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Update on Changes to the Taxation Of New York Nonresident Estates

by Catherine B. Eberl and Nathan W.G. Berti

Catherine B. Eberl

Nathan W.G. Berti

Catherine B. Eberl is a partner and Nathan W.G. Berti is an associate at Hodgson Russ LLP's Buffalo office.

In this article, Eberl and Berti write about recent amendments to New York's estate tax law, saying that with increasing exemption amounts and nonresidents eligible for the full exemption, fewer nonresidents will be required to file a New York estate tax return.

New York attracts nonresidents. From the foreign billionaire who owns a Park Avenue penthouse to the former New Yorker who moved to Florida but keeps a cabin in the Adirondacks, many people find themselves with one foot in the Empire State. While New York has imposed an estate tax on nonresidents for more than a half century, the way New York taxes the estates of nonresidents has changed significantly in the past two years.

Computing the Gross Estate of a Nonresident

New York imposes an estate tax on the estates of both resident and nonresident decedents.[1] In the estate tax context, a decedent is considered a New York resident if he or she was domiciled in New York at the time of death. Domicile should not be confused with a determination of statutory residence for income tax purposes; counting days spent inside and outside New York is irrelevant. Rather, domicile is the place that the decedent intends to make his or her permanent home. For example, a terminally ill, lifelong New Yorker may decide to leave New York to live with family in Florida, never to return. The individual passes away just a few months after the move to Florida. Even if the individual is considered a New York resident for income tax purposes for all or part of that year, the decedent may very well be a nonresident for estate tax purposes.

Last April, New York's estate tax law underwent a major overhaul, including changes to the computation of a nonresident decedent's gross New York estate. Under the prior law, the gross New York estate of a nonresident decedent equaled the sum of all real and tangible personal property having an actual situs in New York that would be included in the decedent's federal gross estate. Tangible personal property is defined as "corporeal personal property, including money held for numismatic purposes"; it does not include "deposits in banks, mortgages, debts, receivables, shares of stock, bonds, notes, credits, evidences of an interest in property, evidences of debt, or choses in action generally."[2]

Effective April 1, 2014, the definition of the New York gross estate was expanded to include some gifts made within three years of the decedent's death. Now, in addition to New York situs real and tangible personal property, the New York gross estate of a nonresident decedent also includes certain gifts made while the decedent was a resident of New York consisting of (1) real or tangible personal property having a location in New York, or (2) intangible personal property employed in a business, trade, or profession carried on in New York.[3] Only gifts made after April 1, 2014, are subject to the addback.

Significantly, the method of calculating the tax has also changed. The prior law contained a nearly incomprehensible formula for determining the estate tax due on a nonresident's New York estate. The formula essentially prorated the former $1 million New York estate tax exemption, with the result that it was possible for a nonresident to owe New York estate tax even though the value of the New York real and tangible personal property was under the $1 million exemption.

[1]N.Y. Tax sections 952, 960.

[2]N.Y. Tax section 951-a.

[3]N.Y. Tax sections 960, 954; N.Y. Department of Taxation and Finance Technical Memorandum TSB-M-14(6)M (Aug. 25, 2014).

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The new statute is more straightforward. Effective April 1, 2014, the estate of a nonresident decedent will not owe New York tax if the nonresident's New York gross estate (including the gift addbacks), less deductions, does not exceed the New York exemption amount. In 2015 the New York exemption amount is $3.15 million, and it is scheduled to increase every year.

Allowable Deductions

The method of determining the New York taxable estate of a nonresident decedent has also evolved over the last year. The New York taxable estate of a resident is the New York gross estate, minus the allowable federal estate tax deductions (regardless of whether a federal estate tax return is required to be filed).[4] However, any deductions related to real or tangible personal property sitused outside New York are not allowed. For example, if a New York resident owns a vacation home in Florida, the appraisal fee for the Florida home may not be deducted on the New York estate tax return. The disallowance of the out-of-state deduction creates symmetry in the law; because the Florida home is not subject to New York estate tax, the estate cannot use the costs associated with the Florida house to reduce the New York estate tax.

As originally enacted in 2014, the section governing the taxation of a nonresident's New York estate did not address the treatment of federal deductions. Rather, it merely provided that the tax imposed on a nonresident's estate would be the same as the tax imposed on a resident's estate, except that in calculating the tax, the nonresident decedent's New York taxable estate would not include any intangible personal property located outside New York.[5] As a result, under the original statute, the nonresident's estate was entitled to all the federal deductions, other than the deductions related to real or tangible personal property sitused outside New York. Accordingly, if a Floridian owned a New York vacation home and a Florida business corporation, only the New York vacation home would be subject to New York estate tax. When determining the available deductions, the Floridian's estate would be subject to the restraints applicable to a resident decedent, meaning that the Floridian's estate would not be able to take deductions related to real or tangible personal property sitused outside New York. But the Floridian's estate would have been able to claim the deductions of winding down the Florida business corporation against the New York real property, an anomalous and unintended result.

