2017–2018 *SURVEY*: TRUSTS & ESTATES

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CONTENTS

INTRODUCTION

This Article covers notable regulatory, statutory, and case law developments related to trusts and estates for the *Survey* period of July 1, 2017 to June 30, 2018.[1]

Part I of this Article discusses changes that occurred at the federal level. This discussion will summarize the significant changes brought

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1. As in previous years, two sources used in the creation of this *Survey* deserve special note: the New York State Bar Association's *Trusts and Estates Law Section Newsletter* (released quarterly) and Sharon L. Klein, *NY's Latest Legislative Session: What Passed, What Didn't, What's Next*, N.Y.L.J. (Sept. 7, 2018, 5:30 P.M.), https://www.law.com/newyorklawjournal/2018/09/07/nys-latest-legislative-session-what-passed-what-didnt-whats-next/?slreturn=20190109144821.

about by the law colloquially known as the Tax Cuts and Jobs Act (TCJA), as well as important developments from the Tax Court. Part II surveys the trust and estate developments specific to New York, including new legislation, regulations, and case law.

At the outset, it is worth noting the federal and New York exemption amounts applicable in the *Survey* period. At the federal level, as a result of the TCJA, the amount of combined gross assets and prior taxable gifts needed to trigger an estate tax more than doubled from $5,490,000 in 2017 to $11,180,000 in 2018.[2] In addition, the federal annual gift tax exclusion changed from $14,000 in 2017 to $15,000 in 2018.[3] The threshold for gifts to a non-citizen spouse not includable in a taxpayer's gifts increased from $149,000 in 2017 to $152,000 in 2018.[4]

Meanwhile, New York adhered to a schedule where equalization between the state exemption amount and federal amount in place prior to the TCJA began on January 1, 2019.[5] Accordingly, the basic exclusion amount in New York stayed at $5,250,000 (applicable to decedents who died on or after April 1, 2017 and before January 1, 2019) throughout the *Survey* period.[6]

I. DEVELOPMENTS AT THE FEDERAL LEVEL

A. Tax Cuts and Jobs Act

Formally known as "An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018," the TCJA brought about sweeping changes to the tax law.[7] The following changes will likely have the most significant influence on estate planning.

1. Basic Exclusion Amount

Under the TCJA, the basic exclusion amount provided in Internal Revenue Code (I.R.C.) § 2010(c)(3) increased from $5 million to $10

2. *Compare* Rev. Proc. 16-55, 2016-45 I.R.B. 707, 714 § 3.35, *with* Rev. Proc. 18-18, 2018-10 I.R.B. 392, 397 § 3.35.

3. *Compare* Rev. Proc. 16-55, 2016-45 I.R.B. 707, 714 § 3.37(1), *with* Rev. Proc. 17-58, 2017-45 I.R.B. 489, 495 § 3.37(1).

4. *Compare* Rev. Proc. 16-55, 2016-45 I.R.B. 707, 714 § 3.37(2), *with* Rev. Proc. 17-58, 2017-45 I.R.B. 489, 495 § 3.37(2).

5. *See* N.Y. TAX LAW § 952 (c)(2)(A) (McKinney 2014 & Supp. 2019).

6. *Id.*

7. *See* Tax Cuts and Jobs Act, Pub. L. No. 115-97, 131 Stat. 2054 (2017) (to be codified in scattered sections of I.R.C. (2018)).

million for decedents dying in the years 2018 through 2025.[8] This amount is indexed for inflation using "chained CPI," which results in a basic exclusion amount of $11.18 million for decedents dying in 2018.[9] Although the TCJA does not specifically reference the generation-skipping transfer (GST) tax exemption amount, because I.R.C. § 2631(c) provides that such amount shall be "equal to the basic exclusion amount under Section 2010(c)," the new GST tax exemption amount also increased under the TCJA.[10] For decedents dying after 2025, the basic exclusion amount will return to the lower amount in place for 2017 ($5 million, indexed for inflation).[11]

2. Potential Clawback

The TCJA adds I.R.C. § 2001(g)(2), which states:

> The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out this section with respect to any difference between (A) the basic exclusion amount under section 2010(c)(3) applicable at the time of the decedent's death, and (B) the basic exclusion amount under such section applicable with respect to any gifts made by the decedent.[12]

This language leaves open the question whether the Secretary could implement a "clawback" provision that would cause an estate tax on a prior gift if the basic exclusion amount decreases between the time of the gift and the decedent's death.[13] Although it appears unlikely that such a result is intended, because no regulation has been prescribed during the *Survey* period confirming this understanding, a "clawback" provision remains a possibility.[14]

3. Miscellaneous Itemized Deductions

There is a question whether executor/trustee fees or other estate/trust expenses remain deductible following the enactment of the TCJA. The new law added I.R.C. § 67(g), which provides:

8. § 11061, 131 Stat. at 2091 (to be codified at I.R.C. § 2010(c)(3)(C) (2018)); I.R.C. § 2010(c)(3) (2012).

9. § 11002, 131 Stat. at 2059 (to be codified at I.R.C. § 1(f) (2018)).

