estate would include in a surviving spouse's New York or federal gross estate property over which **only** a New York QTIP election is made. Code section 2044 will not apply because no federal QTIP election was made, and section 954 is based on the federal gross estate; that is, as drafted section 954 does not contain a modification that would apply to such property. As the concept behind a QTIP election is deferral, not avoidance, of the imposition of estate tax, section 954(a) should, thus, be amended to add a modification applicable to such property, as well as covering the issue discussed in the next paragraph.

- In addition, if the surviving spouse releases his or her income interest in a federal QTIP trust, the resulting gift (including the deemed gift of the remainder under Code section 2519) will be included in the New York taxable estate by reason of the application of section 954(a)(3). If, however, no federal QTIP election was made, Code section 2519 will not apply to create a gift of the remainder, and the taxable gift will be limited to a gift of the income interest. Only the latter would then be included in the survivor's New York gross estate under Tax Law section 954(a)(3). This unintended result should also be corrected.

C. We Support the Budget Bill's Proposal to Eliminate the Generation-Skipping Transfer Tax

The Budget Bill also proposes to repeal Article 26-B of the tax law to eliminate the New York generation-skipping transfer ("GST") tax, which applies to taxable distributions and taxable terminations from a trust to a "skip person" for GST tax purposes. The Final Report of the New York State Tax Reform and Fairness Commission (the "Fairness Commission") dated November 2013 (the "Fairness Commission Report") had noted that the GST tax "is not a major source of revenue for New York State. On average, fewer than 50 GST [tax] returns are filed and the tax generates less than $500,000 annually." Thus, repealing the GST tax would streamline New York Tax Law. We agree, and support this Proposal.

D. We Oppose the Budget Bill's Proposal to Provide for an "Addback" for Taxable Gifts under IRC § 2503 That Were Made on or after April 1, 2014 if the Decedent was a Resident of New York at the Time Such Gift Was Made

In lieu of reinstating the New York gift tax which New York repealed back in 2000 (such reinstatement had been suggested in the Fairness Commission Report), the Budget Bill provides for an "addback" for "any taxable gift under section 2503 of the internal revenue code" made on or after April 1, 2014 if the decedent was a resident of New York State at the time such gift was made. (Prop. N.Y. Tax Law § 954(a)(3))

We oppose this Proposal, particularly in light of its omission from S. 6359-C. If, however, it becomes necessary to include such legislation, we would suggest the following modifications to the language proposed in the Budget Bill to better implement this adjusted taxable gift concept in New York.

First, gifts by a New York resident of real property or tangible personal property located outside of New York should be specifically excluded from any such addback. This adjustment is needed to clarify that the scope of this addback is intended to match what is included in the New York gross estate tax base of a New York resident decedent. For New York estate tax purposes, the New York gross estate of a New York resident decedent specifically excludes real property and tangible personal property that is located outside of New York State.[6] A corresponding adjustment should therefore be made to the "addback."[7]

Second, the addback should be limited to gifts made by a New York resident within one year of his or her death. This would be consistent with the policy decision to put a halt on substantial deathbed gifts. It moreover would be consistent with the approach taken by New York law in EPTL § 5-1.1-A(b)(1)(B) in its treatment of gifts made within one year of death for purposes of a surviving spouse's right of election. In addition, it would be similar to the one-year addback approach that Maine has taken for state estate tax purposes.[8]

Third, to avoid potential double taxation in the New York decedent's estate, the addback should not apply to gifts that are included in the gross estate. As an example, when an individual has retained a life estate, at his or her death the remainder is treated as a taxable transfer for federal estate tax purposes under IRC § 2036 (not as an adjusted taxable gift), thereby essentially subjecting the remainder to double taxation in New York. This is because the property (i) would be included in the federal gross estate which, assuming it is not real or tangible personal property outside of New York state, falls within the definition of "New York gross estate" under section 954(a), and (ii) would also be added to the gross estate of a New York resident under section 954(c). The same result might occur due to inclusion of a revocable transfer under Code section 2038 or a transfer subject to Code section 2702. To obviate this situation, the Budget Bill should include a provision for the reduction of any gifts to the extent already included in the federal gross estate.

