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Steve Leimberg's Estate Planning
Email Newsletter Archive Message #2530

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Subject: Bruce Steiner on the Estate of Oscar Brecher: Reformation of Will to Eliminate State Estate Tax

"With an estate of $8 million and a Will nearly 27 years old, Mr. Brecher should have reviewed his estate plan. The Federal estate tax law changed several times since 1989. The New York estate tax law changed several times since 1989. Mr. Brecher's family situation may have changed since 1989. Many clients such as Mr. Brecher have Wills that are outdated, and this case illustrates the possibility of reforming a Will after death, based on changes in the tax law."

Bruce Steiner previously wrote about the risk that the IRS might disallow a QTIP election that wasn't needed to eliminate the Federal estate tax in Estate Planning Newsletter #2060, the IRS' recent concession that such a QTIP election will be valid in Estate Planning Newsletter #2459 and the use of QTIP elections in smaller estates in Estate Planning Newsletter #2510. Bruce now returns to discuss reformation of a Will in light of the increase in the Federal estate tax exclusion amount and a state estate tax with a lower exclusion amount.

Due to the snowstorm, **Bruce Steiner's** talk on **Planning with IRAs** for the **New Jersey State Bar Association** that was scheduled for Thursday morning, February 9, 2017, has been postponed to Thursday morning, March 30, 2017. Bruce's topics will be trusts as beneficiaries of retirement benefits and Roth conversions. The program will qualify for CLE credit for attorneys. For a link to the announcement of the program, including instructions for registering, please click this link: **Planning with IRAs**

Bruce D. Steiner, of the New York City law firm of **Kleinberg, Kaplan, Wolff & Cohen, P.C.**, and a member of the New York, New Jersey and Florida Bars, is a long time LISI commentator team member and frequent contributor to Estate Planning, Trusts & Estates and other major tax and estate planning publications. He is on the editorial advisory board of Trusts & Estates, and is a

popular seminar presenter at continuing education seminars and for Estate Planning Councils throughout the country. He was named a New York Super Lawyer in 2010, 2011, 2012, 2013, 2014, 2015 and 2016. Bruce has been quoted in various publications including *Forbes*, the *New York Times*, the *Wall Street Journal*, the *Daily Tax Report*, *Investment News*, *Lawyers Weekly, Bloomberg's Wealth Manager, Financial Planning, Kiplinger's Retirement Report, Medical Economics, Newsday*, the *New York Post*, the *Naples Daily News, Individual Investor*, *Fox Business*, *CNBC*, TheStreet.com, CBS News and Dow Jones (formerly CBS) Market Watch.

Here is his commentary:

EXECUTIVE SUMMARY:

Depending on the facts and circumstances, courts will sometimes reform a Will based on changes in the tax law.

FACTS:

Oskar Brecher died on April 17, 2016, a resident of New York County. He was survived by his wife, Adrienne, and his son, Matthew.

Mr. Brecher's estate was valued at approximately $8 million.

Mr. Brecher's Will was dated July 24, 1989. He left to his wife the smallest amount necessary to reduce his Federal estate tax to zero, taking into account all available credits. He then left his residuary estate to a credit shelter trust for his wife and issue in which the trustees had broad sprinkling and invasion powers, with the remainder going to or in trust for the benefit of his issue upon his wife's death.

The Federal estate tax exclusion amount was $600,000 in 1989.

The Surrogate incorrectly described the New York estate tax in 1989 as a sponge tax (an estate tax limited to the old Federal state death tax credit). The New York estate tax exclusion amount was $108,333 in 1989; and the New York estate tax rates were higher than the state death credit, with a top rate of 21% on amounts over $10.1 million. New York did not limit its estate tax to a sponge tax until February 1, 2000.

As a result, if Mr. Brecher had died in 1989 with a Will containing a marital/credit shelter formula based upon the unified credit but not the state death tax credit, his taxable estate would have been $600,000; and there would have been a New York estate tax of $25,500, leaving $574,500 for the credit shelter trust.

Since the New York marginal estate tax rate would have been 6%, Mr. Brecher's Will contained a marital/credit shelter formula based upon both the unified credit and the state death tax credit. If he had died in 1989, his taxable estate would have been $642,425. His Federal estate tax before credits would have been $208,497. There would have been a unified credit of $192,800 and a state death tax credit of $15,697, leaving no Federal estate tax. The New York estate tax would have been $28,045. The payment of an additional $2,545 of New York estate tax would have allowed an additional $39,880 ($42,425 less $2,545 of additional New York estate tax) to be sheltered.

At the time of Mr. Brecher's death on April 17, 2016, the Federal estate tax exclusion amount was $5,450,000 (indexed), and portability was permanent. The New York estate tax exclusion amount was $4,187,500. However, the New York estate tax exclusion amount phases out between 100% and 105% of the exclusion amount, so that it is fully phased out at $4,396,875, for a marginal tax rate of over 100% in the phaseout range. The New York estate tax on a $5,450,000 taxable estate ($5,955,455 before the deduction for state estate taxes) is $505,455.

Applying the formula in Mr. Brecher's Will to an $8 million estate results in his estate passing $5,450,000 to the credit shelter trust, $505,455 for New York estate taxes, and $2,044,545 to Adrienne.

Mr. Brecher's executors asked the court to reform his Will to provide that the marital bequest would be the amount needed to reduce both the Federal and the state estate taxes to zero, rather than to reduce only the Federal estate tax to zero.