10. I.R.C. § 2631(c) (2012).

11. § 11001, 131 Stat. at 2054 (to be codified at I.R.C. § 1(j)); § 11061, 131 Stat. at 2091 (to be codified at I.R.C. § 2010(c)(3)(C)).

12. § 11061, 131 Stat. at 2091 (to be codified at I.R.C. § 2001(g)(2)(A)–(B) (2018)).

13. *See* § 11061, 131 Stat. at 2091.

14. Proposed regulations were issued by the U.S. Department of the Treasury following the *Survey* period. *See* 83 Fed. Reg. 59,343, 59,345 (Nov. 23, 2018) (to be codified at Treas. Reg. pt. 20 (2019)). Such proposed regulations would not result in an estate tax on a prior gift in the event of a decrease in the basic exclusion amount.

"Notwithstanding subsection (a), no miscellaneous itemized deduction shall be allowed for any taxable year beginning after December 31, 2017, and before January 1, 2026."[15] Subsection (a) states that "miscellaneous itemized deductions"—that is, all itemized deductions other than those listed in subsection (b)—may be deducted to the extent the deductions exceed two percent of adjusted gross income.[16] Given that executor/trustee fees are not listed in subsection (b), one could argue that they are covered by subsection (a) and, thus, no longer deductible.[17] However, executor/trustee fees and other estate/expenses are deductible separately under § 67(e) because they are expenses which "would not have been incurred if the property were not held in such trust or estate."[18] Importantly, such deductions under subsection (e) are not subject to the two percent threshold of subsection (a).[19] Thus, to the extent the Joint Explanatory Statement notes an intention to eliminate "all miscellaneous itemized deductions that are subject to the two-percent floor under present law," it would appear that executor/trustee fees and estate/trust expenses should not be included because they were not subject to the two-percent floor.[20]

4. Kiddie Tax

Prior to the TCJA, the unearned income of a child in excess of $2,100 was subjected to a "Kiddie Tax."[21] Essentially, the Internal Revenue Code imposed the tax rates of the child's parents on the unearned income of the child if those rates were higher than the child's rate.[22] The TCJA simplifies the Kiddie Tax by applying the rates for trusts and estates to the unearned income of the child.[23] Although this change certainly simplifies the taxation of a child's unearned income,

15. § 11045, 131 Stat. at 2088 (to be codified at I.R.C. § 67(g) (2018)).

16. I.R.C. § 67(a)–(b) (2012).

17. *See id.*

18. I.R.C. § 67(e)(1).

19. *Id.* § 67(a), (e); *see* JOINT EXPLANATORY STATEMENT OF THE COMMITTEE OF CONFERENCE 99 (2017) [hereinafter JOINT STATEMENT], https://docs.house.gov/billsthisweek/20171218/Joint%20Explanatory%20Statement.pdf.

20. JOINT STATEMENT, *supra* note 19. Shortly following the *Survey* period, the Internal Revenue Service issued Notice 2018-61, which clarifies that I.R.C. § 67(g) does not impact the deductibility of expenses covered by subsection (e). I.R.S. Notice 2018-61, 2018-31 I.R.B. 278.

21. *See* I.R.C. § 1(g) (2012); Sidney Kess, *The Kiddie Tax Post-TCJA*, N.Y.L. J. (Oct. 23, 2018, 2:40 P.M.), https://www.law.com/newyorklawjournal/2018/10/23/the-kiddie-tax-post-tcja/?slreturn=20190104161703.

22. I.R.C. § 1(h).

23. *See* Tax Cuts and Jobs Act, Pub. L. No. 115-97, § 11001, 131 Stat. 2054, 2056 (2017) (to be codified at I.R.C. § 1(j)(2)(F)(4) (2018)).

it subjects such income to a rate that is likely higher than the pre-TCJA rate (the rates for trusts and estate are usually higher than those for the child's parents).[24] Thus, in situations where the Kiddie Tax applies, practitioners should give greater consideration to the timing of income recognition, and perhaps even delay such an event until the Kiddie Tax no longer applies.

5. 529 Plans

Until the TCJA, funds in a 529 plan could only be used to cover college expenses. The TCJA altered this definition by providing that "[a]ny reference in this subsection to the term 'qualified higher education expense' shall include a reference to expenses for tuition in connection with enrollment or attendance at an elementary or secondary public, private, or religious school."[25] However, the TCJA specifically limited the amount of distributions for elementary or secondary education to $10,000 per student per year.[26] Moreover, because each state has its own laws with respect to withdrawals from 529 plans, distributions for elementary or secondary education expenses may not be exempt from state income tax.[27]

6. Electing Small Business Trusts

Finally, the TCJA addressed two existing drawbacks to the use of electing small business trusts (ESBTs). First, the TCJA eliminated the restriction against nonresident aliens being potential beneficiaries of an ESBT.[28] Second, ESBTs may now carry forward excess charitable contributions for five years.[29] Prior to the TCJA, no carryover was permitted for an ESBT.[30] Both of the changes to ESBTs made by the TCJA are permanent, meaning they will not sunset after 2025.[31]

24. *See id.*

25. § 11032, 131 Stat. at 2082 (to be codified at I.R.C. § 529(c)(7) (2018)).

26. *Id.* (to be codified at I.R.C. § 529(e)(3)(A)).