Fourth, we are concerned whether gifts added back into the New York taxable estate for New York estate tax purposes would be deductible state death taxes for *federal* estate tax purposes pursuant to IRC § 2058(a), which provides a deduction for state estate taxes "in respect of any property included in the [federal] gross estate". This actually would make New York even more uncompetitive than it currently is compared to other states and increases, rather than decreases, the incentive for the very wealthy to emigrate. If this element of the Budget Bill must remain at all, the rate of New York estate tax imposed on the portion of the New York gross estate that is not part of the federal gross estate — that is, the lifetime gifts – should be reduced to what the net cost would have been if the tax had been deductible. Under current rates that is generally a reduction of 40% of the New York marginal estate tax rate

[6] *See* N.Y. Tax Law § 954(a)(1).

[7] This adjustment would correspond to the approach taken in New York's repealed gift tax statute, which excluded from New York gift tax gifts of "real or tangible personal property having an actual situs outside New York state." *See* N.Y. Tax Law § 1003(a)(1) (repealed in 2000).

[8] Since 2011, Maine's estate tax statute has limited its pullback of lifetime gifts to a one-year period. *See* 36 Me. Rev. Stat. § 4102(7)(C). *See also* 72 P.S. § 9107(c)(3) (which only pulls back, for Pennsylvania inheritance tax purposes, certain lifetime transfers made within one year of death).

otherwise applicable, although as a drafting matter to accommodate future rate changes it would be advisable for the bill to describe the desired result by a non-mathematical formula.

In addition, there is an estate tax apportionment issue relating to the New York estate tax that is attributable to the inclusion of such New York adjusted taxable gifts – *that is, who should bear the tax – the probate estate or the recipient of the lifetime gift?* We suggest that EPTL § 2-1.8 should be amended to specially allocate this portion of the tax to the residuary estate (unless the governing instrument provides otherwise) – along the lines of the special provisions already there for qualified terminable interest property and certain other property.

Fifth, we are concerned with the Budget Bill's proposed implementation in N.Y. Tax Law section 960(b) of the addback of taxable gifts made by New York residents after March 31, 2014 as it pertains to nonresident decedents. The Budget Bill's amendment to N.Y. Tax Law section 960(b) provides for the computation of estate tax in the case of a nonresident decedent using a modified version of the New York taxable estate applicable to residents under section 952. Under this modified version, excluded from the computation of the nonresident decedent's New York estate are "the amount of any gift unless such gift consists of real or tangible personal property having an actual situs in New York state or *intangible personal property employed in a business, trade or profession carried on in this state*" (emphasis added).

Although we support, in general, this proposed amendment, we oppose its application to lifetime gifts of "intangible personal property employed in a trade or profession carried on in this state." If the intention is to tax such intangibles owned by a nonresident, it would seem that the amendment is defective, since the New York taxable estate of a nonresident, under the immediately preceding language of section 960(b), is already reduced by "the value of any intangible personal property otherwise includible in the deceased individual's New York gross estate." The language of the amendment would have the effect of not reducing the taxable estate by a lifetime gift of such property. We question the policy of imposing estate tax in such a situation when ownership of the same property at death would not be subject to New York estate tax.[9]

E. We Support the Objectives of the Budget Bill's Proposal to Subject "Incomplete Gift Nongrantor Trusts" ("ING Trusts") to New York Income Tax by Treating Such Trusts as Grantor Trusts for New York Income Tax Purposes, Although We Suggest That It Would Be More Consistent with the Way that Trusts Are Taxed in New York, as well as a More Finely-Targeted Remedy, To Modify The Statutory Safe Harbor From New York Resident Trust Income Taxation (Tax Law Section 605(b)(3)(D)) so that such Incomplete-Gift Trusts Do Not Qualify for This Exception.

The Budget Bill proposes to subject "Incomplete Gift Nongrantor Trusts" ("ING Trusts") to New York income tax by treating such trusts as grantor trusts for New York income tax purposes.