N.Y. Tax section 960 was amended as of April 13, 2015, to fix that error by providing that the New York taxable estate of a nonresident does not include the value of — or any allowable federal deduction regarding — intangible personal property. The amendment was made retroactive to apply to estates of nonresident individuals who died on or after April 1, 2014. If a New York estate tax return has already been filed for an individual who died on or after April 1, 2014, and the estate claimed federal deductions related to intangible personal property, the estate is now required to file an amended New York return.[6]

A nonresident's estate clearly may not take deductions "related to" intangible personal property, real property, or tangible personal property located outside New York. But no guidance has been issued regarding determining when a given deduction is "related to" a specific item. For some items, the determination can be easily made. Clearly, the cost of appraising the Florida business corporation should not, and cannot, be deducted against the New York estate.

But a gray area exists regarding many of the estate's general administration expenses. For instance, an invoice from the estate's attorney may include conversations and actions taken regarding the New York real property, the Florida business corporation, and the decedent's bank and brokerage accounts. The invoice from the accountant may include the costs of preparing the estate's federal income tax returns, which report rental income from the New York real property and interest and dividends from the intangible assets.

A question remains on whether 100 percent of the attorney fees and the accountant's fees can be deducted on the New York return, or whether these costs must be allocated so that each time charge on the attorney's and accountant's invoice is assigned to either a New York situs asset or a non-New York situs asset. Perhaps as a middle ground, the deductions falling in the gray area can be allocated on a pro rata basis by using a fraction in which the value of the decedent's New York gross estate is the numerator and the decedent's federal gross estate is the denominator. Until further guidance is issued, return preparers will have to carefully evaluate the estate's federal deductions and decide which deductions can reasonably be claimed on the New York return.

Filing Requirements for Nonresidents

The estate of a nonresident decedent that includes real or tangible property located in New York must file a New York estate tax return if the decedent's federal gross estate, plus any gifts added back to the New York gross estate, exceeds the New York exemption amount in the year of the decedent's death. In the case of nonresident decedents who are also noncitizens, this represents a significant departure from the prior law, which required that an estate tax return be filed if the decedent's U.S. assets exceeded $60,000.

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[4]N.Y. Tax section 955.
[5]N.Y. Tax section 960.

[6]N.Y. Department of Taxation and Finance Technical Memorandum TSB-M-15(3)M (Feb. 12, 2015).

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LLCs and Intangibles

The New York State Department of Taxation and Finance recently reaffirmed its position that a single-member limited liability company that is disregarded for federal income tax purposes will be disregarded for New York estate tax purposes.[7] This is so even though the New York Constitution prohibits the imposition of estate tax on a nonresident's intangible personal property; so long as the intangible assets are not used in carrying on a business in New York, the intangible assets are considered to be located at the domicile of the owner.[8] The constitutional prohibition is carried over to N.Y. Tax section 960, as described above.

Savvy planners will advise nonresident clients to transfer their New York real property and the contents of the real property to an LLC or corporation. The nonresident thereafter owns an interest in an entity, which is an intangible asset not subject to New York estate tax.

The transfer could achieve significant New York estate tax savings for a nonresident, but with one caveat: The entity should not be a disregarded entity for federal income tax purposes. The department continues to maintain that in spite of the constitutional prohibition, if the entity can be disregarded for income tax purposes, it will be disregarded for estate tax purposes, and the decedent will be treated as directly owning the underlying real property. A proactive planner can avoid the potential constitutional quagmire altogether by advising the client to transfer the New York real property to a multi-member LLC. However, it is foreseeable that eventually a nonresident will die owning a significant New York real property interest in a disregarded single-member LLC and that the dollar amounts at stake will be large enough to entice the executor to take the department to court to test the constitutionality of the department's position.

Conclusion

The recent amendments to New York law have significantly changed the taxation of nonresident estates. With the ever-increasing exemption amounts, and a nonresident's ability to now use the full exemption, fewer nonresidents will be required to file a New York estate tax return. However, for those nonresident estates that must file a return, understanding of the new rules is required. ✰

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[7]N.Y. Department of Taxation and Finance Technical Memorandum TSB-A-15(1)M (May 29, 2015).

[8]N.Y. Const. Art. 16, section 3.

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