27. *An Introduction to 529 Plans*, U.S. SEC. & EXCH. COMM'N (May 29, 2018), https://www.sec.gov/reportspubs/investor-publications/investorpubsintro529htm.html.

28. § 13541(a), 131 Stat. at 2154 (to be codified at I.R.C. § 1361(c)(2)(B)(v) (2018)).

29. § 13542(a), 131 Stat. at 2154 (to be codified at I.R.C. § 641(c)(2) (2018)). This carry forward comes with a tradeoff, as the contribution will be subject to the percentage limitations imposed on individuals and the substantiation requirements under I.R.C. § 170. *See* I.R.C. § 170 (2018).

30. *See* Lou Vlahos, *The 2017 Tax Act: Other "Pass-Through" Tax Provisions—Part I*, FARRELL FRITZ ATTY'S. (Jan. 3, 2018), https://www.taxlawforchb.com/tag/esbt/.

31. *See* §§ 13541(b), 13542(b), 131 Stat. at 2154.

B. Withdrawal of 2704 Regulations

As more fully detailed in the 2016–2017 *Survey*, the U.S. Department of the Treasury ("Treasury Department") issued proposed regulations under I.R.C. § 2704 in August 2016 which could have significantly limited valuation discounts for family-owned businesses by subjecting transfers of minority and nonvoting interests to intra-family members to more restrictive requirements.[32] The proposed regulations sought to curtail the efforts by individuals to shift wealth to their family members by utilizing valuation discounts on transfers of closely held enterprises through the creation of minority and nonvoting interests that are transferred to other members of the family.[33] Commentators had criticized the proposed regulations because they "would eliminate or restrict common discounts, such as minority discounts and discounts for lack of marketability, which would result in increased valuations and transfer tax liability that would increase financial burdens."[34] Moreover, commentators explained, "[T]he proposed regulations would make valuations more difficult and that the proposed narrowing of existing regulatory exceptions was arbitrary and capricious."[35] On October 20, 2017, the Treasury Department officially withdrew the proposed regulations under § 2704.[36] Thus, at least for now, individuals can continue to utilize valuation discounts for interests in closely held businesses without concern that more restrictive requirements may be on the horizon.

32. 81 Fed. Reg. 51,413, 51,413–25 (proposed Aug. 2, 2016) (withdrawn 82 Fed. Reg. 48,779 (Oct. 20, 2017)). For a comprehensive discussion of the proposed regulations, see Quincy Cotton et al., Roberts & Holland LLP, *A Sea Change in the Valuation Discounts Rules: Proposed Regulations under the Special Valuation Rules*, EST. & GIFT TAX PLAN. NEWSL., Aug. 2016, https://www.robertsandholland.com/siteFiles/News/08-2016_Sea%20Change%20in%20the%20Valuation%20Discount%20Rules%20(QC,%20SJG,%20MDR) (00392444).DOC%20[Compatibility%20Mode].pdf; see also Martin A. Schwab, *Trust and Estate: Time-Sensitive: Give it Away While There is Still Time*, BOND SCHOENECK & KING ATT'YS (Aug. 12, 2016), https://www.bsk.com/news-insights/trust-estate-time-sensitive-give-it-away-while-there-still-time-8-16.

33. 81 Fed. Reg. at 51,413–25.

34. I.R.S. Notice 2017-38, 2017-30 I.R.B. 148.

35. *Id.*

36. 82 Fed. Reg. 48,779, 48,779 (Oct. 20, 2017) (codified at Treas. Reg. pt. 25 (2018)).

C. Estate of Cahill v. Commissioner *(T.C. Memo 2018-84)*

In the 2016–2017 *Survey*,[37] this Article detailed the decision of the U.S. Tax Court in *Estate of Nancy Powell v. Commissioner of Internal Revenue*, which examined the tax consequences of the decision by Nancy Powell's son to transfer approximately $10 million in cash and securities from her revocable trust to a limited partnership in exchange for a ninety-nine percent limited partnership interest.[38] The *Survey* article cautioned that "[i]t is not yet clear what impact the court's decision in *Estate of Powell* will have on future intra-family transfer cases," but that "both the Tax Court's majority opinion and the distinctions raised by the concurrence will be important considerations for practitioners advising clients on leveraging popular discounts, as it sets forth a potential path for the Internal Revenue Service (IRS) to pursue double taxation."[39] The Tax Court's decision in *Estate of Richard F. Cahill v. Commissioner of Internal Revenue* may provide an indication of how far the IRS will try to stretch the decision in *Estate of Powell*.[40]

Estate of Cahill is ostensibly a non-precedential case in the summary judgment context about split-dollar life insurance arrangements.[41] Mr. Cahill was the settlor of two relevant trusts: (1) the Richard F. Cahill Survivor Trust ("Survivor Trust"), a revocable trust for which his attorney-in-fact and son, Patrick, served as trustee; and (2) the Morrison Brown Trust ("MB Trust"), an irrevocable trust for which Mr. Cahill's cousin, William, served as trustees.[42] "The primary beneficiaries of the MB Trust [were] Patrick and his issue."[43] The MB Trust was created to hold three whole life insurance policies—two on the life of Patrick's wife, and one on Patrick's life.[44] As explained by the Tax Court,

