TRUSTS & ESTATES

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INTRODUCTION

This article covers notable regulatory, statutory, and case law developments related to trusts and estates for the *Survey* period of July 1, 2018 to June 30, 2019.

Part I of this Article discusses changes that occurred at the federal level. This discussion will summarize the decision of the Supreme Court of the United States in *Kaestner* and further developments stemming from law colloquially known as the Tax Cuts and Jobs Act ("TCJA"). 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, the amount of combined gross assets and prior taxable gifts needed to trigger an estate tax increased from $11,180,000 in 2018 to $11,400,000 in 2019.[1] The federal annual gift tax exclusion remained at $15,000 throughout the

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1. *Compare* Rev. Proc. 2018-18, 2018-10 I.R.B. 392 § 3.35, *with* Rev. Proc. 2018-57, 2018-49 I.R.B. 827 § 3.41.

Survey period.[2] The threshold for gifts to a non-citizen spouse not includable in a taxpayer's gifts increased from $152,000 in 2018 to $155,000 in 2019.[3]

On January 1, 2019, New York achieved equalization between the state exemption amount and federal amount in place prior to the TCJA.[4] Accordingly, the basic exclusion amount in New York increased from $5,250,000 (applicable to decedents who died before January 1, 2019) to $5,740,000.[5]

I. DEVELOPMENTS AT THE FEDERAL LEVEL

A. Supreme Court's Decision in Kaestner

In *North Carolina Dep't of Revenue v. Kimberly Rice Kaestner 1992 Family Trust*, the Supreme Court of the United States examined whether a state could tax the undistributed income of a trust based solely on the residence of a trust beneficiary.[6] Joseph Lee Rice III created a trust for the benefit of his children, selecting New York law to govern the trust, and appointing a New York resident as the trustee.[7] The trust provided that the trustee had absolute discretion to make distributions to the beneficiaries in such amounts and proportions as the trustee decided.[8]

At the time that the trust was established, no beneficiary lived in North Carolina.[9] In 1997, Mr. Rice's daughter, Kimberly Rice Kaestner, moved to North Carolina.[10] Following Mrs. Kaestner's move, the trustee divided the initial trust into three separate trusts for the benefit of Mr. Rice's children, including one for Mrs. Kaestner and her three minor children.

2. *Compare* Rev. Proc. 2017-58, 2017-45 I.R.B. 489 § 3.37(1), *with* Rev. Proc. 2018-57, 2018-49 I.R.B. 827 § 3.43(1).

3. *Compare* Rev. Proc. 2017-58, 2017-45 I.R.B. 489 § 3.37(2), *with* Rev. Proc. 2018-57, 2018-49 I.R.B. 827 § 3.43(2).

4. *See* N.Y. STATE ASSEMBLY, FY 2020 N.Y. STATE EXECUTIVE BUDGET MEMORANDUM IN SUPPORT 13 (2019), https://nyassembly.gov/2019budget/2019executive/rev_memo.pdf.

5. *Compare* N.Y. TAX LAW § 952(c)(2)(A) (McKinney Supp. 2019), *with* N.Y. State Dep't of Taxation and Fin., *Estate Tax*, NY.GOV (last updated June 18, 2019), https://www.tax.ny.gov/pit/estate/etidx.htm.

6. *See* 139 S. Ct. 2213, 2217 (2019).

7. *Id.* at 2218.

8. *Id.*

9. *Id.*

10. *Id.*

For the period from 2005 through 2008, the trustee made no distributions to Mrs. Kaestner or her children.[11] During this time, the trust was subject to New York law, the grantor was a New York resident, no trustee lived in North Carolina, the trust documents were kept in New York, and the custodians of the trust assets were in Massachusetts.[12] The trust had no connection to North Carolina other than the residence of the beneficiaries.[13]

"North Carolina taxes any trust income that 'is for the benefit of' a North Carolina resident."[14] Based on the language of the statute, the North Carolina supreme court had determined that the state can tax a trust on the sole basis that the trust beneficiaries live in state.[15] Accordingly, the North Carolina Department of Revenue assessed a tax on the accumulated income of the trust for tax years 2005 through 2008.[16] After paying the assessed tax, the trust challenged the assessment in state court on the basis that the statute's application violated the Due Process Clause of the Fourteenth Amendment.[17]

The trial court, North Carolina court of appeals, and North Carolina supreme court all determined that the residence of the trust beneficiaries alone was not enough to support the state's taxation of the trust.[18] The North Carolina Department of Revenue sought a writ of certiorari to review the judgment of the North Carolina supreme court.[19] The Supreme Court of the United States granted the petition to decide "whether the Due Process Clause prohibits States from taxing trusts based only on the in-state residency of trust beneficiaries."[20]

The Court unanimously agreed with the North Carolina courts and affirmed, holding that:

> the presence of in-state beneficiaries alone does not empower a State to tax trust income that has not been distributed to the beneficiaries where the beneficiaries have no right to demand that income and are uncertain ever to receive it. In limiting our holding to the specific facts presented,

11. *Kaestner*, 139 S. Ct. at 2218.
12. *Id.*
13. *See id.* at 2218–19.
14. *Id.* at 2219 (quoting N.C. GEN. STAT. §§ 105-160.2 (2017)).
15. *Id.* (citing *Kimberly Rice Kaestner 1992 Family Tr. v. N.C. Dep't of Revenue*, 814 S.E.2d. 43, 51 (N.C. 2018)).
16. *Kaestner*, 139 S. Ct. at 2219 (citing N.C. GEN. STAT. §§ 105-160.2).
17. *Id.*
18. *Id.*
19. *See id.* at 2219.
20. *Id.*

