

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

## REPORT ON LEGISLATION BY THE JOINT SUBCOMMITTEE OF THE TRUSTS, ESTATES AND SURROGATES' COURTS COMMITTEE AND THE ESTATE AND GIFT TAXATION COMMITTEE

## MEMORANDUM IN SUPPORT OF MODIFICATIONS TO SECTION 2-1.13 OF THE ESTATES, POWERS AND TRUSTS LAW

### **BACKGROUND**

This memorandum is offered by the Trusts, Estates and Surrogates' Court Committee and the Estate and Gift Taxation Committee of the New York City Bar Association (the "Committees") in support of modifications to Section 2-1.13 of the Estates, Powers and Trusts Law ("EPTL").

Section 2-1.13 was enacted in 2010 in response to the repeal of the federal estate tax for decedents dying in 2010 and the repeal of the generation-skipping transfer ("GST") tax in 2010. According to the bill summary accompanying the legislation:

"Many wills, trusts and beneficiary forms prepared prior to 2010 were based on formula dispositions in the case of married testators. The aim was typically to leave as much as possible on the first spouse's death to a trust or to individuals other than the surviving spouse (typically issue of the decedent) without causing estate tax on the first spouse's death. This was commonly referred to as a "credit shelter bequest", since the amount involved (\$3.5 million for decedent dying in 2009) would be sheltered from estate tax on the first death by a "unified credit" allowed under the Internal Revenue Code. The credit shelter bequest is not subject to estate the spouse's death. tax at surviving

"The credit shelter bequest is usually phrased in terms of the maximum amount that can pass free of Federal estate tax on the first death, or in terms of like effect. The same results were obtained with formulas leaving a spouse outright or in a form qualifying for a marital deduction against the Federal estate tax, the minimum amount necessary to avoid imposition of an estate tax on the first spouse's death. With repeal of the estate tax, these formula clauses could be interpreted to leave the entire estate in a credit shelter disposition and nothing to the spouse or in a form

qualifying for a marital deduction. This conclusion is reached since the entire estate and not just the part formerly sheltered by statutory credits can now pass under a credit shelter disposition without there being any estate tax.

The Federal generation-skipping transfer tax is also temporarily repealed for transfers in 2010. Many wills and testamentary instruments also left to grandchildren (or to trusts that would eventually pass to grandchildren) maximum amounts allowable without imposition of a Federal generation skipping transfer tax. With repeal, this amount is now unlimited, and may pass to grandchildren to the detriment of the decedent's children. "

Accordingly, in order to prevent unintended consequences of estate and GST tax repeal in the form of distorted formula dispositions, the EPTL was modified to construe certain formula bequests or other dispositions of property as if they were made pursuant to the provisions of the Internal Revenue Code of 1986, as amended, as those provisions were in effect on December 31, 2009.

The bill summary also indicated that (at the time the summary was prepared) there was still a possibility that Congress may have reinstated an estate tax or a GST tax for 2010 retroactively.

As a result, the EPTL was modified to contemplate a retroactive estate or GST tax by providing that the statutory rules of construction would not apply if the Federal estate tax "becomes applicable" before January 1, 2011.

## LEGISLATION SHOULD BE CLARIFIED IN LIGHT OF FEDERAL ELECTION

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "2010 Act"), retroactively reinstates the federal estate tax, with a \$5,000,000 estate tax exemption amount and 35% estate tax rate for 2010. The 2010 Act also includes an option to elect out of estate tax treatment and be subject to a carry-over basis regime. The GST tax is also retroactively reinstated, with a \$5,000,000 exemption amount and 0% tax rate for 2010.

Pursuant to EPTL Section 2-1.13(a)(4), the statutory rules of construction will not apply if the federal estate tax or GST tax "becomes applicable" before January 1, 2011. Accordingly, if an estate is subject to estate tax under the 2010 Act, the statutory rules of construction will not apply, and formulaic provisions will be keyed to the \$5,000,000 exemption amount.

However, the result is unclear if an election is made not to have the federal estate tax apply. In such a case, the estate tax would not "be applicable" to the particular estate at hand. If the estate tax has to be applicable to the case at hand in order for the statutory construction rules not to apply, there may be an anomalous result if carry-over basis treatment is elected: in the estate tax default treatment scenario, a \$5,000,000 exemption would apply in the interpretation of formula clauses. However, if carry-over basis treatment is chosen and the statutory construction rules are applicable, formulaic clauses may be interpreted with a \$3,500,000 exemption (because the EPTL refers to federal law as of December 31, 2009). This election option could present a very difficult dilemma for a fiduciary, typically subject to duties of impartiality, if the fiduciary's election might determine a funding amount.