> To fund these policies, three separate split-dollar agreements (one for each policy) were executed by Patrick Cahill, as trustee of Survivor Trust, and William Cahill, as trustee of MB Trust. Under these agreements, Survivor Trust promised to pay the policy premiums listed above; the agreements describe Survivor Trust's promise as an

37. Steven Cunningham, *2016–17 Survey of New York Law: Trusts & Estates*, 68 SYRACUSE L. REV. 1064, 1066–70 (2018).
38. 148 T.C. 392, 393 (2017).
39. Cunningham, *supra* note 37, at 1070.
40. *See* T.C. Memo 2018-84, at 15 (2018) (citing 148 T.C. at 401).
41. *See id.* at 15–16.
42. *Id.* at 3–4.
43. *Id.* at 4.
44. *Id.*

"advance" to MB Trust.[45]

In order to pay the premiums, Patrick—in his capacities as attorney-in-fact for Mr. Cahill and trustee of the Survivor Trust—obtained a $10 million loan from Northern Trust.[46]

Each split-dollar agreement provided that, upon the death of the insured, the Survivor Trust would receive an amount of the death benefit under the policy equal to the greatest of (1) the remaining balance on the loan for such policy, (2) the total premiums paid by the Survivor Trust for such policy, or (3) the cash surrender value of such policy immediately before the insured's death.[47] The balance of the policy would be paid to the MB Trust.[48] The split-dollar agreements also provided that the trustees of the Survivor Trust and MB Trust could terminate the agreement during the insured's life, whereupon the MB Trust could retain the policies by paying the Survivor Trust the greater of the total premiums paid or the cash surrender value.[49] In 2010, Mr. Cahill reported $7,578 in gifts to the MB Trust.[50]

Upon his death, the estate reported Mr. Cahill's interest in the split-dollar agreements as $183,700.[51] The IRS issued a notice of deficiency based on an adjustment in the value of Mr. Cahill's interest from $183,700 to $9,611,624—the total cash surrender value of the policies at the time of Mr. Cahill's death.[52] In support of its adjustment, the IRS relied upon I.R.C. §§ 2036, 2038, and 2703.[53] The estate of Mr. Cahill moved for summary judgment on the basis that such sections were inapplicable.[54]

The Tax Court denied the estate's motion for summary judgment.[55] In analyzing §§ 2036 and 2038, the court observed:

> The $10 million decedent paid to the insurance companies for the benefit of MB Trust was accounted for in three parts as of decedent's date of death. Part was paid to the insurance companies as commissions, fees, etc. Part was used while decedent was alive to pay the cost of current life insurance protection on the insured parties. The remaining

45. *Estate of Cahill*, T.C. Memo 2018-84, at 4.
46. *Id.* at 5.
47. *Id.* at 5–6.
48. *Id.* at 6.
49. *Id.*
50. *Estate of Cahill*, T.C. Memo 2018-84, at 6.
51. *Id.* at 7.
52. *Id.*
53. *Id.* at 9.
54. *Id.*
55. *Estate of Cahill*, T.C. Memo 2018-84, at 20.

> part is attributable to the cash surrender value remaining in the policies as of decedent's date of death (i.e., the remaining investment component of the life insurance policies plus appreciation). The parties' disagreement with respect to sections 2036 and 2038 generally concerns the third part.[56]

Although the estate asserted that §§ 2036 and 2038 did not apply because Mr. Cahill had "retained no rights with respect to the amounts transferred" to the MB Trusts, the Tax Court emphasized:

> On the undisputed facts presently before us, however, the rights to terminate and recover at least the cash surrender value were clearly rights, held in conjunction with another person (MB Trust), both to designate the persons who would possess or enjoy the transferred property under section 2036(a)(2) and to alter, amend, revoke, or terminate the transfer under section 2038(a)(1).[57]

The Tax Court disagreed with the estate's argument that Mr. Cahill did not have such rights because the Survivor Trust could only terminate the agreements in conjunction with the MB Trust.[58] The court explained that, by accepting the estate's position, "the words 'in conjunction with any person' in section 2036(a)(2), and 'in conjunction with any other person' in section 2038(a)(1), would have no force or meaning."[59] In addition, the court also rejected the estate's argument that the split-dollar arrangements qualified for the bona fide sale exception to the application of §§ 2036 and 2038.[60] The Tax Court observed that "the undisputed facts strongly suggest that decedent's son Patrick stood on both sides of the transactions in question and that the arrangements were therefore not bona fide sales resulting from arm's-length transactions."[61]

Indeed, the court questioned, "[D]id decedent have a legitimate and significant nontax reason, established by the record, for transferring the $10 million?"[62] The Tax Court noted a number of unresolved factual issues regarding whether Mr. Cahill had a legitimate business purposes, including:

> (1) Were these arrangements actually intended to provide liquidity decades from now, or were they intended merely to eliminate the cash

56. *Id.* at 14.
57. *Id.* at 14–15 (citing Estate of Powell v. Comm'r, 148 T.C. 392, 401 (2017)).
58. *Id.* at 15.
59. *Id.*
60. *Estate of Cahill*, T.C. Memo 2018-84, at 18.
61. *Id.* at 16–17.
62. *Id.* at 17 (citing Estate of Hurford v. Comm'r, 96 T.C.M. (CCH) 422, 2008 Tax Ct. Memo LEXIS 276, at *52 (Dec. 11, 2008)).

