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July 2, 2010

The Honorable David A. Paterson
New York State Governor
Executive Chamber
State Capitol
Albany, NY 12224

Re: A.9857-C/S.8056 – regarding generation-skipping transfer tax laws - Support with Suggested Modification

Dear Governor Paterson:

I am writing on behalf of the Committee on Estate and Gift Taxation and Committee on Trusts, Estates and Surrogate's Courts of the New York City Bar Association to urge that A.9857-C/S.8056 be amended before becoming law.

This legislation would modify the Estates Powers and Trusts Law in relation to credit shelter and similar formula provisions in Wills and Trusts and provisions in Wills and Trusts relating to the unused generation-skipping transfer ("GST") tax exemption after federal estate and GST tax repeal in 2010. The Committees believe that the legislation is necessary to remedy unintended and potentially severe consequences that may result from such formula bequests or other dispositions under documents executed prior to repeal.

While we support the idea of this legislation, we believe that the application of the statute should be limited to direct skips to natural persons so as not to cause unintended GST taxes on trust distributions in later years. We recommend a modification that would achieve this end. If, however, the intent of the statute is to reach all GST tax transfers – something we urge against - then the bill should be amended to delete language that is superfluous and confusing. We respectfully submit that the amendments to the bill outlined in the attached memo would bring the legislation closer to accomplishing the true spirit of the bill.

I attach for your reference: (i) our original memo in support with modification; (ii) Assembly Member Carrozza's response; and (iii) our supplemental memo in support with modification. Thank you for your consideration. The Committees are happy to provide whatever further assistance would be helpful.

Respectfully,

Michael Frankel

Michael Frankel

Cc: Hon. Ann-Margaret Carrozza
Hon. Carl Kruger



**NEW YORK
CITY BAR**

Contact: Maria Cilenti - Director of Legislative Affairs - mcilenti@nycbar.org - (212) 382-6655

**SUPPLEMENTAL REPORT ON LEGISLATION BY
THE COMMITTEE ON ESTATE & GIFT TAXATION AND
THE COMMITTEE ON TRUSTS, ESTATES & SURROGATE'S COURT**

**A.9857-C
S.8056**

**M. of A. Carrozza
Sen. Kruger**

AN ACT to amend the estates, powers and trusts law, in relation to certain formula clauses to be construed to refer to the federal estate and generation-skipping transfer tax laws applicable to estates of decedents dying after December 31, 2009 and before January 1, 2011.

THIS BILL IS APPROVED WITH MODIFICATION

This supplemental memorandum is offered by the Estate and Gift Taxation Committee and Trusts, Estates and Surrogate's Court Committee of the New York City Bar Association (the "Committees") in support of A.9857-C/S.8056, to modify the Estates Powers and Trusts Law in relation to credit shelter and similar formula provisions in Wills and trusts and provisions in Wills and trusts relating to the unused generation-skipping transfer ("GST") tax exemption after federal estate and GST tax repeal in 2010. We support the bill with one important modification, as further described below.

The Committees believe that the legislation is necessary to remedy unintended and potentially severe consequences that may result from such formula bequests or other dispositions under documents executed prior to repeal. However, we disagree with the provisions regarding bequests and other dispositions that refer to the GST tax exemption.

This bill contains language regarding the GST tax that is superfluous and confusing. In our initial memorandum in support of the legislation (a copy of which is attached), we urged modification of the bill's provisions regarding the GST tax so that the remedial legislation would apply only to direct skips to natural persons. In that regard, we suggested that the legislation should apply to any bequest that (i) makes reference to the GST provisions of the Code and (ii) is a "direct skip to a natural person." However, the sponsor declined to adopt our suggested modification. Rather than limiting the provision's applicability to direct skips to natural persons, the Assembly substituted "or" for "and." (See Section 1, subdivision (a)(2), line 15.) This change makes the bill, as currently written, applicable to all GST type transfers. If that is the intent of the legislation, then the reference to "direct skips to natural persons" is unnecessary and confusing. Therefore, while we again urge that the legislation be limited to such direct skips, if it is not so limited, then the reference to "direct skip to a natural person" should be removed from the legislation as follows:

(2) IF BY REASON OF THE DEATH OF A DECEDENT PROPERTY PASSES OR IS ACQUIRED UNDER A BENEFICIARY DESIGNATION, IN THE CASE OF A WILL OR TRUST OF A DECEDENT WHO DIES AFTER DECEMBER THIRTY-FIRST, TWO THOUSAND NINE AND BEFORE JANUARY FIRST, TWO THOUSAND ELEVEN, THAT CONTAINS A BEQUEST OR OTHER DISPOSITION BASED UPON THE AMOUNT OF PROPERTY THAT CAN BE SHELTERED FROM FEDERAL GENERATION-SKIPPING TRANSFER TAX BY REFERRING TO THE "GENERATION-SKIPPING TRANSFER TAX EXEMPTION", "GST EXEMPTION", "GENERATION-SKIPPING TRANSFER TAX", "GST TAX" OR SIMILAR WORDS OR PHRASES THAT MEASURES A SHARE OF AN ESTATE OR TRUST BASED ON THE AMOUNT THAT CAN PASS FREE OF FEDERAL GENERATION-SKIPPING TRANSFER TAXES, OR THAT IS OTHERWISE BASED ON A SIMILAR PROVISION OF FEDERAL GENERATION-SKIPPING TRANSFER TAX LAW; ~~OR IF SUCH BEQUEST WOULD HAVE PASSED AS A "DIRECT SKIP" TO A "NATURAL PERSON" WITHIN THE MEANING OF SUCH TERMS UNDER CHAPTER 13 OF THE INTERNAL REVENUE CODE OF 1986 IF THE DECEDENT HAD DIED ON DECEMBER THIRTY-FIRST, TWO THOUSAND NINE,~~ THEN SUCH WILL OR TRUST SHALL BE DEEMED TO REFER TO THE FEDERAL GENERATION-SKIPPING TRANSFER TAX LAW IN EFFECT ON DECEMBER THIRTY-FIRST, TWO THOUSAND NINE.

We remain concerned, however, with having the legislation apply to all GST type bequests or other transfers under Wills and Trusts of decedents dying in 2010 (rather than only to direct skips to natural persons). As stated in our prior memorandum, such application may result in future adverse GST tax consequences, for example, with respect to transfers in trust, since the GST exemption may not be allocated to transfers that occur in 2010. In addition, when the GST exemption may be allocated (in 2011 or thereafter), the GST exemption may be less than the amount passing pursuant to 2009 law. Therefore, future distributions may attract a GST tax.

For these reasons we initially urged that the bill's GST tax provisions be limited to apply only to direct skips to natural persons. In response, the Assembly sponsor raised a concern that our proposed modification may create the potential of disinheriting a spouse or children (a copy of Assembly Member Carrozza's memo is attached). It is true that this might occur, but only if the Will or Trust language referred to "an amount that can pass free of GST tax," or similar wording, without also saying "by reason of the GST tax exemption," or similar wording. In order to address this concern, other GST type bequests should be interpreted to mean "zero" so as to avoid the potential GST tax from applying in future years. In that case, the threat of disinheriting a spouse or children is not present. To achieve that result, the bill could be modified as follows:

(2) IF BY REASON OF THE DEATH OF A DECEDENT PROPERTY PASSES OR IS ACQUIRED UNDER A BENEFICIARY DESIGNATION, IN THE CASE OF A WILL OR TRUST OF A DECEDENT WHO DIES AFTER DECEMBER THIRTY-FIRST, TWO THOUSAND NINE AND BEFORE JANUARY FIRST, TWO THOUSAND ELEVEN, THAT CONTAINS A BEQUEST OR OTHER DISPOSITION BASED UPON THE AMOUNT OF PROPERTY THAT CAN BE SHELTERED FROM FEDERAL GENERATION-SKIPPING TRANSFER TAX BY REFERRING TO THE "GENERATION-SKIPPING TRANSFER TAX EXEMPTION", "GST EXEMPTION", "GENERATION-SKIPPING TRANSFER TAX", "GST TAX" OR SIMILAR WORDS

OR PHRASES THAT MEASURES A SHARE OF AN ESTATE OR TRUST BASED ON THE AMOUNT THAT CAN PASS FREE OF FEDERAL GENERATION-SKIPPING TRANSFER TAXES, OR THAT IS OTHERWISE BASED ON A SIMILAR PROVISION OF FEDERAL GENERATION-SKIPPING TRANSFER TAX LAW ("A GST BEQUEST") ~~AND OR~~ IF SUCH GST BEQUEST WOULD HAVE PASSED AS A "DIRECT SKIP" TO A "NATURAL PERSON" WITHIN THE MEANING OF SUCH TERMS UNDER CHAPTER 13 OF THE INTERNAL REVENUE CODE OF 1986 IF THE DECEDENT HAD DIED ON DECEMBER THIRTY-FIRST, TWO THOUSAND NINE, THEN SUCH WILL OR TRUST SHALL BE DEEMED TO REFER TO THE FEDERAL GENERATION-SKIPPING TRANSFER TAX LAW IN EFFECT ON DECEMBER THIRTY-FIRST, TWO THOUSAND NINE. ANY OTHER SUCH GST BEQUEST OR OTHER DISPOSITION (OTHER THAN A DIRECT SKIP TO A NATURAL PERSON) SHALL BE DEEMED TO BE A BEQUEST OR OTHER DISPOSITION OF ZERO.