While the modifications to the EPTL enacted in 2010 were drafted to anticipate a possible retroactive estate/GST tax, an election about whether to have the estate tax apply does not seem to have been anticipated.

The Committees believe that a modification to the EPTL is necessary in order to effect consistency in the interpretation of formula clauses (whether an estate is subject to an estate tax or a modified carry-over basis regime), and clarify that formula clauses will be interpreted with reference to a \$5,000,000 federal estate and GST tax exemption amount.

## LEGISLATION SHOULD BE CLARIFIED REGARDING ITS APPLICATION TO BENEFICIARY DESIGNATIONS

EPTL 2-1.13(a)(1) and (2) both provide:

"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...that contains a bequest or other disposition based upon the amount of property that can be sheltered from ... tax..." (Italics added)

The Committees believe that the addition of the phrase "in the case of" leads to ambiguity as to whether the statute applies to beneficiary designations generally, or only those designations that are payable to an estate or trust. The ambiguity regarding the statute's application to beneficiary designations is compounded because the reference to "beneficiary designation" does not consistently appear in the statute with each reference to a "will or trust".

Accordingly, the Committees recommend that the phrase "in the case of" be deleted from the statute and that the reference to "beneficiary designation" appear consistently with each reference to a will or trust. These changes are necessary to clarify that the statute applies generally to beneficiary designations.

## LEGISLATION SHOULD BE CLARIFIED REGARDING BEQUESTS AND OTHER DISPOSITIONS THAT REFER TO THE GST TAX EXEMPTION

In light of the 2010 Act, the Committees believe that language in EPTL Section 2-1.13(a)(2) regarding direct skips to natural persons should be removed. The previous proposal of the Committees that the GST tax provisions of the EPTL apply only to outright gifts to natural persons stemmed from concerns regarding the inability to allocate GST exemption in 2010. These concerns were relevant before the 2010 Act was enacted. As a result of the clarification provided by the 2010 Act regarding the GST tax regime, the EPTL provisions should reach all GST type transfers. The reference to direct skips to natural persons is therefore unnecessary and confusing and should be removed.

### TIME FOR BRINGING A JUDICIAL PROCEEDING SHOULD BE EXTENDED

The EPTL currently allows a judicial proceeding to be brought within 12 months following the death of the testator or grantor. Since federal law was not clarified until December 2010, the

Committees recommend extending the time for bringing a proceeding until the end of the later to expire of (1) 24 months of death and (2) 6 months from the date of enactment of the Committees' recommended modifications to the EPTL. Indeed, with a 12 month time-frame, the time to bring a proceeding may have already expired with regard to decedents who died early in 2010. The Committees also recommend that the court have discretion to further extend the time for filing a proceeding (parallel to the discretion granted to the court pursuant to EPTL Section 2-1.11 "Renunciation of property interest").

## OTHER STATES ARE ACTING TO CLARIFY FORMULAIC CONSTRUCTION LEGISLATION IN LIGHT OF 2010 ACT

Other states, including Virginia, have introduced legislation to clarify the operation of state formulaic construction statutes, in light of the 2010 Act. The proposal introduced in Virginia on January 20, 2011 also seeks to effect consistency in the interpretation of formula clauses (whether an estate is subject to an estate tax or a modified carry-over basis regime), and clarify that formula clauses will be interpreted with reference to a \$5,000,000 federal estate and GST tax exemption amount. The Virginia bill also includes a provision that will extend the time for bringing a judicial proceeding, beyond the original time frame of within 12 months of death.

### RECOMMENDATIONS

The Committees recommend that EPTL Section 2-1.13 be modified to incorporate the changes suggested above, as well as other changes necessitated by the passage of the 2010 Act. A proposed bill is attached.