> surrender value from decedent's estate? (2) The guaranteed return (3%) on the investment in the policies appears to be lower than the interest rate on the loan decedent used to purchase the policies (one month LIBOR plus 1.14%); taking into account all of the economic facts and circumstances, would this arrangement actually be capable of providing liquidity decades from now? How much liquidity, in present valued terms (i.e., valued to the date of execution)? At what cost, in present valued terms? And (3) why was an arrangement intended to provide liquidity potentially decades from now funded with a loan that required a balloon payment of the entire principal amount after only five years? That is, if decedent was acting as a prudent business person, why did he fund a long-term obligation with a short-term loan? Because such questions remain, summary judgment is inappropriate with respect to whether decedent's transfer of $10 million was part of a bona fide sale.[63]

In addition, the court noted that a significant question existed as to whether, in entering into the split-dollar agreement, Mr. Cahill transferred property "roughly equal [in] value of what he received in return."[64] The Tax Court interpreted the estate's valuation theory to mean that Mr. Cahill exchanged property worth $9,611,664 (the cash surrender value) for an interest worth only $183,700 (the death benefit rights of Mr. Cahill).[65] Thus, the court concluded that "[t]he bona fide sale for adequate and full consideration exception [was] not satisfied because the value of what decedent received was not even close to the value of what decedent paid."[66]

In its analysis of I.R.C. § 2703, the Tax Court appeared to signal its agreement with the IRS's position that the "MB Trust's ability to veto termination of the split dollar agreements should be disregarded under section 2703(a)(1) or (2) for purposes of valuing decedent's rights in the split-dollar agreements."[67] The court rejected the estate's argument that the split dollar agreements resembled promissory notes (to which § 2703 does not apply), again emphasizing that MB Trust had not bargained for the agreements as part of a bona fide sale.[68] The Tax Court also rejected the position that the agreements were akin to the partnership interests considered in *Estate of Strangi v. Commissioner* because "[n]o State law entity is involved in this

63. *Id.* at 17–18.
64. *Id.* at 18 (citing *Estate of Hurford*, 2008 Tax Ct. Memo LEXIS 276, at *52).
65. *Estate of Cahill*, T.C. Memo 2018-84, at 18.
66. *Id.* at 20.
67. *Id.* at 20–22.
68. *Id.* at 24.

case."[69] Finally, the court dismissed the estate's assertion that application of § 2703 to the split dollar agreements would result in that provision applying "to all sorts of other options, agreements, rights, . . . restrictions[,] . . . [and] 'almost every two-party agreement . . . [where] one party cannot unilaterally terminate the agreement.'"[70] The court observed that "[t]he estate's implicit claim would appear to be that its hypothetical restriction is so obviously legitimate that Congress could not have meant for section 2703(a) to apply."[71] However, the court noted, Congress had provided restrictions in the form of § 2703(b), which sets forth exceptions to § 2703(a).[72] Thus, the court opined, the estate's arguments should be made in the context of a § 2703(b) analysis, which the parties had not yet addressed.[73]

Based on its analysis, the Tax Court denied the estate's motion for partial summary judgment.[74] The court also declined to treat the IRS's response to the motion as a cross-motion for partial summary judgment because "there may be other facts or theories not yet presented."[75]

As with *Estate of Powell*, it is not yet clear the full implications *Estate of Cahill* might have going forward.[76] Some practitioners view the case as another example of "pigs get fat, hogs get slaughtered."[77]

69. *Id.* at 25 (quoting 115 T.C. 478, 488 (2000)).
70. *Estate of Cahill*, T.C. Memo 2018-84, at 27.
71. *Id.*
72. *See id.*
73. *Id.* at 27–28.
74. *Id.* at 34.
75. *Estate of Cahill*, T.C. Memo 2018-84, at 34.
76. *See id.* at 14–15 (citing 148 T.C. 392, 401 (2017)).
77. STEVE R. AKERS, BESSEMER TRUST CO., ESTATE PLANNING CURRENT DEVELOPMENTS AND HOT TOPICS 128 (2018), https://www.bessemertrust.com/sites/default/files/2019-01/Hot%20Topics%20Current%20Developments_01_10_19.pdf. Akers explains the result as follows:

> The court's reaction to an attempt of an incompetent 90-year old's son to structure the transfer of $10 million to a trust and only make a transfer of less than $200,000 for gift or estate tax purposes is not surprising. Furthermore, the *Cahill* case does not present a sympathetic fact situation. The transaction was implemented by a decedent's son under a power of attorney. The transaction was implemented with an irrevocable trust created by the son under the power of attorney, having the son's cousin (and business partner) as trustee, apparently with no negotiation. The arrangement involved borrowing $10 million from a third-party lender under a 5-year note, without any assurances of the note being renewed, even though the split dollar arrangement ostensibly would be in place for decades.

Id.

