

Memorandum Concerning Proposed Amendment to Section 954(a)(3) of the New York Tax Law Contained in the Governor's Fiscal Year 2020 Executive Budget

TRUSTS AND ESTATES LAW SECTION

T&E #1

March 4, 2019

The Trusts and Estates Law Section of the New York State Bar Association (the "Section") respectfully submits this memorandum to address its concerns regarding the retroactive application of the proposed amendment to Section 954(a)(3) of the New York Tax Law (the "NYTL") contained in the Governor's Fiscal Year 2020 Executive Budget (the "Budget Proposal") released on January 15, 2019. The Budget Proposal would retroactively extend the 3-year "clawback" provisions of NYTL 954(a)(3) that applies to certain taxable gifts made by New York residents between April 1, 2014 and December 31, 2018 (the "3-year clawback"). The 3-year clawback recently expired and no longer applies to New Yorkers who previously made gifts and subsequently die after December 31, 2018.

Surprisingly, the Budget Proposal applies *retroactively* and includes gifts made on or after April 1, 2014 all the way through and including the date of enactment. This provision ignores the expiration date of December 31, 2018 contained in the existing law. The retroactivity of the current Budget Proposal will be deeply troubling to many New Yorkers who relied upon the well-known expiration date included since the enactment of NYTL 954(a)(3) and made taxable gifts in reliance thereon. In particular, many New Yorkers whose estates were only slightly in excess of New York's basic exclusion amount reasonably relied upon the clear language of NYTL 954(a)(3) and made taxable gifts in order to avoid the confiscatory New York State estate tax "cliff."¹ Retroactively taxing transactions that were made in good faith by New Yorkers who relied on existing law may encourage further migration by New Yorkers to other

¹ The estate tax "cliff" contained in NYTL § 952(c)(1) results from the rapid phase-out of the applicable credit amount for taxable estates that are only slightly in excess of the basic exclusion amount for New York estate tax purposes. NYTL § 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 105% of the basic exclusion amount. For New Yorkers who die in 2019, the cliff has the effect of producing a *marginal New York estate tax rate in excess of 100%* for estates between \$5,740,001 and \$6,286,696. Beneficiaries of estates between \$5,740,001 and \$6,286,696 actually inherit less than \$5,740,000. The effect of the cliff is therefore confiscatory.

states. A fairer approach would be simply to mirror the existing provisions of NYTL 954(a)(3) and provide a corresponding statutory provision that applies to taxable gifts made on or after the date of enactment (presumably on or about April 1, 2019).

Making a taxable gift is *not* a neutral event from a tax standpoint. Giving away assets is a conscious decision that taxpayers do not make lightly, as giving away assets can have potentially adverse tax consequences to the donor and the donor's estate. Section 2058 of the Internal Revenue Code² (the "IRC"), per its terms, precludes a state death tax deduction for gifts of property that are not included in the federal gross estate. In addition, gifted property is ineligible to receive a step-up in basis for income tax purposes under IRC section 1014. Given the fact that many New Yorkers relied on Section 954(a)(3) in carefully considering their planning options, and have potentially acted to their detriment if the law is changed without warning, we believe that principles of fairness and due process warrant that the 3-year clawback be limited in its application to taxable gifts made on or after the date that the Budget Proposal is enacted into law (or at a minimum, January 15, 2019, when the Budget Proposal was released to the public).

I. DISCUSSION

NYTL 954(a) presently provides as follows:

General.--The New York gross estate of a deceased resident means his or her federal gross estate as defined in the internal revenue code (whether or not a federal estate tax return is required to be filed) modified as follows:

(1) Reduced by the value of real or tangible personal property having an actual situs outside New York state.

(2) Increased by the amount determined under [section nine hundred fifty-seven](#) of this part (relating to limited powers of appointment created prior to September first, nineteen hundred thirty).