March 2011



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

# PROPOSED MODIFICATIONS TO SECTION 2-1.13 OF THE ESTATES, POWERS AND TRUSTS LAW BY THE JOINT SUBCOMMITTEE OF THE TRUSTS, ESTATES AND SURROGATES' COURTS COMMITTEE AND THE ESTATE AND GIFT TAXATION COMMITTEE

## STATE OF NEW YORK

## 2011-2012 Regular Sessions

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

The People of the State of New York, represented in Senate and Assembly, do enact as follows:

- 1 § 2-1.13 Certain formula clauses to be construed to refer to the federal estate and
- 2 generation-skipping transfer tax laws applicable to estates of decedents dying after
- 3 December thirty-first, two thousand nine and before January first, two thousand
- 4 eleven
- 5 (a)(1) If by reason of the death of a decedent property passes or is acquired under a
- 6 beneficiary designation, [in the case of] a will or trust of a decedent who dies after
- 7 December thirty-first, two thousand nine and before January first, two thousand eleven,
- 8 that contains a bequest or other disposition based upon the amount of property that
- 9 can be sheltered from federal estate tax by referring to the "unified credit", "estate tax
- 10 exemption", "applicable exclusion amount", "applicable exemption amount",
- 11 "applicable credit amount", "marital deduction", "maximum marital deduction",
- "unlimited marital deduction", "charitable deduction", "maximum charitable deduction"
- or similar words or phrases relating to the federal estate tax, or that measures a
- share of an estate or trust based on the amount that can pass free of federal estate taxes,

### **DRAFT**

- 1 or that is otherwise based on a similar provision of federal estate tax then such 2 beneficiary designation, will or trust shall be deemed to refer to the federal estate tax 3 law as applied with respect to decedents dying [on December thirty-first, two 4 thousand nine in 2010, regardless of whether an election is made not to have the federal 5 estate tax apply to a particular estate. (2) If by reason of the death of a decedent property passes or is acquired under a 6 7 beneficiary designation, [in the case of] a will or trust of a decedent who dies after 8 December thirty-first, two thousand nine and before January first, two thousand 9 eleven, that contains a bequest or other disposition based upon the amount of property 10 that can be sheltered from federal generation-skipping transfer tax by referring to the 11 "generation-skipping transfer tax exemption", "GST exemption", "generationskipping transfer tax", "GST tax" or similar words or phrases that measures a share 12 13 of an estate or trust based on the amount that can pass free of federal generation-14 skipping transfer taxes, or that is otherwise based on a similar provision of 15 federal generation-skipping transfer tax law [; or if such bequest would have passed as 16 a "direct skip" to a "natural person" within the meaning of such terms under chapter 17 13 of the Internal Revenue Code of 1986 if the decedent had died on December thirty-18 first, two thousand nine], then such beneficiary designation, will or trust shall be 19 deemed to refer to the federal generation-skipping transfer tax law in effect on 20 December thirty-first, two thousand nine in 2010, regardless of whether an election is 21 made not to have the federal estate tax apply to a particular estate. 22 (3) This paragraph shall not apply to a beneficiary designation, will or trust that [: 23 (A) is executed or amended after December thirty-first, two thousand nine; or (B) M] manifests an intent that a contrary rule shall apply [if the decedent dies on a 24 25 date on which there is no then applicable federal estate tax or generation-skipping 26 transfer tax 1.
- [(4) The reference to January first, two thousand eleven in this paragraph shall, if a federal estate tax or generation-skipping transfer tax becomes applicable before that date, be construed to refer instead to the first date on which the federal estate tax or generation-skipping transfer tax becomes applicable.]

## DRAFT

1	(b) The executor, trustee or other interested person under a beneficiary designation,
2	will or trust referred to in paragraph (a) of this section may bring a proceeding to
3	determine whether the beneficiary designation, will or trust manifests a contrary
4	intention within the meaning of subparagraph (3) of paragraph (a) of this section
5	[decedent intended that the references described in such paragraph be construed with
6	respect to the law as it existed on the decedent's date of death, without regard to the
7	provisions of paragraph (a) of this section]. In any such proceeding, extrinsic evidence
8	may be admitted to establish the decedent's intent. [Such proceeding]
9	(c) Any proceeding described in subparagraph (b) of this section must be commenced
10	by the date which is (i) [within twelve] twenty-four months following the date of death of
11	the <u>decedent</u> , testator or grantor or (ii) six months following the date of enactment of this
12	paragraph (c), whichever date is later, and not at any time thereafter. Notwithstanding the
13	foregoing, the time to commence such a proceeding may be extended, in the discretion
14	of the court, on a petition showing reasonable cause and on notice to such persons and in
15	such manner as the court may direct.
16	§ 2. This act shall take effect immediately and shall be deemed to have been in full force
17	and effect on and after January 1, 2010, and the provisions of this act shall apply to wills
18	and trusts of decedents who die after December 31, 2009 and before January 1, 2011.