Other have suggested that the decision is "perfectly reasonable" given the letter of the law.[78] Regardless, practitioners should note that the IRS appears to be attempting to expand the application of § 2036(a)(2) articulated in *Estate of Powell*, and that § 2703 may apply in more situations than previously understood under the Tax Court's rationale in *Estate of Cahill*.[79]

II. DEVELOPMENTS AT THE STATE LEVEL

In contrast to the seismic shifts at the federal level, New York had a relatively quiet *Survey* period in terms of statutory, regulatory, and case law developments. Nonetheless, a number of points warrant discussion.

A. New York Statutory and Regulatory Law

1. Decoupling

The 2018–2019 New York budget decoupled the state tax law from two changes made by the TCJA. First, New York will retain the pre-TCJA treatment of alimony payments.[80] This means that New York will include alimony payments in the adjusted gross income of the recipient rather than the payor, but the federal government will include alimony payments in the adjusted gross income of the payor rather than the recipient.[81] Second, New York will not follow the TCJA's limitation on itemized deductions for individuals, but will instead allow such deductions "as such deductions existed immediately prior to the enactment of" the TCJA.[82]

Apart from these changes, it is worth emphasizing again that the New York estate tax was already decoupled from the federal estate tax. Thus, although the federal basic exclusion amount increased to $11.18 million in 2018 as a result of the TCJA, the New York amount remained at $5.25 million throughout the *Survey* period, and only increased to $5.74 million for decedents dying after January 1, 2019.[83]

78. Jonathan Curry, *Estate Planning Community Splits Over Consequences of Cahill*, TAX NOTES 563, 564 (July 23, 2018), https://www.bc.edu/content/dam/bc1/schools/law/News/Estate%20Planning%20Community%20Splits%20Over%20Consequences%20of%20Cahill.pdf.

79. *See id.*

80. New York State Budget for Fiscal Year 2019, S.7509-C; A.9509-C, at 41 (N.Y. 2018).

81. *Id.*

82. *Id.* at 42.

83. *See* Tax Cuts and Jobs Act, Pub. L. No. 115-97, § 11002, 131 Stat. 2054, 2059 (2017)

2. Change to Statute of Limitations

The 2018–2019 budget made an important change to the statute of limitations for assessments of amended tax returns.[84] In previous years, the New York Department of Taxation had to issue an assessment within three years from the date of filing of the original return, regardless of whether an amended return was filed during that three-year period. In practice, this meant that the taxpayer could file an amended return close to the expiration of the limitations period, and the Department of Taxation had no additional time in which it could issue an assessment.[85] With the 2018–2019 budget, the New York Legislature closed this potential loophole by adding Tax Law § 683(c)(12):

> Except as otherwise provided in paragraph three of this subsection, or as otherwise provided in this section where a longer period of time may apply, if a taxpayer files an amended return, an assessment of tax (if not deemed to have been made upon the filing of the amended return), including recovery of a previously paid refund, attributable to a change or correction on the amended return from a prior return may be made at any time within one year after such amended return is filed.[86]

Accordingly, the Department of Taxation now has until the latter of three years from the filing of the original return or one year from the filing of the amended return in which to issue an assessment, eliminating the incentive for taxpayers to file amended returns as the expiration of the original statute of limitations approaches.[87]

3. Residency

New York State imposes an income tax on individuals who are residents of the state.[88] Prior to the *Survey* period, the two ways to establish resident status were (1) the domicile of the individual in New York, and (2) the statutory residency test under Tax Law § 605(b)(1).[89] The statutory residency test defines a New York resident as "an individual who is not domiciled in New York State but maintains a permanent place of abode in the state and spends more than 183 days of the tax year in New York State, unless they were in active service

(to be codified at I.R.C. § 1(f) (2018)); N.Y. TAX LAW § 952 (c)(2)(A) (McKinney 2014 & Supp. 2019).

84. *See* Klein, *supra* note 1.
85. *Id.*
86. N.Y. TAX LAW § 683(c)(12) (McKinney Supp. 2019).
87. Klein, *supra* note 1.
88. N.Y. TAX LAW § 605(b)(1) (McKinney 2014 & Supp. 2019).
89. *Id.*

in the military."[90] The wording of this definition led to an odd result in the case of *In re Sobotka*.[91] In that case, the judge excluded the days in which the taxpayer was domiciled in New York State from the 183-day count under the statutory resident test.[92] As some commentators have noted, such an interpretation "could be significant if a taxpayer receives a large payment or bonus during a non-domiciliary period (in January, for example), and is not taxable as a statutory resident for the year in question, potentially allowing that large payment to be excluded from his New York income."[93]

As part of the 2018–2019 budget, New York State changed the definition of a statutory resident as follows: "[A]n individual who maintains a permanent place of abode in New York State and spends more than 183 days of the tax year in New York State, *whether or not they are domiciled in this state*, is a resident unless they were in active service in the military."[94] Accordingly, beginning in 2019, New York State will count all days an individual is present in the state in determining whether he or she meets the definition of a statutory resident, and will not exclude any days during which the individual is present in the state as a domiciliary.[95]

B. New York Case Law

1. Substantial Compliance for Beneficiary Designations

In the case of *In re Durcan*, the Surrogate's Court for New York County provided a reminder of the importance of maintaining valid beneficiary designations on individual retirement accounts.[96] Joan Durcan died in November 2014, survived by two siblings—James Durcan and Mary Anne Cunney—and five nieces and nephews who were the children of a predeceased brother.[97] James obtained letters of administration for Joan's estate and petitioned under Surrogate's

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90. N.Y. Dep't of Taxation and Fin. Tech. Mem. TSB-M-18(4)I (May 25, 2018) [hereinafter Tech. Mem.] (summarizing the changes to the personal income tax code in the 2018–2019 New York State Budget Bill).