(3) Increased by the amount of any taxable gift under [section 2503 of the internal revenue code](#) not otherwise included in the decedent's federal gross estate, made during the three year period ending on the decedent's date of death, but not including any gift made: (A) when the decedent was not a resident of New York state; or (B) before April first, two thousand fourteen; or (C) that is real or tangible personal property having an actual situs outside New York state at the time the gift was made. Provided, however that this paragraph shall not apply to the estate of a decedent dying on or after January first, two thousand **nineteen.**

The Budget Proposal would amend NYTL 954(a)(3) to change the expiration date of this statutory provision so that it instead no longer applies to decedents dying on or after January first, two thousand **twenty-six** (as opposed to on or after January 1, 2019, as this statute currently

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

provides).³ The Budget Proposal further provides that this proposed amendment to NYTL 954(a)(3) “shall apply to estates of decedents dying on or after January 1, 2019.”

The application of the Budget Proposal to persons dying on after January 1, 2019 imposes an unfair burden on those New Yorkers who reasonably relied upon the clear language of NYTL 954(a)(3) which, by its terms, does not apply to gifts made by persons dying on or after January 1, 2019. We have identified the following categories of persons who would be adversely affected by the Budget Proposal. (We assume for this purpose that the date of enactment is April 1, 2019.)

(1) persons who made taxable gifts prior to January 1, 2019 and die on or after January 1, 2019 but less than 3 years after making such taxable gifts;

(2) persons who made taxable gifts on or after January 1, 2019 and died on or before January 15, 2019 (the date of release of the Budget Proposal); and

(3) persons who made taxable gifts on or after January 1, 2019 but prior to April 1, 2019 and die before or after April 1, 2019 (but less than 3 years after making such taxable gifts).

Each of these categories of persons share the following common thread --- a New York resident who, in reliance upon NYTL 954(a)(3)’s well-known expiration date of December 31, 2018, has made a taxable gift with the expectation that such gift would not be included in their New York taxable estate.

The Section believes that the fairest approach would be to eliminate the retroactive aspects of the Budget Proposal and instead begin a separate clawback period under NYTL 954(a)(3) that would apply to taxable gifts made on or after April 1, 2019. This could be accomplished by amending NYTL 954(a)(3) to add a companion provision as a subparagraph “B” that applies to taxable gifts made on or after April 1, 2019 by decedents dying on or after January 1, 2019. As so amended, NYTL 954(a)(3) would then read as follows (with certain provisions highlighted for emphasis):

(3)(A) Increased by the amount of any taxable gift under [section 2503 of the internal revenue code](#) not otherwise included in the decedent's federal gross estate, made during the three year period ending on the decedent's date of death, but not including any gift made: (i) when the decedent was not a resident of New York state; or (ii) before April first, two thousand fourteen; or (iii) that is real or tangible personal property having an actual situs outside New York state at the time the gift was made. Provided, however that this subparagraph shall not apply to the estate of a decedent dying on or after January first, two thousand nineteen.

³ The Budget Proposal would also correct the spelling of the word “descendent” to instead read “decedent.” In addition, the Budget Proposal would add new NYTL 954(a)(4) and amend NYTL 955(c). The Section does not have any issues with any of those proposed changes.

(B) Increased by the amount of any taxable gift under [section 2503 of the internal revenue code](#) not otherwise included in the decedent's federal gross estate, made during the three year period ending on the decedent's date of death, but not including any gift made: (i) when the decedent was not a resident of New York state; or (ii) before April first, two thousand nineteen; or (iii) that is real or tangible personal property having an actual situs outside New York state at the time the gift was made. Provided, however that this subparagraph shall not apply to the estate of a decedent dying before January first, two thousand nineteen and on or after January first, two thousand twenty-six.

II. RECOMMENDATION

The Section respectfully recommends that the Budget Proposal be modified in the manner indicated above to eliminate its retroactive application so that it solely applies on a prospective basis to taxable gifts made on or after April 1, 2019.

We appreciate your consideration of our recommendation.