We support the objectives of this Proposal in order to address perceived abuses stemming from the use of ING Trusts to avoid New York income tax on the sale of highly appreciated property that otherwise would have been subject to New York income tax had the New York resident grantor sold the

[9] We also note that while it otherwise appears that a nonresident decedent's estate is entitled to a New York credit against estate tax, that entitlement could be made clearer by including in Section 960(b) a cross reference to subsection (c) of section 952 (i.e., the subsection that sets forth the credit).

property herself instead of contributing such property to the ING Trust.[10] We believe, however, that the proposed amendment to section 612(b)(41) that would treat ING Trusts as grantor trusts for New York income tax purposes, thereby subjecting the grantors of such trusts to New York income tax, is not the best way to accomplish this. We think it is unnecessary and unduly complex to create a discrepancy between the federal treatment of these trusts as complex trusts and the proposed treatment of such trusts by New York State as grantor trusts. For example, would a sale between such a trust and the grantor generate capital gain recognition for federal but not New York purposes? As a result, will the sold asset now have a different tax basis for federal and New York purposes? And perhaps a different depreciation schedule for the two tax systems (if the sold item is depreciable property)? Would the payment of interest between the settlor and the trust generate ordinary income for federal but not New York purposes? Would the settlor be able to pay the trust's New York income tax without that economic benefit being treated as a gift?

We suggest that it would be more consistent with the way that trusts are taxed in New York, as well as a more finely-targeted remedy, to modify the statutory safe harbor from New York resident trust income taxation (Tax Law section 605(b)(3)(D)) so that such incomplete-gift trusts do not qualify for the exception. The statutory safe harbor (the "New York Resident Trust Exception") would continue to apply to all other nongrantor trusts for which (1) all of the trustees are domiciled outside of New York State; (2) all real and tangible trust property is located outside of New York State; and (3) all trust income and gains is derived from sources outside of New York State.[11] As a consequence, such incomplete-gift trusts would be treated exactly as they are for federal tax purposes (i.e., separate taxpayers) but would also be subject to NY income tax. That is the desired result and would be achieved in a way less disruptive to the current system.

[10] We do not take any position as to whether the imposition of New York income tax upon a New York resident grantor of an ING Trust should withstand scrutiny under the Due Process Clause and the Commerce Clause of the U.S. Constitution.

[11] *See* N.Y. Tax Law § 605(b)(3)(D).

F. We Oppose the Proposal to Subject to New York Income Tax on a "Throwback Tax" Basis "Accumulation Distributions" to New York Resident Beneficiaries from Nongrantor Trusts (other than "ING Trusts") that Are Currently Exempt from New York Income Tax Under Either the New York Resident Trust Exception, or as Nonresident Trusts That Do Not Have Any New York Source Income.

In addition, we oppose the Budget Bill's Proposal to subject to New York income tax on a "throwback tax" basis "accumulation distributions" to New York resident beneficiaries from nongrantor trusts (other than "ING Trusts") that are currently exempt from New York income tax under either the New York Resident Trust Exception, or as nonresident trusts that do not have any New York source income. As more fully discussed below, there are two (2) primary reasons for our opposition to the proposed throwback tax:

- As drafted, it is technically flawed; and
- It would be unduly burdensome upon trustees and New York resident beneficiaries, as well as upon practitioners.[12]

1. The Throwback Tax Provisions of the Budget Bill Are Technically Flawed

The throwback tax provisions of the Budget Bill are technically flawed in the following respects:

- The Budget Bill fails to limit its tax on an accumulation distribution to undistributed net income ("UNI") as required under the corresponding federal throwback provisions contained in IRC § 665(a); and

- The Budget Bill fails to include capital gains in distributable net income ("DNI") as required under the corresponding federal throwback provisions contained in IRC § 643(a)(6)(C).[13]

---

[12] We do not take any position as to whether New York's imposition of a throwback tax upon a New York resident beneficiary of either a New York resident trust qualifying for the New York Resident Trust Exception, or a nonresident trust, would withstand scrutiny under the Due Process Clause and the Commerce Clause of the U.S. Constitution.

[13] The 21 Day Amendments contained the following technical corrections relating to this Proposal:

- Language clarifying that distributions of income accumulated from nonresident trusts and exempt resident trusts prior to tax year 2011 are not taxable.

- Language clarifying that distributions of income accumulated by a trust prior to the beneficiary first becoming a resident of New York State are not taxable.