> we do not imply approval or disapproval of trust taxes that are premised on the residence of beneficiaries whose relationship to trust assets differs from that of the beneficiaries here.[21]

Writing for the Court, Justice Sotomayor explained that "[i]n the context of state taxation, the Due Process Clause limits States to imposing only taxes that 'bea[r] fiscal relation to protection, opportunities and benefits given by the state.'"[22] In order to satisfy this requirement, (1) "there must be 'some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax"; and (2) "the 'income attributed to the State for tax purposes . . . be rationally related to "values connected with the taxing State.'"[23] Citing *International Shoe Co.*, Justice Sotomayor emphasized that "[u]ltimately, only those who derive 'benefits and protection' from associating with a State should have obligations to the State in question."[24]

Justice Sotomayor observed that "[i]n the past, the Court has analyzed state trust taxes for consistency with the Due Process Clause by looking to the relationship between the relevant trust constituent (settlor, trustee, or beneficiary) and the trust assets that the State seeks to tax."[25] She referenced two cases—*Safe Deposit & Trust Co. of Baltimore v. Virginia* and *Brooke v. Norfolk*—as examples of when the Court had "invalidated state taxes premised on the in-state residency of beneficiaries."[26] In the former case, the Court ruled against the state's ability to tax the entire trust because "nobody within Virginia ha[d] present right to [the trust property's] control or possession, or to receive income therefrom."[27] Similarly, the Court in *Brooke* rejected taxation of the entire trust based on the residency of a beneficiary because "the trust property '[wa]s not within the State, d[id] not belong to the [beneficiary] and [wa]s not within her possession or control.'"[28] In contrast, Justice Sotomayor explained, "[t]he Court has decided that States may tax trust income that is actually distributed to an in-state beneficiary. In those circumstances, the beneficiary 'own[s] and enjoy[s]' an interest in the trust property, and the State can exact a tax in exchange for offering the beneficiary

21. *Kaestner*, 139 S. Ct. at 2221.
22. *Id.* at 2219 (quoting Wisconsin v. J.C. Penny Co., 311 U.S. 435, 444 (1940)).
23. *Id.* at 2220 (quoting Quill Corp. v. North Dakota, 504 U.S. 298, 306 (1992)).
24. *Id.* at 2220 (citing Int'l Shoe Co. v. Washington, 326 U.S. 310, 319 (1945)).
25. *Id.* at 2221.
26. *Kaestner*, 139 S. Ct. at 2221.
27. *Id.* (quoting Safe Deposit & Tr. Co. of Balt. v. Virginia, 280 U.S. 83, 91 (1929)).
28. *Id.* (quoting Brooke v. Norfolk, 277 U.S. 27, 29 (1928)).

protection."[29] She described these cases as reflecting "a common governing principle: When a State seeks to base its tax on the in-state residence of a trust beneficiary, the Due Process Clause demands a pragmatic inquiry into what exactly the beneficiary controls or possesses and how that interest relates to the object of the State's tax."[30]

Justice Sotomayor noted that similar principles were at work in the context of taxes based on the residency of settlors or trustees.[31] With respect to settlors, she observed, "the Court upheld a Tennessee trust tax because the settlor was a Tennessee resident who retained 'power to dispose of' the property, which amounted to 'a potential source of wealth which was property in her hands,'" and that "practical control over the trust assets obliged the settlor 'to contribute to the support of the government whose protection she enjoyed.'"[32] With respect to trustees, Justice Sotomayor cited the Court's decision in *Greenough*, which explained that "[t]he trustee is 'the owner of [a] legal interest in' the trust property, and in that capacity he can incur obligations, become personally liable for contracts for the trust, or have specific performance ordered against him," but that "[a]t the same time, the trustee can turn to his home State for 'benefit and protection through its law.'"[33]

Justice Sotomayor summarized the overarching theme of these cases, which all relate to the taxation of a trust based on residency, as follows:

> In sum, when assessing a state tax premised on the in-state residency of a constituent of a trust—whether beneficiary, settlor, or trustee—the Due Process Clause demands attention to the particular relationship between the resident and the trust assets that the State seeks to tax. Because each individual fulfills different functions in the creation and continuation of the trust, the specific features of that relationship sufficient to sustain a tax may vary depending on whether the resident is a settlor, beneficiary, or trustee. When a tax is premised on the in-state residence of a beneficiary, the Constitution requires that the resident have some degree of possession, control, or enjoyment of the trust property or a right to receive that property before the State can tax

29. *Id.* at 2221 (quoting Maguire v. Trefry, 253 U.S. 12, 17 (1920)) (citing Guaranty Tr. v. Virginia, 305 U.S. 19, 21–23 (1983)).

30. *Id.* at 2221–22 (citing *Safe Deposit & Tr. Co. of Balt*., 280 U.S. at 91).

31. *Kaestner*, 139 S. Ct. at 2222.

32. *Id.* (quoting Curry v. McCanless, 307 U.S. 357, 370–71 (1939)) (citing Graves v. Elliot, 307 U.S. 383, 387 (1939)).

33. *Id.* (quoting Greenough v. Tax Assessors of Newport, 331 U.S. 486, 494, 496 (1947)).