91. DTA No. 826286, 2015 WL 5096196, at *4 (N.Y. Div. Tax. App. 2015).

92. *Id.* at *6.

93. Klein, *supra* note 1.

94. Tech. Mem., *supra* note 90 (emphasis added); N.Y. TAX LAW § 605(b)(1)(B) (McKinney 2014 & Supp. 2019); N.Y. TAX LAW § 1305(a)(2) (McKinney 2017 & Supp. 2019); N.Y.C. Admin. Code § 11-1705(b)(1)(B) (2019).

95. *See* Tech. Mem., *supra* note 90.

96. No. 2014-4296/C, 2018 N.Y. Slip Op. 30629(U), at 5–6 (N.Y. Sur. Ct. Apr. 11, 2018), *aff'd*, 165 A.D.3d 585, 586, 87 N.Y.S.3d 26, 27 (1st Dep't 2018).

97. *In re Durcan*, N.Y. Slip Op. 30629(U), at 1.

Court Procedure Act (SCPA) § 2103 for the payment of proceeds from Joan's retirement accounts to Joan's estate.[98]

Joan's retirement accounts had been created in 2002 at Merrill Lynch.[99] At the time of creation, Joan executed the documents necessary to designate Mary as the sole beneficiary.[100] In October 2014, Joan's financial advisor transferred employment from Merrill Lynch to Morgan Stanley, and Joan agreed to move her assets to follow her advisor.[101] In October 2014, Joan completed a Client Data Form naming Mary as one-hundred percent beneficiary, but did not sign the document.[102] In November 2014, Joan also received a Traditional IRA Adoption Agreement (the "Agreement") in which she could name Mary as beneficiary.[103]

Joan's financial advisor testified that he spoke to Joan about this form over the phone and assisted her in filling out the portion for designating a beneficiary.[104] The financial advisor stated that Joan consistently indicated that she wanted Mary to be the sole beneficiary, as she had been on the accounts when held at Merrill Lynch, and never even mentioned that she had a brother.[105] Joan died a few days after the call with her advisor.[106] The Agreement was not received by Morgan Stanley, nor was it discovered among Joan's papers.[107] Following Joan's death, Morgan Stanley paid the proceeds of her retirement accounts to Mary based on the information contained in the Client Data Form.[108]

John—Joan's brother and the administrator of her estate—asserted that Morgan Stanley should have paid the proceeds to Joan's estate because she failed to execute a valid beneficiary designation at Morgan Stanley pursuant to Estates, Powers, and Trusts Law (EPTL) § 13-3.2(e).[109] In response, Mary argued that the equitable doctrine of "substantial compliance" with the beneficiary designation provisions of the retirement plan should support Morgan Stanley's decision to

98. *Id*. at 1–2.
99. *Id*. at 2.
100. *Id.*
101. *Id.*
102. *In re Durcan*, N.Y. Slip Op. 30629(U), at 2.
103. *Id*. at 2–3.
104. *Id.* at 3.
105. *Id.*
106. *Id.*
107. *In re Durcan*, N.Y. Slip Op. 30629(U), at 3.
108. *Id.* at 3–4.
109. *Id.* at 4; N.Y. EST. POWERS & TRUSTS LAW § 13-3.2(e) (McKinney 2001).

distribute the proceeds to her.[110] Morgan Stanley did not file papers supporting or opposing either position.[111]

The Surrogate's Court explained that EPTL § 13-3.2(e) "requires that a beneficiary designation be made: a) in a writing signed by the person making the designation; and b) in accordance with the rules prescribed for the pension, retirement, death benefit, stock bonus, profit-sharing plan, system or trust or insurance contract."[112] The court observed that the absence of a signature on the Client Data Form resulted in the first prong of the statute being "wholly lacking."[113] The court reasoned that, even if the terms of the plan would permit such a method of designation, "Morgan Stanley's acceptance of this unsigned form as a beneficiary designation . . . cannot make up for the lack of compliance with the first requirement of the statute here."[114] The Surrogate's Court rejected Mary's position on that basis that no authority for "the application of the substantial compliance doctrine to excuse the complete absence of a beneficiary designation signed by the insured or plan participant, or, for that matter, to excuse a complete failure to comply with the requirements of EPTL § 13-3.2(e) for the designation of a beneficiary."[115]

