Leimberg Information Services, Inc.

Steve Leimberg's Estate Planning
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Subject: Sharon L. Klein on *Estate of Evelyn Seiden* - New York Estate Tax Refund Claims for State Only QTIP Property Might Soar

*"A New York court has found that a QTIP Trust, created for New York purposes in 2010 when the federal estate tax lapsed for the year, was **not** includible in the estate of the surviving spouse for New York estate tax purposes. It's probably fair to say that, in light of the court's finding and comments, a statutory change to alter that result might be in the cards.*

Note that, while the size of New York-only QTIPs filed in 2010 when the federal estate tax lapsed is potentially huge, the rationale of the case does not seem to be limited to estates of surviving spouses where the first spouse died in 2010. If an estate was under the federal filing threshold and filed only a New York estate tax return with a pro forma federal return that contained a QTIP election, the same logic should apply to exclude QTIP trust assets from a survivor's estate.

Other states with a comparable statutory framework might have a similar result. It is unclear at this early point whether the decision will be appealed or how quickly a statutory change might come. In any event, time is probably ticking to take advantage of this interplay between state and federal law."

Sharon Klein provides members with important and timely commentary on *Estate of Evelyn Seiden*.

Sharon L. Klein is **President of Family Wealth**, **Eastern Region**, for **Wilmington Trust, N.A.**[i] She is responsible for coordinating the delivery of all Wealth Advisory Services by teams of professionals, including planning, trust, investment management, family governance and education, family office, and private banking services, to high net worth clients in the Eastern United States. Sharon has presented at the Heckerling Institute on Estate Planning, the New York University Institute on Federal Taxation, the Notre Dame Estate Planning Institute, the Duke University Estate Planning

Conference, and the Bloomberg BNA Tax Management Advisory Board. Sharon is frequently featured or quoted in publications such as the Wall Street Journal, The New York Times, Estate Planning Magazine and Trusts & Estates Magazine.

Sharon is a Fellow of the American College of Trust and Estate Counsel and a member of New York Bankers Association Trust & Investment Division Executive Committee, The Rockefeller University Committee on Trust and Estate Gift Plans, the Professional Advisory Council of the Anti-Defamation League, the Estates, Gifts and Trusts Advisory Board for The Bureau of National Affairs and the Thomson Reuters Trusts & Estates Advisory Board. She is a past Chair of the New York City Bar Association's Trusts, Estates and Surrogate's Court Committee, a past Chair of the New York State Bar Association's Trusts and Estates Law Section Taxation Committee, and a member of the New York City Bar Association's Matrimonial Committee. In June, 2018, Sharon was honored by the UJA-Federation of New York Lawyers Division for her contributions to the Trusts & Estates community and the community at large.

Here is Sharon's commentary:

EXECUTIVE SUMMARY:

A New York court has found that a QTIP Trust, created for New York purposes in 2010 when the federal estate tax lapsed for the year, was **not** includible in the estate of the surviving spouse for New York estate tax purposes**.**

FACTS:

It All Seemed Quite Ordinary…

In *Estate of Evelyn Seiden***,** Husband died in 2010. He created a trust for his surviving spouse. Had the federal estate tax regime been in effect that year, his executor would have filed an estate tax return and made a Qualified Terminal Interest Property (QTIP) election under Internal Revenue Code (IRC) § 2044 to defer the taxes otherwise due on Husband's death. That election requires trust property for which a martial deduction "was allowed" to be included in the survivor's estate.

But Here's the Twist…

Due to the lapse of the federal estate tax in 2010, no federal estate tax return was filed in Husband's estate. However, a New York estate tax

return was required to be filed. In TSB-M-10(1)(M), Estate Tax, March 16, 2010 (TSB) the New York State Department of Taxation of Finance (the Department), published guidance regarding estates required to file a New York State estate tax return but not a federal return. According to the TSB:

> This may occur if there is no federal estate tax in effect on the decedent's date of death or if the decedent died while the federal estate tax was in effect but the value of his or her gross estate was too low to require the filing of a federal estate tax return. In either instance, and if applicable, the estate may still elect to take a marital deduction for Qualified Terminal Interest Property (QTIP) on a pro-forma federal estate tax return that is attached to the New York State estate tax return....In addition, the value of the QTIP property for which the election is made must be included in the estate of the surviving spouse. See: IRC § 2044 and New York Tax Law § 954.