> the asset. Otherwise, the State's relationship to the object of its tax is too attenuated to create the 'minimum connection' that the Constitution requires.[34]

Applying the principles to the case at hand, Justice Sotomayor concluded that the residence of the trust beneficiaries in North Carolina did not, by itself, provide the minimum contacts necessary to support the tax.[35] In reaching this conclusion, she noted that: (1) "the beneficiaries did not receive any income from the trust during the years in question," and (2) "the beneficiaries had no right to demand trust income or otherwise control, possess, or enjoy the trust assets in the tax years at issue."[36] Although the trust agreement had discretionary trust language "suggesting that the trustee was to make distributions generously" and "the trustee of a discretionary trust has a fiduciary duty not to 'act in bad faith or for some purpose or motive other than to accomplish the purposes of the discretionary power,'" Justice Sotomayor emphasized that "the Trust agreement still deprived Kaestner and her children of any entitlement to demand distributions or to direct the use of the Trust assets in their favor in the years in question."[37]

Furthermore, she explained, Mrs. Kaestner and her children could not demand distributions during the years in question.[38] Indeed, although the trust's terms provided that it would terminate upon Mrs. Kaestner turning forty, it could not be guaranteed that the beneficiaries would ever receive any income from the trust, because "New York law allowed the trustee to roll over the trust assets into a new trust rather than terminating it. Here, the trustee did just that."[39]

In rejecting North Carolina's argument that the residence of a beneficiary should alone be sufficient to support income taxation, Justice Sotomayor stated that "[t]he State's argument fails to grapple with the wide variation in beneficiaries' interests."[40] Although beneficiaries are central to the trust relationship, "depending on the trust agreement, a beneficiary may have only a 'future interest,' an interest that is 'subject to conditions,' or an interest that is controlled by a trustee's discretionary decisions."[41] Accordingly, "[t]he different

34. *Id. at* 2222. (quoting *Quill Corp.*, 504 U.S. at 306).
35. *Id.* at 2223.
36. *Kaestner,* 139 S. Ct. at 2223.
37. *Id.*
38. *See id.*
39. *Id.* at 2223 (citing N.Y. EST. POWERS & TRUSTS LAW § 10-6.6(b) (McKinney 2002)).
40. *Id.* at 2225.
41. *Kaestner,* 139 S. Ct. at 2225

forms of beneficiary interests counsels against adopting the categorical rule that the State urges."[42] Justice Sotomayor also rejected North Carolina's assertion that the Court's decision would undermine many state taxation regimes:

> Today's ruling will have no such sweeping effect. North Carolina is one of a small handful of States that rely on beneficiary residency as a sole basis for trust taxation, and one of an even smaller number that will rely on the residency of beneficiaries regardless of whether the beneficiary is certain to receive trust assets. Today's decision does not address state laws that consider the in-state residency of a beneficiary as one of a combination of factors, that turn on the residency of a settlor, or that rely only on the residency of noncontingent beneficiaries. We express no opinion on the validity of such taxes.[43]

Lastly, Justice Sotomayor considered North Carolina's suggestion that ruling in favor of the trust would encourage "opportunistic gaming of state tax systems," where "a beneficiary in Kaestner's position will delay taking distributions until she moves to a State with a lower level of taxation."[44] The Court was not persuaded:

> Though this possibility is understandably troubling to the State, it is by no means certain that it will regularly come to pass. First, the power to make distributions to Kaestner or her children resides with the trustee. When and whether to make distributions is not for Kaestner to decide, and in fact the trustee may distribute funds to Kaestner while she resides in North Carolina (or deny her distributions entirely). Second, we address only the circumstances in which a beneficiary receives no trust income, has no right to demand that income, and is uncertain necessarily to receive a specific share of that income. Settlors who create trusts in the future will have to weigh the potential tax benefits of such an arrangement against the costs to the trust beneficiaries of lesser control over trust assets. In any event, mere speculation about negative consequences cannot conjure the 'minimum connection' missing between North Carolina and the object of its tax.[45]

Justice Alito joined the Court's opinion, but wrote a separate concurrence (joined by Chief Justice Roberts and Justice Gorsuch) "to make clear that the opinion of the Court merely applies our existing precedent and that its decision not to answer questions not presented

(citing RESTATEMENT (THIRD) OF TRUSTS § 49, cmt. B (AM. LAW INST. 2003)).

42. *Id.*

43. *Id.*

44. *Id.* at 2225–26.

45. *Id.* at 2226.

by the facts of this case does not open for reconsideration any points resolved by our prior decisions."[46] Justice Alito explained that:

> Here, as in *Brooke* and *Safe Deposit*, the resident beneficiary has neither control nor possession of the intangible assets in the trust. She does not enjoy the use of the trust assets. The trustee administers the trust and holds the trust assets outside the State of North Carolina. Under *Safe Deposit* and *Brooke*, that is sufficient to establish North Carolina cannot tax the trust or the trustee on the intangible assets held by the trust. [Thus,] [t]he opinion of the Court rightly concludes that the assets in this trust and the trust's undistributed income cannot be taxed by North Carolina because the resident beneficiary lacks control, possession, or enjoyment of the trust assets. The Court's discussion of the peculiarities of this trust does not change the governing standard, nor does it alter the reasoning applied in our earlier cases.[47]

B. Continued Fallout from the TCJA

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 at the end of 2017.[48] Many of the significant changes to estate planning were examined in last year's *Survey*.[49] However, there were several issues created by the TCJA that did not have a definitive answer. Fortunately, a number of those issues were addressed during the current *Survey* period.