CONCLUSION

For the sake of avoiding unintended consequences and achieving greater clarity in this much-needed legislation, the Committees urge the bill's modification before it is signed into law.

Thank you for your consideration. Please feel free to contact the undersigned with any further questions or concerns.

Committee on Estate and Gift Taxation
Michael Frankel, Chair
(212) 238-8802

June 2010



NEW YORK
CITY BAR

Contact: Maria Cilenti - Director of Legislative Affairs - mcilenti@nycbar.org - (212) 382-6655

**REPORT ON LEGISLATION BY
THE COMMITTEE ON ESTATE & GIFT TAXATION AND
THE COMMITTEE ON TRUSTS, ESTATES & SURROGATE'S COURT**

A.9857-C

M. of A. Carrozza

AN ACT to amend the estates, powers and trusts law, in relation to certain formula clauses to be construed to refer to the federal estate and generation-skipping transfer tax laws applicable to estates of decedents dying after December 31, 2009 and before January 1, 2011

THIS BILL IS APPROVED WITH MODIFICATION

This memorandum is offered by the Estate and Gift Taxation Committee and Trusts, Estates and Surrogate's Court Committee of the Association of the Bar of the City of New York (the "Committees") in support of Assembly Bill number A.9857-C, to modify the Estates Powers and Trusts Law in relation to credit shelter and similar formula provisions in Wills and trusts and provisions in Wills and trusts relating to the unused generation-skipping transfer ("GST") tax exemption after federal estate and GST tax repeal in 2010. We support the bill with one modification, as further described below.

The Committees believe that the legislation is necessary to remedy unintended and potentially severe consequences that may result from such formula bequests or other dispositions under documents executed prior to repeal.

Background

Under Section 2210 of the Internal Revenue Code of 1986, as amended (the "Code"), the estate tax will not apply to decedents dying in 2010. This Section, along with other significant changes to the federal estate, gift and generation-skipping transfer taxes, was added to the Code as part of the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA").¹ Due to the sunset provisions of EGTRRA, the estate, gift and generation-skipping transfer tax provisions of EGTRRA will sunset after December 31, 2010, resulting in reinstatement of the pre-2001 federal transfer taxes.

Prior to repeal, Section 2010 of the Code provided each estate with a credit against the estate tax equal to the amount of tax that would have been due on a certain sum. That sum, referred to in the Code as the "applicable exclusion amount" and often referred to colloquially as the "unified credit amount" or "credit shelter amount," was \$1,000,000 in 2001 when EGTRRA was enacted, and

¹ P.L. 107-16.

increased gradually to \$3.5 million in 2009. In addition, prior to the repeal of the estate tax, the Code provided an unlimited marital deduction for property passing outright or in certain trusts to or for the benefit of surviving U.S. citizen spouses. As a result, many wills and revocable trusts include formula bequests intended to divide a decedent's estate into two primary shares: one which sets aside the maximum amount that could pass under Section 2010 of the Code without federal estate tax, with the remaining share passing to the surviving spouse (in the case of married testators). A formula used to determine the applicable exclusion, or credit shelter, amount frequently is phrased in terms of the maximum amount that can pass free of federal estate tax (to someone other than the surviving spouse) and may include a specific reference to Section 2010 of the Code. Alternatively, the formula could describe a pecuniary amount payable to the surviving spouse as the minimum amount necessary to avoid a federal estate tax taking into account all applicable credits under the Code.

With the repeal of the estate tax, these formula bequests based on prior tax law may result in significant and unintended consequences. For example, a bequest to children of the maximum amount that can pass free of federal estate tax with the balance passing to the surviving spouse may completely disinherit the surviving spouse and may force the spouse to exercise his or her right to the elective share amount under state law.² If the will refers to Code Section 2010, it is unclear whether any amount would pass to the children under the bequest (since Section 2010 of the Code is not effective in the year 2010).

Similarly, many documents refer specifically to the amount that can pass free of the generation-skipping transfer, or GST, tax under the exemption provided in Section 2632 of the Code. These bequests may create sufficient ambiguity as to the amount, if any, of such bequests and the identity of the beneficiaries so as to force the executor to file a construction proceeding in the Surrogate's Court. For example, a bequest of the "amount that can pass free of the GST tax" may result in the entire estate payable to a grandchild or more remote descendant rather than to the surviving spouse and children. Alternatively, a gift of the amount that can pass under the exemption provided under Section 2632 may be void since the exemption does not exist in 2010.