- Language clarifying that the effective dates of this Proposal apply to both nonresident trusts and exempt resident trusts.

- Language amending the modification increasing federal adjusted gross income by the amount of accumulation distributions from a trust to not include income accumulated by the trust prior to the birth of the beneficiary or prior to the beneficiary attaining the age of twenty-one. The 21 Day Amendments accomplished this by deleting the following language from the proposed paragraph 40 to Subsection (b) of Section 612 to exclude from tax the income accumulated by the trust prior to the birth of the beneficiary or prior to the beneficiary attaining the age of twenty-one:

2. The Throwback Tax Would Be Unduly Burdensome upon Trustees and New York Resident Beneficiaries, as well as upon Practitioners

Given the complexity of the proposed throwback tax provisions contained in the Budget Bill and our concerns that these provisions as drafted are technically flawed, we strongly oppose the enactment of the throwback tax in any form. If, however, a modified form of the throwback tax provisions contained in the Budget Bill were to be enacted in light of the concerns that we have identified above, we would strongly suggest that the following recommendations be incorporated into the statute to reduce the substantial administrative burdens that would otherwise be imposed upon trustees and New York resident beneficiaries, as well as upon practitioners.

- All income earned by the trust during taxable years beginning prior to the date of enactment should be permanently excluded from the throwback tax. Although we are grateful that the 21 Day Amendments have excluded any income earned by a trust in any taxable year starting before January 1, 2011, we still have concerns that there will be instances where efforts to take into account accumulated trust income for tax years beginning prior to the date of enactment will be futile due to the inadequacy of records to support this data. Not unlike the New York GST tax (which is now slated for repeal as part of the Budget Bill), this would effectively penalize those trustees or New York beneficiaries who maintain better records and are more rigorous in learning a complex body of law, and reward trustees and New York beneficiaries who expend minimal effort (or lack the ability given the complexity of the task involved) to maintain adequate records to track accumulation distributions from year to year.

- Simplified methods for computing the throwback tax should be employed. We consider it very telling that the Internal Revenue Service has adopted simplified conventions for dealing with the throwback tax (although we observe that the federal throwback tax, in contrast to the Proposal, also involves deferred interest charges). ***Moreover, Congress repealed the throwback tax in 1997 with respect to most domestic trusts due to its complexity, so that throwback now only applies to foreign nongrantor trusts and to certain domestic nongrantor trusts created before March 1, 1984.***[14] ***There is no better evidence of the complexity of the throwback rules than this.*** We would welcome the opportunity to assist in developing a simplified method of throwback tax computation, which could be an adaptation of the alternate simplified method of computation of the throwback tax that the Internal Revenue Service uses for foreign nongrantor trusts in Part III of the IRS Form 3520. (Please see page 5 of the IRS Form 3520

"[without regard] to the penultimate sentence of such subsection [six hundred sixty five of the internal revenue code] that references section six hundred sixty seven of such [internal revenue] code . . ."

This restored as operative the cross-referenced language of the penultimate sentence of IRC Section 665(b), which provides as follows:

"For purposes of section 667 (other than subsection (c) thereof, relating to multiple trusts), the amounts specified in paragraph (2) of section 661(a) shall not include amounts properly paid, credited, or required to be distributed to a beneficiary from a trust (other than a foreign trust) as income accumulated before the birth of such beneficiary or before such beneficiary attains the age of 21."

[14] IRC § 665(c).

at http://www.irs.gov/pub/irs-pdf/f3520.pdf.) That method involves the much simpler exercise of determining whether current year distributions exceed 125% of the average annual distributions during the three preceding tax years (or fewer years if the trust has been a foreign trust for less than three years).[15]

Our Additional Recommendations, Including to Allow Portability of the Applicable Exclusion Amount Between Spouses for New York Estate Tax Purposes (To Match the Corresponding Federal Estate Tax Portability Rules)

1. <u>Portability</u>

In order to better integrate the federal and New York State estate tax systems, we recommend that portability of the estate tax exemption between spouses be allowed for New York estate tax purposes, to match the corresponding federal estate tax portability rules that are set forth in IRC § 2010(c).[16] Portability of the deceased spouse's *entire* unused exclusion amount for New York estate tax purposes (as opposed to partial portability) is necessary to avoid creating a significant federal/state mismatch that would undermine the objective of attaining a comprehensive integration of the federal and New York estate tax systems.