1. No Clawback

One open question was how to calculate the federal estate tax for an individual who made gifts during a period when the higher exemption amount applied and then died when the exemption had decreased. Specifically, the TCJA added the following language to I.R.C. section 2001(g)(2):

> 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

46. *Kaestner,* 139 S. Ct. at 2226 (Alito, J., concurring).

47. *Id.* at 2228 (Alito, J., concurring).

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

49. *See* Steven Cunningham, *2017–18 Survey of New York Law: Trusts and Estates*, 69 SYRACUSE L. REV. 999, 999–1000 (2019).

exclusion amount under such section applicable with respect to any gifts made by the decedent.[50]

However, this language did not indicate whether the Secretary might prescribe 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.[51]

On November 23, 2018, the Department of the Treasury issued proposed regulations that would not result in an estate tax being imposed on a prior gift in the event of a decrease in the basic exclusion amount.[52] At a high level, the proposed regulations "provide a special rule that allows the estate to compute its estate tax credit using the higher of the BEA applicable to gifts made during life or the BEA applicable on the date of death."[53] With the proposed regulations, the IRS sought to address "two questions regarding a potential for inconsistent tax treatment or double taxation of transfers resulting from the temporary nature of the increased" exemption amount:

> First, in cases in which a taxpayer exhausted his or her BEA [basic exclusion amount] and paid gift tax on a pre-2018 gift, and then either makes an additional gift or dies during the increased BEA period, will the increased BEA be absorbed by the pre-2018 gift on which gift tax was paid so as to deny the taxpayer the full benefit of the increased BEA during the increased BEA period? Second, in cases in which a taxpayer made a gift during the increased BEA period that was fully sheltered from gift tax by the increased BEA but makes a gift or dies after the increased BEA period has ended, will the gift that was exempt from gift tax when made during the increased BEA period have the effect of increasing the gift or estate tax on the later transfer (in effect, subjecting the earlier gift to tax even though it was exempt from gift tax when made)?[54]

Addressing the first question, the proposed rules to the regulations observed that "the gift tax determination appropriately reduces the increased BEA only by the amount of BEA allowable against prior period gifts, thereby ensuring that the increased BEA is

50. Tax Cuts and Jobs Act § 11061 at 2091 (codified at I.R.C. § 2001(g)(2)(A)–(B) (2018)).

51. *See id.*

52. *See* Estate and Gift Taxes; Difference in the Basic Exclusion Amount, 83 Fed. Reg. 59343 (proposed Nov. 23, 2018) (to be codified at 26 C.F.R. pt. 20).

53. IRS, *Treasury, IRS: Making Large Gifts Now Won't Harm Estates After 2025*, IRS NEWSROOM (Nov. 20, 2018), https://www.irs.gov/newsroom/treasury-irs-making-large-gifts-now-wont-harm-estates-after-2025.

54. Estate and Gift Taxes; Difference in the Basic Exclusion Amount, 83 Fed. Reg. 59343, 59344–45 (proposed Nov. 23, 2018) (to be codified at 26 C.F.R. pt. 20).

not reduced by a prior gift on which gift tax in fact was paid."[55] Moreover, the IRS explained that "the increased BEA is not reduced by the portion of any prior gift on which gift tax was paid, and the full amount of the increased BEA is available to compute the credit against the estate tax."[56] Thus, those individuals who made pre-2018 gifts in excess of the exemption amount would not lose the benefit of the increased exemption if they make gifts or die between 2018 and 2025.[57]

With respect to the second question:

> [T]he proposed regulations also would amend § 20.2010-1 to provide a special rule in cases where the portion of the credit as of the decedent's date of death that is based on the BEA is less than the sum of the credit amounts attributable to the BEA allowable in computing gift tax payable within the meaning of section 2001(b)(2). In that case, the portion of the credit against the net tentative estate tax that is attributable to the BEA would be based upon the greater of those two credit amounts.[58]

The proposed regulations offer the following example to demonstrate how this rule would work:

> [I]f a decedent had made cumulative post-1976 taxable gifts of $9 million, all of which were sheltered from gift tax by a BEA of $10 million applicable on the dates of the gifts, and if the decedent died after 2025 when the BEA was $5 million, the credit to be applied in computing the estate tax is that based upon the $9 million of BEA that was used to compute gift tax payable.[59]

By taking this approach, "[t]he proposed regulations [would] ensure that a decedent's estate is not inappropriately taxed with respect to gifts made during the increased BEA period."[60]

While the preamble to the proposed regulations provides a lengthy explanation of the impact of the TCJA on gift and estate tax calculations, the actual language of the proposed regulations is rather targeted, with most of the operative language appearing in the form of a new paragraph (c) to Section 20.2010-1:

55. *Id*. at 59345.
56. *Id*.
57. *See id*. at 59346.
58. *Id*.
59. Estate and Gift Taxes; Difference in the Basic Exclusion Amount, 83 Fed. Reg. 59343, 59346 (proposed Nov. 23, 2018) (to be codified at 26 C.F.R. pt. 20).
60. *Id*.