Some practitioners may have drafted documents to take into account the possibility of repeal under EGTRRA; however, many existing wills and trusts do not take into account that the federal estate tax or GST tax law may not be in effect at the time of death. The result is that many wills and trusts of decedents dying in 2010 will be construed in a manner that is inconsistent with the intent of the decedent and may have severe results. In those cases, a construction proceeding may not offer a remedy. Absent legislation, if a bequest under a Will or Revocable Trust is unambiguous on its face, say, for example, a bequest of the "maximum amount that can pass free of federal estate tax," extrinsic evidence, including statements by the attorney-draftsman regarding the testator's intent, may not be admissible.³

² See N.Y. EPTL § 5-1.1-A.

³ In general, extrinsic evidence is admissible in a construction proceeding only if a Will provision is ambiguous. See *In re Baylis*, 78 N.Y.S.2d 893 (Sur. Ct. Queens County, 1948); *In re Fowles*, 158 N.Y.S. 456 (Sur. Ct. New York County 1916). See Warren's Heaton on Surrogate's Court Practice § 190.01[3]. Accordingly, extrinsic evidence is ordinarily not admissible "to vary, contradict or add terms or to show an intention different from that disclosed by language used in the will," Warren's Heaton § 190.01[1][a]. See also *In re Cord's Estate*, 58 N.Y.2d 539 (1983).

Proposed Legislation

The proposed legislation addresses the unintended consequences of estate tax repeal by construing certain formula bequests or other dispositions of property as if they were made pursuant to the Code provisions that were in effect on December 31, 2009.⁴ In that regard, we support the proposed legislation.

However, with respect to the GST tax, we believe that any remedial legislation must be tailored narrowly to the specific circumstance of a GST bequest that is a direct skip to a natural person (as those terms are defined in Chapter 13 of the Code in effect on December 31, 2009). We considered whether the legislation should be enacted to interpret all references to the GST tax or GST tax exemption under the law in effect on December 31, 2009 (as set forth in the original bill), however, we concluded that such broad legislation could have unintended negative consequences. For example, if a transfer is made to a trust in 2010 intended to exploit the GST tax exemption in effect on December 31, 2009, there may be no GST tax upon the initial transfer. However, distributions from that trust in the future may be subject to a generation-skipping transfer tax, since there is no GST tax exemption that may currently be allocated to the bequest, and the available exemption that may be allocated in 2011 may be less than the exemption that was available on December 31, 2009. In the case of a direct skip to a natural person, there is no possibility that a future distribution will generate a GST tax. As a result, we believe that the GST provisions should be limited to such direct skips and the proposed modifications reflect those concerns.

Therefore, we suggest that subparagraph (A)(2) of proposed Section 2-1.13 be modified as follows:

(2) IF BY REASON OF THE DEATH OF A DECEDENT PROPERTY PASSES OR IS ACQUIRED UNDER A BENEFICIARY DESIGNATION, IN THE CASE OF A WILL OR TRUST OF A DECEDENT WHO DIES AFTER DECEMBER THIRTY-FIRST, TWO THOUSAND NINE AND BEFORE JANUARY FIRST, TWO THOUSAND ELEVEN, THAT CONTAINS A BEQUEST OR OTHER DISPOSITION BASED UPON THE AMOUNT OF PROPERTY THAT CAN BE SHELTERED FROM FEDERAL GENERATION-SKIPPING TRANSFER TAX BY REFERRING TO THE "GENERATION-SKIPPING TRANSFER TAX EXEMPTION", "GST EXEMPTION", "GENERATION-SKIPPING TRANSFER TAX", "GST TAX" OR SIMILAR WORDS OR PHRASES THAT MEASURES A SHARE OF AN ESTATE OR TRUST BASED ON THE AMOUNT THAT CAN PASS FREE OF FEDERAL GENERATION-SKIPPING TRANSFER TAXES, OR THAT IS OTHERWISE BASED ON A SIMILAR PROVISION OF FEDERAL GENERATION-SKIPPING TRANSFER TAX LAW; ~~OR IF SUCH BEQUEST WOULD HAVE PASSED AS A "DIRECT SKIP" TO A "NATURAL PERSON" WITHIN THE MEANING OF SUCH TERMS UNDER CHAPTER 13 OF THE INTERNAL REVENUE CODE OF 1986 IF THE DECEDENT HAD DIED ON DECEMBER THIRTY FIRST, TWO THOUSAND NINE, AND SUCH BEQUEST OR~~

⁴ There is historical support for this type of remedial legislation. Similar legislation was enacted in 2000 in order to address provisions relating to the credit for state death taxes in Wills executed prior to February 1, 2000 after the change in New York State's estate tax law to a "sponge tax" on February 1, 2000. EPTL §2-1.12 (Under this Section, certain formula bequests that included a reference to the credit for state death taxes will be deemed not to include the reference, absent evidence of a contrary intent).

