

**New York State Department of Taxation and Finance**  
**Office of Counsel**  
**Advisory Opinion Unit**

TSB-A-12(1)M  
Estate Tax  
October 16, 2012

STATE OF NEW YORK  
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. M111207A

The Department of Taxation and Finance received a Petition for Advisory Opinion from [REDACTED], on behalf of the [REDACTED] (“estate of Surviving Spouse”), care of [REDACTED]. Petitioner asks whether the estate of Surviving Spouse may exclude from its gross estate certain property that was treated as qualified terminal interest property (“QTIP”) on the Federal estate tax return filed by Surviving Spouse’s predeceased spouse. We conclude that NY’s estate tax would not permit the exclusion of the property from the estate’s gross estate.

**Facts**

Petitioner offers the following facts: [REDACTED] (the “Predeceased Spouse”) died on June 1, 1999, survived by his wife, [REDACTED] (the “Surviving Spouse”). On the date of his death, the Predeceased Spouse owned a 50% interest as tenant-in-common in certain real property in [REDACTED], New York (the “[REDACTED] property”). The Surviving Spouse died on February 14, 2011. On March 24, 2011, the Surviving Spouse’s will was admitted to probate and her son, [REDACTED], was appointed as executor of her estate.

The Predeceased Spouse’s estate was not required to file a federal estate tax return because his federal gross estate was less than his available federal estate tax exemption amount (\$650,000). The Predeceased Spouse’s estate timely filed its New York State Estate Tax Return (Form ET-90) and received a New York Estate Tax Discharge from Liability on December 15, 1999.

The Predeceased Spouse estate’s ET-90 reported both its “New York adjusted gross estate” and its “total New York allowable deductions” as \$407,493.76 and its “New York adjusted taxable estate” as \$0.00. No New York estate tax was due. The ET-90 shows that the Predeceased Spouse’s estate elected QTIP treatment for assets valued in the aggregate amount of \$378,923.25. One of the assets for which QTIP treatment was elected was the Predeceased Spouse’s interest in certain [REDACTED] property, which was valued at \$242,500.00 on the ET-90. All of the assets for which the QTIP election was made passed to a credit shelter trust for the benefit of the Surviving Spouse created under the Predeceased Spouse’s will (the “Credit Shelter Trust”).

Citing the principal residence deduction under former Tax Law section 955(f), Petitioner contends that the Predeceased Spouse’s estate was eligible to deduct up to \$250,000 of the net value of the [REDACTED] property on the ground that the property was the Predeceased Spouse’s principal residence for purposes of determining the New York estate tax payable in connection with his estate. Had the Predeceased Spouse’s estate taken the principal residence deduction for the full value of his interest in the [REDACTED] property for New York estate tax purposes (\$242,500), not made any QTIP election with respect to the other assets reported in the Predeceased Spouse’s

ET-90, and not made any other change on the return, the estate's New York adjusted taxable estate would have been \$136,423.25 calculated as follows:

New York adjusted gross estate	\$407,493.76
Less marital deduction	28,570.51
Less deduction for Predeceased Spouse's interest in his principal residence	<u>242,500.00</u>
New York adjustable taxable estate	\$136,423.25

If the Predeceased Spouse's estate had taken the principal residence deduction in the full amount for which it was eligible and made no QTIP election, both the preliminary tentative New York State estate tax and New York State estate tax unified credit would have been \$3,592.70 and no New York estate tax would have been payable by his estate. Petitioner asserts that, therefore, making the QTIP election was not necessary to reduce the New York estate tax of the estate of the Predeceased Spouse to zero. Petitioner claims that if that election is disregarded, the assets of the Credit Shelter Trust will not be included in the Surviving Spouse's New York gross estate, the surviving spouse's New York gross estate will be less than \$1,000,000, and no New York estate tax will be payable by the surviving spouse's estate. Petitioner cites Revenue Procedure 2001-38 as persuasive authority to nullify the QTIP election under these facts.

### Analysis

The Tax Law imposes an estate tax on the transfer of the New York estate by every deceased individual who at his or her death was a resident of New York. The measure of the tax is the maximum allowable Federal state death tax credit under section 2011 of the Internal Revenue Code (IRC) as amended through July 22, 1998 (Tax Law sections 951, 952, 960[a]). The maximum state death tax credit available under section 2011 depends on the amount of the federal "adjusted taxable estate," which is the value of all the property of the decedent at the time of death less a \$60,000 exclusion available to all estates, and less the deductions provided for in IRC sections 2053 through 2056. See IRC sections 2011, 2051. Section 2056(a) provides that, for purposes of IRC section 2001, and except as limited by section 2056(b), the value of a taxable estate is determined by deducting from the value of the gross estate an amount equal to the value of any interest in property which passes or has passed from the decedent to the surviving spouse (the "marital deduction"). Section 2056(b)(1) denies that deduction for an interest passing to the surviving spouse that is a "terminable interest." An interest is a terminable interest if the interest passing to the surviving spouse will terminate or fail on the lapse of time or on the occurrence of an event or contingency or on the failure of an event or contingency to occur, and on termination, an interest in the property passes to someone other than the surviving spouse. See IRC § 2056(b)(1)(A), (B).

Section 2056(b)(7)(A) provides an exception to the terminable interest rule in the case of QTIP property. For purposes of section 2056(a), QTIP property is treated as passing to the surviving spouse, and no part of the property is treated as passing to any person other than the surviving spouse. Pursuant to section 2056(b)(7)(B)(i), QTIP property is property which passes from the decedent, in which the surviving spouse has a qualifying income interest for life, and to which an election under section 2056(b)(7)(B)(v) applies. Under both federal law and New York law in effect at the time, once

the election is made to treat property as QTIP property, the election is irrevocable. (See IRC §2056(b)(7); Tax Law §955(c)(3) *repealed* effective February 1, 2000)

Crucially for this matter, IRC section 2044(a) and (b) provide generally that an estate must include in its gross estate the value of any property in which the decedent has a qualifying income interest for life and with respect to which a deduction was allowed for the transfer of the property to the decedent under IRC section 2056(b)(7).