Back to Ordinary…

In accordance with this guidance, Husband's executor made a QTIP election on the pro- forma federal return filed with the New York return, taking a marital deduction for New York estate tax purposes. The Tax Department issued a closing letter in 2012.

And Now for the Zinger…

When Wife died, her executor excluded the value of the trust property on the federal estate tax return on the basis that no federal marital deduction had been claimed or "allowed" in Husband's estate, as is required to trigger inclusion in the second estate under IRC §2044. The Internal Revenue Service issued a closing letter accepting the return as filed. The estate also excluded the trust property on Wife's New York estate tax return, taking the position that New York law defines its gross estate by reference to the federal gross estate, which clearly excludes the property. The Tax Department disagreed and assessed additional tax and interest of almost $530,000.

The court rejected the Department's various arguments that IRC §2044 applied, finding that the Husband's executor simply did not make that election. Consequently, the property was not included in the Wife's federal gross estate, nor in the New York gross estate.

But We Said So!

The Department argued that its own TSB guidance was controlling and dispositive of the issue:

> In addition, the value of the QTIP property for which the election is made must be included in the estate of the surviving spouse. See: IRC § 2044 and New York Tax Law § 954.

Not so, said the court, a TSB is merely a statement of the Department's position, it has no legal effect, and the Department cannot use it to override statutory provisions.

What About the Duty of Consistency??

The Department argued that the "duty of consistency" doctrine prevents a taxpayer from benefiting from its error or omission on a tax return, only to take a contrary position on a subsequent return after the statute of limitations has expired on the first. According to the court, that argument had a double flaw: Husband's estate did not make an error or omission, and Wife's estate had not taken a contrary position. Both estates followed the law in effect at the time of each decedent's death.

But We Always Meant That!

The Department also argued that the legislature always intended for the QTIP property to be included in the estate of the second to die. However, the court noted that, although the legislature had amended the Tax Law in other ways to take account of federal changes, in the eight years since the repeal of federal tax for the year 2010, it had not acted to change the effect of the repeal on QTIP property in the circumstances of this case.

OK, You Have Left Us No Other Choice – FLOODGATES!!

Finally, the Department argued that the court's holding would open the doors to tax avoidance, which the court countered by simply referring to the estate's point that the legislature could still amend the Tax Law to apply to future estates. Further, the tax collection is not guaranteed anyway if the surviving spouse spends the trust assets or changes domicile, for example.

COMMENT:

It's probably fair to say that, in light of the court's finding and comments, a statutory change might be in the cards. Note the court specifically said the legislature could still amend the Tax Law to apply to **future** estates. Query,

however, whether a statutory change might attempt to apply retroactively to estates of second to die decedents.

Note that, while the size of New York-only QTIPs filed in 2010 when the federal estate tax lapsed is potentially huge, the rationale of the case does not seem to be limited to estates of surviving spouses where the first spouse died in 2010. If an estate was under the federal filing threshold and filed only a New York estate tax return with a pro forma federal return that contained a QTIP election, the same logic should apply to exclude QTIP trust assets from a survivor's estate.

Other states with a comparable statutory framework might have a similar result. It is unclear at this early point whether the decision will be appealed or how quickly a statutory change might come. In any event, time is probably ticking to take advantage of this interplay between state and federal law.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Sharon L. Klein

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CITES:

Estate of Evelyn Seiden, (N.Y. Surr Ct, Oct. 9, 2018); TSB-M-10(1)(M), Estate Tax, March 16, 2010; IRC § 2044; New York Tax Law § 954.

CITATIONS:

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