OTHER DISPOSITION WOULD HAVE PASSED AS A “DIRECT SKIP” TO A “NATURAL PERSON” WITHIN THE MEANING OF SUCH TERMS UNDER CHAPTER 13 OF THE INTERNAL REVENUE CODE OF 1986 IN EFFECT ON DECEMBER THIRTY-FIRST, TWO THOUSAND NINE, THEN SUCH WILL OR TRUST SHALL BE DEEMED TO REFER TO THE FEDERAL GENERATION-SKIPPING TRANSFER TAX LAW IN EFFECT ON DECEMBER THIRTY-FIRST, TWO THOUSAND NINE.

May 2010



THE ASSEMBLY
STATE OF NEW YORK
ALBANY

DEPUTY MAJORITY WHIP

COMMITTEES
Aging
Insurance
Rules
Steering

ANN-MARGARET CARROZZA
Assemblywoman 26th District
Queens County

A 9857-C

RESPONSE TO REPORT OF NEW YORK CITY BAR

The report on A 9857-C (the "Bill") of The Committee on Trusts, Estates and Surrogate's Court of the New York City Bar ("Report") aptly summarizes problems that Bill attempts to resolve with respect to temporary generation-skipping transfer tax repeal when it states:

Similarly, many documents refer specifically to the amount that can pass free of the generation-skipping transfer, or GSWT, tax under the exemption provided in Section 2632 of the Code. These bequests may create sufficient ambiguity as to the amount, if any, of such bequests and the identity of the beneficiaries so as to force the executor to file a construction proceeding in the Surrogate's Court. For example, a bequest of the "amount that can pass free of the GST tax" may result in the entire estate payable to a grandchild or more remote descendant rather than to the surviving spouse and children. Alternatively, a gift of the amount that can pass under the exemption provided under Section 2632 may be void since the exemption does not exist in 2010.

The Bill attempts to solve the problem and to create certainty by providing that reference to the "Generation-skipping transfer tax exemption", "GST exemption" and similar references in a Will or Trust executed before 2010 in the case of a decedent who dies in 2010 during repeal of the generation-skipping transfer tax, will be interrupted based on the law in effect on December 31, 2009. The Report, however, would limit these provisions of the Bill to direct skips to natural persons.

The reasoning in the Report is that there is uncertainty as to whether a grantor's GST exemption may be allocated to a trust while repeal is in effect. If that is the case, later distributions from the trust would be subject to GST tax after the generation-skipping transfer tax is reinstated. This problem would not occur in the case of direct skip transfers directly to a natural person. Other unspecified problems are also alluded to. The question is which is the greater evil; preventing children and spouses from being

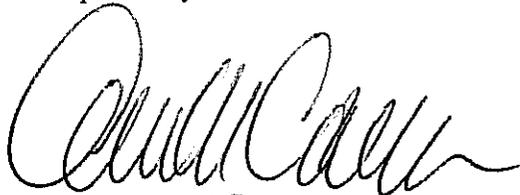
disinherited or setting the stage for possible GST taxes in the future, assuming Congress does not act to remedy the problem raised by the Report. We opt for the solution in the Bill.

The Report of the City Bar Association provides no solution to the basic problem addressed in the Bill and leaves it unsolved. In fact, the very result the Report wishes to avoid could occur if the Bill applied *only* to direct skips to natural persons. In that event, a formula bequest to a trust might result in a greater amount than contemplated (or even all) passing to a trust to which the decedent's GST exemption might not be able to be allocated.

Furthermore, some of the concerns expressed in the Report might be remedied by the Bill's provisions concerning a testator who manifests a contrary intent, and by provisions in the Bill for a construction proceeding.

It should be noted also that neither Virginia, which has enacted similar provisions to the Bill, or to our knowledge other states considering similar bills, have a limitation such as that proposed by the City Bar Association in its Report.

Respectively Submitted,

A handwritten signature in black ink, appearing to read "Ann-Margaret Carrozza". The signature is fluid and cursive, with a large initial "A" and "M".

Ann-Margaret Carrozza

Member of Assembly