As with each of the other items set forth in this Report (except for the addback of taxable gifts), we endorse and expressly adopt the position taken on this issue by the New York City Bar Association in the City Bar March 2014 Report, which included a proposed New York portability statute to be incorporated into proposed N.Y. Tax Law § 952(c). The City Bar March 2014 Report proposes the following language (the proposed additional language relating to portability is set forth below in blue italics):

> (c) Applicable credit amount. (1) 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

---

[15] In light of our opposition to the throwback tax, we likewise oppose the imposition of any additional reporting requirements in connection with "accumulation distributions" to New York resident beneficiaries from nongrantor trusts (other than "ING Trusts") that are currently exempt from New York income tax under either the New York Resident Trust Exception, or as a nonresident trust that does not have any New York source income.

[16] A related measure to better integrate the federal and New York State estate tax systems for a married couple involves permitting the executor to claim a separate New York QTIP deduction on the New York estate tax return for eligible property passing in trust for the benefit of a surviving spouse *independent* of whether a QTIP election has been made on the federal estate tax return. The separate QTIP deduction on the New York estate tax return (and our proposed modification to the language of the Budget Bill) has already been addressed by us in Item B of this Report.

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. *Provided, further, that the credit allowed by this subsection shall be increased by an amount equal to the unused applicable credit amount of the decedent's last deceased spouse.*

(2) For purposes of this subsection, the unused applicable credit amount of the decedent's last deceased spouse is (i) the amount of the credit that would have been allowed under subdivision (1) on the New York taxable estate of the last deceased spouse if that spouse's New York taxable estate had been equal to the basic exclusion amount allowable at the date of death of the decedent's last deceased spouse reduced by (ii) the amount of the credit allowed the estate of the decedent's last deceased spouse. Provided, however, that no credit amount of the decedent's last deceased spouse shall be allowed if the New York taxable estate of the decedent's last deceased spouse was equal to or greater than the basic exclusion amount allowable at the date of death of such last deceased spouse. Provided, further, the unused applicable credit amount of the decedent's last deceased spouse who was not a resident of the state of New York shall be equal to the unused applicable credit amount of the decedent's last deceased spouse calculated under the immediately foregoing sentence multiplied by a fraction, the numerator of which is the decedent's New York gross estate and the denominator of which is the decedent's federal gross estate. Both the credit amount of the decedent's last deceased spouse, and the unused applicable credit amount of the decedent's last deceased spouse, as referenced in the immediately preceding two sentences, shall take into account such adjustments as may be warranted pursuant to Tax Law § 952(c)(1).

The New York State Department of Taxation of Finance, presumably through the issuance of a Technical Services Memorandum, would be charged with the responsibility of determining "such adjustments as may be warranted pursuant to Tax Law § 952(c)(1)" in accordance with the language appearing in the last sentence of the City Bar's proposed Tax Law § 952(c)(2), as set forth above. This computation would be extraordinarily complex due to the cliff aspects of the proposed law.

As set forth in Item A of this Report, we recommend that the "cliff" aspects of proposed Tax Law § 952(c)(1) be eliminated in their entirety. Eliminating this estate tax cliff would render unnecessary the last three sentences of proposed Tax Law § 952(c)(2) and considerably simplify the computation.

2. <u>Other Items Supported, Although with Clarification Required</u>

We also support the following additional amendments that are contained in the Budget Bill, subject to the clarifications set forth below:

- The amendment to section 955(b), which provides that if a right to any deduction otherwise allowable is waived for federal estate tax purposes, it shall be considered waived for New York estate tax purposes. For the reasons discussed in Item B of this Report, it should be clarified, however, that this waiver shall not apply to an executor's failure to make a QTIP election for federal estate tax purposes.

- The amendment to section 960(d), which liberalizes the current exemption for a nonresident's works of art in New York on loan for exhibition at a nonprofit gallery or museum at the time of the nonresident's death. We observe, however, that the first reference to "public gallery" (Budget Bill, page 254, line 2) should be revised to read "public gallery or museum" to conform to the corresponding language of the amendment.