In reaching its determination that the proceeds should be paid to Joan's estate, the court noted it was "mindful that the proof offered by [Mary], and in particular, the testimony of [the financial team] that decedent told them that she wanted her sister to be the beneficiary of the new accounts."[116] However, "the court must reluctantly conclude that compliance with the statutory requirement that a beneficiary designation be in writing and signed by the designator may not be disregarded."[117] The Surrogate's Court explained that such an approach prevents a court from speculating on the intentions of the deceased, and "represents the legislative choice of protecting an insured or retirement plan participant from the possibility of fraud after her death by forgoing even persuasive testimonial evidence in favor of a formal requirement that has the virtue of objectivity and can be easily satisfied."[118]

110. *In re Durcan*, N.Y. Slip Op. 30629(U), at 4–5.
111. *Id.* at 5; N.Y. E.P.T.L. § 13-3.2(e).
112. *In re Durcan*, N.Y. Slip Op. 30629(U), at 5.
113. *Id.* at 5–6.
114. *Id.* at 6.
115. *Id.* at 6–7; N.Y. E.P.T.L. § 13-3.2(e).
116. *In re Durcan*, N.Y. Slip Op. 30629(U), at 7.
117. *Id.*
118. *Id.* at 8.

2. Cure of Defective Acknowledgment

In the case of *In re Koegel*, the Appellate Division, Second Department considered "whether a defective acknowledgment of a prenuptial agreement could be remedied by extrinsic proof provided by the notary public who took a party's signature"[119]—a question left unaddressed by the New York Court of Appeals in *Galetta v. Galetta*.[120] Prior to their marriage in August 1984, William and Irene Koegel had entered into a prenuptial agreement.[121] Under the terms of the agreement, William and Irene waived any right he or she had to elect against the will of the other, and agreed not to make any claim against the estate of the other.[122] Both William and Irene signed the agreement in the presence of a notary public, but the notary's acknowledgment did not recite that either party was known to the notary.[123]

Following William's death, Irene filed a notice of election under EPTL § 5-1.1-A, exercising her right "to take [her] share of [William's] P5314*3 estate to which [she was] entitled pursuant to said statute."[124] John Koegel—the executor of William's estate and his son from a prior marriage—sought to invalidate Irene's notice of election based on her waiver under the prenuptial agreement.[125] In response, Irene "asserted that the prenuptial agreement was defective, invalid, and unenforceable pursuant to *Galetta*, because the acknowledgments omitted language expressly stating that the notaries knew the signers or had ascertained, through some sort of proof, that the signers were the persons described as required by Domestic Relations Law § 236(B)(3)."[126] John presented affidavits from the notaries in which each specifically stated that he "observed the document being signed, took the acknowledgment in question, and personally knew the individual signer signing before him."[127]

The Second Department noted that "the Surrogate's Court correctly found that the Court of Appeals, in *Galetta*, left open the

119. 160 A.D.3d 11, 12, 70 N.Y.S.3d 540, 541 (2d Dep't 2018).

120. *See* 21 N.Y.3d 186, 194, 991 N.E.2d 684, 689, 969 N.Y.S.2d 826, 831 (2013).

121. *In re Koegel*, 160 A.D.3d at 13, 70 N.Y.S.3d at 541.

122. *Id.*

123. *Id.* at 13, 70 N.Y.S.3d at 542.

124. *Id.* at 15, 70 N.Y.S.3d at 543; N.Y. EST. POWERS & TRUSTS LAW § 5-1.1-A (McKinney 1999 & Supp. 2019).

125. *In re Koegel*, 160 A.D.3d at 15, 70 N.Y.S.3d at 543.

126. *Id.* at 16, 70 N.Y.S.3d at 544; *see* Galetta v. Galetta, 21 N.Y.3d 186, 189, 991 N.E.2d 684, 685, 969 N.Y.S.2d 826, 827 (2013).

127. *In re Koegel*, 160 A.D.3d at 27, 70 N.Y.S.3d at 551–52.

issue of whether a defective acknowledgment can be cured."[128] However, the court also observed that "[t]he situation at bar is akin to the hypothetical described by the Court of Appeals in *Galetta*, where the notaries here, the decedent's law partner and Irene's attorney, actually recalled acknowledging the signatures at issue."[129] The Second Department emphasized the explanation of the Court of Appeals that "the confirmation of the identity of the signer, through an affidavit, is sufficient without having to explain how the identity was confirmed."[130] The court concluded that, through the affidavits of the notaries, "the defect in the acknowledgment was cured in order to give vitality to the expressed intent of the parties set forth in the prenuptial agreement."[131]

CONCLUSION

This *Survey* year saw sweeping changes to the tax law at the federal level that have a significant impact on estate planning. However, as noted throughout this article, there are a number of open questions about implementation that require further clarification from the IRS. Moreover, with some of the most impactful changes to the tax law scheduled to sunset after 2025, it is important to continue monitoring developments in this area of the law and to review estate planning documents with an understanding of what lays on the horizon.

128. *Id.* at 24, 70 N.Y.S.3d at 549; *Galetta*, 21 N.Y.3d at 197, 991 N.E.2d at 691, 969 N.Y.S.2d at 833.

129. *In re Koegel*, 160 A.D.3d at 27, 70 N.Y.S.3d at 551 (citing *Galetta*, 21 N.Y.3d at 198, 991 N.E.2d at 692, 969 N.Y.S.2d at 834).

130. *Id.*

131. *Id.* at 27, 70 N.Y.S.3d at 551–52.