> Special rule in the case of a difference between the basic exclusion amount applicable to gifts and that applicable at the donor's date of death—(1) Rule. Changes in the basic exclusion amount that occur between the date of a donor's gift and the date of the donor's death may cause the basic exclusion amount allowable on the date of a gift to exceed that allowable on the date of death. If the total of the amounts allowable as a credit in computing the gift tax payable on the decedent's post-1976 gifts, within the meaning of section 2001(b)(2), to the extent such credits are based solely on the basic exclusion amount as defined and adjusted in section 2010(c)(3), exceeds the credit allowable within the meaning of section 2010(a) in computing the estate tax, again only to the extent such credit is based solely on such basic exclusion amount, in each case by applying the tax rates in effect at the decedent's death, then the portion of the credit allowable in computing the estate tax on the decedent's taxable estate that is attributable to the basic exclusion amount is the sum of the amounts attributable to the basic exclusion amount allowable as a credit in computing the gift tax payable on the decedent's post-1976 gifts. The amount allowable as a credit in computing gift tax payable for any year may not exceed the tentative tax on the gifts made during that year, and the amount allowable as a credit in computing the estate tax may not exceed the net tentative tax on the taxable estate. Sections 2505(c) and 2010(d).[61]

If finalized, the proposed regulations would mean that "individuals planning to make large gifts between 2018 and 2025 can do so without concern that they will lose the tax benefit of the higher exclusion level once it decreases after 2025."[62]

2. Clarification on Miscellaneous Itemized Deductions

The TCJA had also left open the question whether executor/trustee fees or other estate/trust expenses would still be deductible for income tax purposes. I.R.C. section 67(g) states that: "Notwithstanding subsection (a), no miscellaneous itemized deduction shall be allowed for any taxable year beginning after December 31, 2017, and before January 1, 2026."[63] Subsection (a) provides 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.[64] Given that executor/trustee fees are not listed in subsection (b), there

61. *Id.* at 59347.
62. IRS, *supra* note 53.
63. I.R.C. § 67(g) (2018).
64. *See id.* § 67(a)–(b).

was some concern that they are covered by subsection (a) and, thus, no longer deductible.[65]

However, executor/trustee fees and other estate/trust expenses are deductible separately under I.R.C. section 67(e) because they are expenses which "would not have been incurred if the property were not held in such trust or estate."[66] Importantly, such deductions under subsection (e) are not subject to the two percent threshold of subsection (a).[67] Thus, to the extent the Joint Explanatory Statement noted an intention to eliminate "all miscellaneous itemized deductions that are subject to the two-percent floor under present law," practitioners hoped that executor/trustee fees and estate/trust expenses would still be deductible because they were not subject to the two-percent floor.[68]

The IRS removed any doubt about the continued deductibility of such fees and expenses with Notice 2018-61.[69] Effective July 13, 2018, the Notice clarified that the Treasury and IRS intend to issue regulations clarifying "that estates and non-grantor trusts may continue to deduct expenses described in section 67(e)(1) and amounts allowable as deductions under section 642(b), 651, or 661."[70] According to the IRS, section 67(g) cannot apply to trust and estate expenses because they are not "miscellaneous itemized deductions."[71] Thus, trust and estate fees and expenses will continue to be deductible after the implementation of section 67(g).[72]

C. Estate of Streightoff

In *Estate of Streightoff*, the Tax Court considered the type and value of an interest that the decedent transferred to a revocable trust prior to death.[73] Frank D. Streightoff formed a limited partnership, Streightoff Investments, in October 2008.[74] Under the terms of the partnership agreement, the purpose of the entity was "to make a profit,

65. *See id.*

66. *Id.* § 67(e)(1).

67. *See id. See also* COMM. OF CONFERENCE, 115TH CONG., JOINT EXPLANATORY STATEMENT 99 (2017) [hereinafter JOINT EXPLANATORY STATEMENT], https://docs.house.gov/billsthisweek/20171218/Joint%20Explanatory%20Statement.pdf.

68. *See* JOINT EXPLANATORY STATEMENT, *supra* note 67, at 99.

69. *See* I.R.S. Notice 2018-61, 2018-31 C.B. 278.

70. *See id.* at 279.

71. *Id.*

72. *See id.*

73. Estate of Steightoff v. Comm'r, 116 T.C.M. (CCH) 437, 2018 Tax Ct. Memo LEXIS 179, at *1 (Oct. 24, 2018).

74. *Id.* at *2.

increase wealth, and provide a means for decedent's family to manage and preserve family assets."[75] Frank funded the partnership with marketable securities, municipal bonds, mutual funds, investments, and cash.[76] The sole general partner of Streightoff Investments was Streightoff Management, LLC, managed by Frank's daughter, Elizabeth Doan Streightoff.[77] The limited partners were Frank, his children, and a former daughter-in-law.[78] Frank held an 88.99% limited partnership interest.[79] The partnership agreement provided that limited partners holding 75% of the partnership interests could remove a general partner and reconstitute the partnership with a successor general partner.[80] The agreement also stated that a limited partner could not sell or assign an interest in Streightoff Investments without meeting certain requirements, including obtaining approval from the general partner.[81]

On the same day that Streightoff Investments was formed, Frank established a revocable trust and transferred his 88.99% limited partnership interest to such trust.[82] Frank was the sole beneficiary of the trust during his lifetime, and he retained the power to amend and revoke the trust.[83] Elizabeth was named as the sole trustee.[84] Frank's transfer of his interest to the trust was a permitted transfer under the terms of the partnership agreement.[85]

Frank died on May 6, 2011.[86] On August 9, 2012, his estate filed a federal estate tax return, showing a gross estate (less exclusion) of $5,051,299.[87] The estate valued the 88.99% limited partnership interest at $4,588,000 by using a net asset value of $7,307,951 and 37.2% of discounts for lack of marketability, control, and liquidity.[88] The IRS issued a notice of deficiency for $491,750 based on its

