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REPORT ON LEGISLATION BY THE COMMITTEE ON ESTATE & GIFT TAXATION AND THE COMMITTEE ON TRUSTS, ESTATES & SURROGATE'S COURTS[1]

A.9857-C **M. of A. Carrozza**
S.8056 **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 memorandum is offered by the Estate and Gift Taxation Committee and Trusts, Estates and Surrogate's Courts Committee of the Association of the Bar of the City of New York (the "Committees") in support of Assembly Bill number A.9857-C and Senate Bill number 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 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").[2] 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.

[1] This report has been reissued to reflect introduction of Senate bill.

[2] P.L. 107-16.

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 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.[3] 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.[4]

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[3] See N.Y. EPTL § 5-1.1-A.

[4] 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

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.[5] 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~~

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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).

[5] 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).

~~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 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.

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