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# Tax Bulletin

## New York's Failure to Amend Its Estate Tax Law Can Be Very Costly to Non-Residents

*The following information is of critical importance to our clients and friends who reside outside the State of New York yet own a home, jewelry, art, household furnishings — any tangible personal property — in the State of New York.*

### The Problem

For estates of persons dying before 2002, the estate tax payable to the state where the decedent resided was (in the case of most states) an amount equal to the "state death tax credit" allowed by the IRS on the federal estate tax return. When a person died leaving property in his or her state of residence and in another state, those states would share the portion of state death tax credit, more or less in proportion to the value of the assets in each state.

Consider the following example: Assume a non-New Yorker who resided in State X, **died in 2001** with a \$10,000,000 estate all of which was located in State X. The state death tax credit allowed by IRS would have been \$1,067,600, all of which would have been paid to State X. If, on the other hand, \$100,000 of the estate consisted of New York tangible personal property or real estate in New York and all of his remaining property was in State X, the state death tax credit would have been allocated 99% to State X (\$1,056,924) and 1% to New York (\$10,676).

A change to the federal tax law provides that starting in 2002, the amount of the state death tax credit is to be reduced 25% per year until it is fully phased out in 2005. However, some states, including New York, still base their estate tax on the state death tax credit in effect *before* the change in the federal law. To complicate matters further, an anomaly in the New York law can result in a much higher than normal state estate tax for non-residents leaving tangible personal property or real estate in New York.

Consider the following example: Assume a non-New Yorker who resided in State X, **dies in 2003** with a \$10,000,000 estate all of which is located in State X. The state death tax credit allowed by IRS would be \$533,800, all of

which would be paid to State X.

Now for the twist: If \$100,000 of the estate consisted of New York tangible personal property or real estate in New York, the amount of estate tax payable to State X would be \$528,264, and the amount of estate tax payable to New York would be \$539,138, for a total estate tax of \$1,067,600 (*twice* the amount that would have been paid if there were no property in New York). It may seem impossible that New York could collect a tax of \$539,138 on property having a value of \$100,000, but that's what the law says.

In 2004, the results are even more disturbing due to the final phase out of the state death tax credit.

### **The Solution**

The good news is that there is a way to completely avoid the New York estate tax and to considerably reduce the total estate tax bill. To do so, all of the New York tangible personal property and real estate owned by a non-New Yorker can be transferred to a Limited Liability Company owned by family members. Using this technique, the non-New York resident would own no taxable property in New York at death, because ownership of an interest in a Limited Liability Company is considered "intangible personal property" which is not subject to tax in New York if the owner is a non-resident of New York. There would still be a tax in the state of residence, but the New York tax would be zero.

### **Next Steps**

The savings provided through such planning can be significant. If the estate discussed in the examples above had been protected by this technique in 2003, there would have been a total tax savings of **\$533,800**.

Some commentators have speculated that New York will amend its tax law to return to a more logical and fair estate tax, but in this climate of significant state budgetary deficits, such an amendment seems to be wishful thinking.

In sum, forethought and planning can result in substantial savings. If this situation applies to you or to anyone you know and you would like more information, please contact us for a discussion in greater detail.

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