In other words, they wanted Mr. Brecher's estate to pass $4,187,500 to the credit shelter trust and $3,812,500 to Adreienne, with no New York estate tax.

Mr. Brecher's issue consented to the petition, the petition was unopposed, and the New York County Surrogate's Court granted the petition.

COMMENT:

Married couples with large estates in states with no state estate tax will generally create a credit shelter trust for the Federal estate tax exclusion amount. This offers several advantages over portability. It shelters the income and growth in the credit shelter trust during the spouse's lifetime. Portability is not indexed for inflation, and there is no portability for the GST exemption. Most states do not allow portability for state estate tax purposes. If the trust so permits, the trustees can always distribute the trust assets to the surviving spouse if desired.

In states that do not have a state estate tax, married couples with smaller estates may use credit shelter trusts, or may take advantage of portability with disclaimer trusts, QTIP trusts or Clayton QTIP trusts. The use of QTIP trusts in smaller estates is discussed in more detail in Estate Planning Newsletter #2510.

The planning can be more complicated in states that have a state estate tax with a lower exclusion amount than the Federal estate tax exclusion amount.

Some states have a state estate tax with a lower exclusion amount than the Federal, but allow a separate state-only QTIP election. Examples of this are Massachusetts (with a $1 million exclusion amount), Minnesota (with a $1.8 million exemption), Oregon (with a $1 million exemption) and Washington State (with a $2,129,000 exemption). In these states, the typical plan for medium size estates is to create a credit shelter trust for the state exemption or exclusion amount and a gap trust in QTIP form for the difference between the state and the Federal exclusion amounts, for which a QTIP election would be made for state but not Federal estate tax purposes.

Other states have a state estate tax with a lower exclusion amount than the Federal, but do not allow a separate state-only QTIP election unless no Federal estate tax return is filed or required to be filed. Examples of this are New Jersey (with a $2 million exclusion amount, up from $675,000 prior to 2017, and with the tax scheduled to be repealed beginning in 2018) and New York (where the exclusion amount was $1 million prior to April 1, 2014, $2,062,500 effective April 1, 2014, $3,125,000 effective April 1, 2015, $4,187,500 effective April 1, 2016, $5,250,000 effective April 1, 2017, and equal to the Federal exclusion amount effective January 1, 2019).

As a result of Rev. Proc. 2016-49, which allows a QTIP election on a Federal estate tax return filed to elect portability, smaller estates in these states would shelter the state exclusion amount and elect portability.

Where the state exclusion amount is substantially lower than the Federal exclusion amount, larger estates will often shelter the Federal exclusion amount and pay the resulting state estate tax. In 2016, when Mr. Brecher died, this meant sheltering $5,450,000 and incurring state estate tax of $505,455. If the state has a true exemption rather than an exclusion amount that phases out, the state estate tax will be somewhat lower.

However, as the state exclusion amount increases to a level closer to the Federal exclusion amount, it may make sense even in large estates to limit the credit shelter trust to the state exclusion amount. That was what Mr. Brecher's estate sought to do.

By limiting the credit shelter trust to $4,187,500, Mr. Brecher's estate saved $505,455 of New York estate tax. The cost was throwing an additional $1,767,955 into Adrienne's estate. That might or might not result in additional Federal and state estate taxes in her estate, depending upon the size of her estate and the law at her death. However, any additional Federal estate tax in her estate will be offset by a $1,262,500 deceased spousal unused exclusion (DSUE) amount), and any additional New York estate taxes are likely to be at the marginal (non-phaseout) rates, with a top rate of 16%.

This will be even more important in New York beginning April 1, 2017, when the New York estate tax exclusion amount increases to $5,250,000.

With an estate of $8 million and a Will nearly 27 years old, Mr. Brecher should have reviewed his estate plan. The Federal estate tax law has changed several times since 1989. The New York estate tax law has changed several times since 1989. Mr. Brecher's family situation may have changed since 1989. The Internal Revenue Service issued Revenue Ruling 95-58 in 1995, which by corollary permits a beneficiary to have the power to remove and replace his or her co-trustee (provided the replacement trustee is not a close relative or subordinate employee). That facilitates providing for children in trust rather than outright, while allowing the child to effectively control his or her own trust.

However, many clients have Wills that are outdated. This case illustrates the possibility of reforming a Will after death, based on changes in the tax law.

In granting the petition, the court explained that:

> … reformation as a general rule is only sparingly allowed … however, the courts have been more liberal in their regard to petitions seeking reformation when that relief is needed to avert tax problems caused by a defective attempt to draft a will provision in accordance with the then tax law or instead caused by a change in law, subsequent to execution of the will, that renders a tax-driven will provision counterproductive. The central question in such a case is whether the clear wording of the subject instrument subverts rather than serves the testator's intent. ….

Concluding Observation

Clients should review their estate plans periodically. However, when someone dies, consideration should be given to seeking to reform the Will based upon changes in the tax law enacted after the Will was signed.

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

Bruce Steiner

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LISI Estate Planning Newsletter #2530 (March 27, 2017) at http://www.leimbergservices.com

CITES:

Matter of Brecher, 2017 NY Slip Op. 30022(U) (Surr. Ct. N.Y. Co. Jan. 11, 2017); Revenue Ruling 95-58.