75. *Id.*
76. *Id.*
77. *See id.* at *2–*3.
78. *Estate of Streightoff*, 2018 Tax Ct. Memo LEXIS 179, at *3.
79. *See id.* at *7.
80. *Id.* at *4.
81. *Id.*
82. *Id.* at *7.
83. *Estate of Streightoff*, 2018 Tax Ct. Memo LEXIS 179, at *7.
84. *Id.* at *7–*8.
85. *Id.* at *9.
86. *Id.* at *1.
87. *Id.* at *9.
88. *See Estate of Streightoff*, 2018 Tax Ct. Memo LEXIS 179, at *10.

determination that the fair market value of the partnership interest was $5,993,000.[89] The estate challenged the notice of deficiency.[90]

The Tax Court detailed the scope of the dispute as follows: "[t]he parties disagree as to the type of interest that must be valued and included in the value of decedent's gross estate."[91] On the one hand, the estate asserted that the interest was an assignee interest and should be valued on that basis.[92] On the other hand, the IRS argued that the revocable trust held a limited partnership interest and that valuation as such an interest was appropriate.[93]

As a threshold matter, the court indicated that it would "consider both the form and the substance of decedent's transfer to the revocable trust to determine whether the property interest transferred was an assignee interest or a limited partnership interest."[94] The court determined that "the form of the agreement establishes that decedent transferred to the revocable trust a limited partnership interest and not an assignee interest," and that "[t]he economic realities underlying the transfer of decedent's interest also support our conclusion that the transferred interest should be treated as a limited partnership interest for Federal estate tax purposes."[95] However, the court ultimately concluded that, "regardless of whether an assignee or a limited partnership interest had been transferred, there would have been no substantial difference before and after the transfer to the revocable trust."[96]

The Tax Court noted that "[t]here were no votes by limited partners following the execution of the agreement."[97] The court observed that, even assuming the revocable trust held only an assignee interest in the partnership, Frank had the ability to revoke the trust, thereby reinstating his limited partner rights.[98] Moreover, "Streightoff Management as the general partner could have treated the holder of an assignee interest as a substitute limited partner."[99] Thus, the court explained, "[u]nder the facts and circumstances of this case, there was

89. *See id.* at *10–*11.
90. *See id.* at *11.
91. *Id.* at *14.
92. *See id.*
93. *Estate of Streightoff*, 2018 Tax Ct. Memo LEXIS 179, at *14.
94. *Id.* at *16.
95. *Id.* at *19.
96. *Id.* (citing Kerr v. Comm'r, 113 T.C. 449, 467–68 (1999)).
97. *Id.* at *20.
98. *See Estate of Streightoff*, 2018 Tax Ct. Memo LEXIS 179 at *20.
99. *Id.* at *20–*21.

no difference in substance between the transfer of a limited partnership interest in Streightoff Investments and the transfer of an assignee interest in that limited partnership interest."[100]

On the issue of valuation, the Tax Court noted that the parties had stipulated to the net asset value of the partnership, making the primary issue the discounts applicable to the 88.99% limited partnership interest.[101] The court agreed with the IRS that a discount for lack of control was not appropriate because the 88.99% limited partnership interest exceeded the 75% needed to remove the general partner and terminate the partnership.[102] On the discount for lack of marketability, the court accepted the position of the IRS's expert, who had concluded that a discount of 18% was appropriate because "the diversification and high liquidity of the assets would make an interest in the partnership highly attractive to a hypothetical buyer" and "the amount of control provided by an 88.99% limited partnership interest is a factor favoring a lower discount."[103] The court was not persuaded by the report of the estate's expert, which had concluded that the discount for lack of marketability was 27.5%.[104] In particular, the court emphasized the testimony of the estate's expert that "his analysis for the lack of marketability discount would have included different considerations if the interest was a limited partnership interest with voting rights under the partnership agreement."[105]

II. DEVELOPMENTS AT THE STATE LEVEL

In contrast to the significant developments at the federal level, New York had another quiet *Survey* period in terms of statutory, regulatory, and case law developments. Below are a few of the statutory, regulatory, and case developments that warrant discussion.

100. *Id.* at *21 (first citing *Kerr*, 113 T.C. at 467–68; and then citing Astleford v. Comm'r, 95 T.C.M. (CCH) 1497, 2008 Tax Ct. Memo LEXIS 129 at *16 (May 5, 2008)).

101. *See id.* at *22.

102. *Id.* at *22–*23.

103. *See Estate of Streightoff*, 2018 Tax Ct. Memo LEXIS 179 at *25, *27–*28.

104. *See id.* at *27.

105. *Id.*

A. New York Statutory and Regulatory Law

1. Gift Add-Back

On April 10, 2019, Governor Cuomo announced the New York Fiscal Year 2020 Budget.[106] As part of this budget, the Legislature extended the three-year add-back provisions of Tax Law section 954(a)(3).[107] Section 954(a)(3) provides that the estate of a New York resident includes the amount of any taxable gifts made by such resident in the three years preceding death.[108] As explained in the Memorandum of Support for the legislation, "[t]his requirement was added to deter New York residents from transferring large amounts of wealth shortly before death solely to take advantage of the higher federal estate tax thresholds, while at the same time reducing their otherwise taxable New York estate."[109] However, prior to the enactment of the 2020 Budget, this clawback provision was only to apply to residents dying before January 1, 2019.[110]

This expiration date had been implemented "because on that date the New York and federal estate tax thresholds were expected to coincide, eliminating the incentive for deathbed gifts."[111] With the enactment of the TCJA, the equalization of exemption amounts at the federal and state level would no longer occur on January 1, 2019.[112] Thus, without extension of section 954(a)(3), there would now be an incentive for New York residents to make deathbed gifts.[113] To avoid this potential loss of revenue, under the 2020 Budget, the application of section 954(a)(3) is extended to residents dying after January 16, 2019 but prior to January 1, 2026.[114]

106. State of N.Y, *Governor Cuomo Announces Highlights of FY 2020 Budget*, NY.GOV (Apr. 10, 2019), https://www.governor.ny.gov/news/governor-cuomo-announces-highlights-western-new-york-fy-2020-enacted-budget.