Here, when the Predeceased Spouse died in 1999, the estate was below the federal estate tax filing threshold. On its New York State estate tax return, the ET-90, the estate chose to treat the [REDACTED] property as QTIP property. Surviving Spouse died in 2011. Petitioner claims that, in filing its New York estate tax, Surviving Spouse's estate must be allowed to compute its maximum state death tax credit based on a gross estate that excludes the [REDACTED] property, contrary to the rule in IRC section 2044(a) and (b) that property in relation to which a QTIP election has been taken must be included in the gross estate of the surviving spouse's estate. In support of that claim, Petitioner relies on Revenue Procedure 2001-38. That Revenue Procedure provides that its scope is limited to "elections under § 2056(b)(7) to treat property as qualified terminable interest property where the election was not necessary to reduce the estate tax liability to zero, based on values as finally determined for federal estate tax purposes." According to that that Revenue Procedure, in regard to a QTIP within that scope, "the Service will disregard the election and treat it as null and void for purposes of [IRC section 2044(a)] and the property will not be includible in the gross estate of the surviving spouse" under that section.

This Revenue Procedure is not based on interpretation of the Internal Revenue Code, but rather seems to be a policy decision on the part of the Internal Revenue Service. New York ordinarily follows federal interpretations of its own estate tax provisions that have been closely tailored to federal law.<sup>1</sup> But it is not clear that that rule would apply to non-interpretative exercises of the Internal Revenue Service's discretionary authority, especially where the resulting policy runs directly contrary to the express prohibition in New York law. See former Tax Law §955(c)(3), which made QTIP elections irrevocable. Thus, it is not clear that the Department is required to adhere to the Revenue Procedure 2001-38.

Even assuming that the Department would follow the Revenue Procedure, however, the facts of this case do not fit within the intended scope of Revenue Procedure 2001-38. That procedure dealt with QTIP elections that were "not necessary to reduce the estate tax liability to zero." All four examples discussed in the "Background" section of the Revenue Procedure were ones in which, for the estate's liability to remain at zero after nullifying the QTIP election, no other change was necessary to the return. But that is not the case here. Rather, for the Predeceased Spouse's estate to have zero estate tax liability after nullifying its QTIP election in relation to the [REDACTED] property, it is also necessary to grant the estate the permanent resident deduction for that property. The problem is that whether that deduction is applicable is a question of fact that would be subject to audit if taken on the ET-90.

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<sup>1</sup> See Matter of Watson's Estate, 70 AD2d 777 (4<sup>th</sup> Dep't 1979), citing Matter of Marx v. Bragalini, 6 N.Y.2d 332, 333-334 (1959).

For purposes of the principal residence deduction, “a principal residence shall mean property that would qualify as the decedent’s principal residence under [former IRC section 1034], had such property been sold on the date of death” (former Tax Law section 955[f]). While former IRC section 1034(a) did not define the term, the regulations to that section indicate that “the question of what constitutes a principal residence is a fact-dependent one, where no one circumstance is determinative, including whether the taxpayer is occupying the property when it is sold” (Treas. Reg. § 1.1034-1[c]). Consistent with that approach, a number of factors have been considered in determining whether a house constitutes a taxpayer’s principal residence: (1) The length of time the house was occupied by the individual as his residence before placing it on the market for sale; (2) whether the individual permanently abandoned all further use of the house; (3) the character of the property (recreational or otherwise); (4) offers to rent; and (5) offers to sell” (*Saunders v. C.I.R.* , T.C. Memo. 2002-143).

Thus, determining whether the [REDACTED] property was the principal residence of the Predeceased Spouse is a question of fact. Moreover, the QTIP deduction is limited to \$250,000 (former Tax Law section 955[f]). If the estate of the Predeceased Spouse had sought a principal residence deduction for the [REDACTED] property, the Department might have opted to audit the estate’s valuation of the property, possibly leading to an upward adjustment, thereby increasing the value of the gross estate and possible estate tax liability for the estate. In contrast, since the predeceased spouse’s estate listed the [REDACTED] property as QTIP property, the Department would have had no incentive to audit the estate’s valuation of that property since increasing that valuation would only lead to a larger QTIP deduction. In short, at this juncture, more than 10 years after the filing of the return on which the “irrevocable” QTIP election was taken, it is not possible to conclude without an audit whether substituting a principal residence deduction for the actual QTIP election taken by the estate of the predeceased spouse would not change the “no tax due” status of the estate. Nothing in the Revenue Procedure indicates that the procedure outlined there would apply where questions of fact would have to be resolved for the taxing authority to know that nullifying the QTIP election would give rise to no estate tax liability on the part of the estate.

In sum, even assuming that the Revenue Procedure is binding on the Department, the factual situation here falls outside its scope. Accordingly, the estate of the Surviving Spouse may not exclude the value of the [REDACTED] property from its gross estate.

DATE: October 16, 2012

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NOTE: An Advisory Opinion is issued at the request of a person or entity. It is limited to the facts set forth therein and is binding on the Department only with respect to the person or entity to whom it is issued and only if the person or entity fully and accurately describes all relevant facts. An Advisory Opinion is based on the law, regulations, and Department policies in effect as of the date the Opinion is issued or for the specific time period at issue in the Opinion. The information provided in this document does not cover every situation and is not intended to replace the law or change its meaning.