107. *Id.*

108. N.Y. TAX LAW § 954(a)(3) (McKinney 2014).

109. N.Y. STATE ASSEMBLY, *supra* note 4, at 13.

110. *See id.*

111. *See id.*

112. *See id.*

113. *See id.*

114. N.Y. STATE ASSEMBLY, *supra* note 4, at 13. In a strange quirk of the new law, the gift add back does *not* apply to decedents dying between January 1 and 15, 2019. This is because Governor Cuomo's initial budget containing the extension of the provision was released on January 15, 2019. *See* State of N.Y. Div. of the Budget, *Governor Cuomo Outlines 2019 Justice Agenda: The Time Is Now*, NY.GOV (Jan. 15, 2019), https://www.budget.ny.gov/pubs/press/2019/pr-eBudgetfy20.html.

2. 529 Plan Withdrawals

In December 2018, the New York Department of Taxation issued Technical Memorandum TSB-M-18(6)I which, among other things, indicated that New York would not follow the TCJA with respect to qualified withdrawals from 529 plans.[115] New York Education Law section 695-b defines "eligible educational institution" as "any institution of higher education defined as an eligible educational institution in section 529(e)(5) of the Internal Revenue Code of 1986, as amended."[116] Section 529(e)(5) provides that such term means an institution described in 20 U.S.C. section 1088 (i.e., an institution providing undergraduate or graduate programs).[117]

The TCJA did not alter the definition in I.R.C. section 529(e)(5) in order to allow withdrawals from 529 plans to cover tuition expenses for elementary or secondary school.[118] Instead, it added section 529(c)(7), which provides that "[a]ny reference in this subsection [i.e., (c)] 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."[119] Thus, because the New York statute references the definition in subsection (e) and has no overlap with the language in subsection (c), "[f]or New York purposes, withdrawals for kindergarten through 12th grade school tuition are not qualified withdrawals under the New York 529 college savings account program."[120]

B. New York Case Law: In Re Evelyn Seiden

In *In re Evelyn Seiden*, the surrogate's court for New York County considered "the effect of the federal estate tax repeal for the year 2010 on the New York estate tax attributable to 'QTIP' trusts for surviving spouses of individuals who died in that year."[121] Jules Seiden

115. N.Y. STATE DEP'T OF TAXATION AND FIN., NEW YORK STATE DECOUPLES FROM CERTAIN PERSONAL INCOME TAX INTERNAL REVENUE CODE (IRC) CHANGES FOR 2018 AND AFTER 2 (2018), https://www.tax.ny.gov/pdf/memos/income/m18-6i.pdf.

116. N.Y. EDUC. LAW § 695-b(5) (McKinney 2019).

117. I.R.C. § 529(e)(5); 20 U.S.C. § 1088(b) (2018).

118. *See* Robert Farrington, *How to use a 529 Plan for Private Elementary and High School*, THE COLLEGE INVESTOR (last updated Oct. 9, 2019), https://thecollegeinvestor.com/21959/529-plan-private-school/.

119. I.R.C. § 529(c)(7).

120. N.Y. STATE DEP'T OF TAXATION AND FIN., *supra* note 115, at 2.

121. No. 2014-4802/B, 2018 N.Y. Slip Op. 32541(U), at 1 (Surr. Ct. N.Y. Cty. Oct. 9, 2018).

died in 2010.[122] Under his will, Jules created a trust for the benefit of his wife, Evelyn, which "was eligible for estate tax treatment as Qualified Terminable Interest Property, known as a 'QTIP' trust."[123] In order for a trust to qualify as a QTIP trust, the estate "must make a specific election on its federal estate tax return."[124] I.R.C. section 2044 provides that trust property for which a marital deduction "was allowed" must be included in the estate of the surviving spouse.[125] However, as a result of the repeal of the federal estate tax in 2010, Jules's estate was not required to file a federal estate tax return.[126] On the New York estate tax return, the estate elected QTIP treatment for the trust for Evelyn, filing a pro forma federal return with the New York return and reporting a marital deduction for the trust property.[127]

Evelyn died in 2014.[128] On the federal estate tax return, her estate did not include the value of the trust property "on the basis that no federal marital deduction had been claimed or 'allowed' in the husband's estate, as is required to trigger inclusion in the second estate under I.R.C. § 2044."[129] The IRS issued a closing letter accepting the estate tax return.[130] On the New York estate tax return, Evelyn's estate also excluded the trust property, "taking the position that New York law defines its gross estate by reference to the federal gross estate, which clearly excludes the property."[131] Unsurprisingly, the New York Department of Taxation disagreed with the stance taken by the estate, assessing an additional estate tax of $462,546.18.[132] The estate sought to vacate the deficiency.[133]

The surrogate's court observed that

> [t]he estate argues that I.R.C. § 2044 has no application to the wife's estate because, as stated above, no federal marital deduction was allowed in the estate of her predeceased husband. Since the trust property is not includible in her federal gross estate, it follows, the estate

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122. *See id.*
123. *Id.*
124. *Id.* at 1–2 (citing I.R.C. § 2056(b)(7)(B)(i)(III)).
125. *See id.* at 2; I.R.C. § 2044(c).
126. *In re Seiden*, 2018 N.Y. Slip Op. 32541(U), at 2.
127. *See id.* at 2–3.
128. *Id.* at 1.
129. *Id.* at 3.
130. *Id.*
131. *In re Seiden*, 2018 N.Y. Slip Op. 32541(U), at 3.
132. *Id.*
133. *Id.*

> maintains, that the property is not includible in her New York gross estate, which is defined solely by reference to the federal definition.[134]

In support of this position, the estate cited New York Tax Law section 954(a): "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). . . ."[135] In opposition, the Tax Department emphasized that section 951, as in effect in 2010, provided that "[A]ny reference to the Internal Revenue Code means the United States Internal Revenue Code of 1986, with all amendments enacted on or before July 22, 1998."[136] Accordingly, the Tax Department asserted:

> the reference in [Tax Law] § 954(a) to the internal revenue code means the internal revenue code as it existed on July 22, 1998, when a federal marital deduction was 'allowed,' making IRC § 2044 operative under New York's tax regime to require inclusion of the trust property in the second estate.[137]

The surrogate's court rejected the analysis of the Tax Department, concluding that:

> [T]he relevant tax laws is that which existed in 2014, when decedent died, and not in 2010, because it is the tax on the wife's estate that concerns us here. In 2014, TL § 951(a) was rewritten to change references to the federal tax law from that in effect on July 22, 1998, to the law as in effect on January 1, 2014. The statute as amended was made applicable to estates of persons, like decedent, who died after April 1, 2014. Under the federal tax law in effect on January 1, 2014, no marital deduction was 'allowed' for decedents dying in 2010.[138]

Additionally, the court observed, "even under the law as it existed prior to 2014, no federal marital deduction was 'allowed' in the husband's estate."[139] The court noted the decision of the tax court in *Estate of Morgens v. C.I.R.*, which stated:

> Three requirements must be met for terminable interest property to qualify as QTIP: (1) The property passes from the decedent, (2) the surviving spouse has a qualifying income interest for life in the

134. *Id.*
135. *Id.* at 3–4 (citing TAX § 954(a)).
136. *In re Seiden*, 2018 N.Y. Slip Op. 32541(U), at 4 (citing TAX § 951)).
137. *Id.*
138. *Id.*
139. *Id.*

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> property, and (3) *the executor of the estate of the first spouse to die makes an affirmative election to designate the property as QTIP*.[140]

Finally, the surrogate's court rejected the Tax Department's argument based on a "duty of consistency," which would prevent Evelyn's estate from taking one position on the tax return when Jules's estate had taken a different position.[141] The court determined that:

> The flaw in this argument is twofold: the husband's estate did not make an error or omission, and the wife's estate has not taken a contrary position. Both estates followed the law in effect at the time of their decedents' respective deaths. In a related argument the Tax Department attempts to show that it 'relied' to its detriment on the husband's estate return by allowing the statute of limitations to run on the claim for a marital deduction. But that claim was entirely lawful, and the Tax Department cites no authority for how it might properly have denied that deduction.[142]

The court agreed with the estate's argument that, "it is entitled to rely on the plain language of the statute, without resort to speculation about what the legislature intended."[143] The court emphasized that the legislature had amended the Tax Law in other respects to account for changes to the federal tax law, "but, in the eight years since the repeal of federal tax for the year 2010, has not acted to change the effect of the repeal on QTIP property in the circumstances of this case."[144] The surrogate's court concluded its opinion as follows:

> Lastly, the Tax Department posits that a decision vacating the deficiency in this case will 'open the floodgates' to tax avoidance. As the estate points out, however, the legislature could still amend the Tax Law to apply to future estates. Moreover, it is not guaranteed that all or even part of any QTIP trust would be subject to New York estate tax at the death of the surviving spouse under present law. The trust property might decrease in value; it might be distributed and spent down; or the surviving spouse might change domicile to another state.[145]

Accordingly, the court granted the estate's petition and vacated the tax deficiency.[146]

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140. *Id.* at 5 (quoting Estate of Morgens v. C.I.R., 133 T.C. 402, 410–11 (2009)).

141. *In re Seiden*, 2018 N.Y. Slip Op. 32541(U), at 6.

142. *Id.* at 6–7.

143. *Id.* at 7.

144. *Id.*

145. *Id.* at 8.

146. *Id.* Subsequent to the surrogate's court's decision, the New York legislature did indeed amend the Tax Law to prevent the result from recurring. As explained in the Memorandum of Support:

> In light of the fact that New York's estate tax will continue to diverge from the federal estate tax in effect in future years, it is important to clarify the manner by which a QTIP election must be reflected on a transferring spouse's New York estate tax return, in order to avoid inconsistent elections and potential revenue loss to the State. This bill would address this issue first by amending Tax Law § 954 to require that any QTIP property that benefited from a previous New York marital deduction must be included in the surviving spouse's New York gross estate, whether the QTIP election was made on the transferring spouse's New York estate tax return or via a federal pro forma return if an actual federal return was not otherwise required. In addition, this bill would amend Tax Law § 955 to require that the QTIP election for New York estate tax purposes be made on the New York estate tax return of the transferring spouse.

N.Y. STATE ASSEMBLY, *supra* note 4, at 13.