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

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Estate Tax
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STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. M100806A

A petition filed by the estate of [redacted] (Petitioner) asks whether, in determining the value of New York real property included in its gross estate, the estate should discount the value of the property to reflect that the decedent's will subjected it to a life estate. We conclude that petitioner is not entitled to a discount in the value of the New York real property based on the will's creation of a life estate in the property.

Facts

Paragraph sixth of the last will and testament of [redacted], a resident of this State who died on June 14, 2006, gives [redacted] "an estate for life in all my right, title and interest" in specified real property in New York, New York ("New York real property"). That paragraph further provides that, upon [redacted] death, the New York real property would be distributed according to the will's residual clause.

Analysis

As relevant here, the Tax Law imposes an estate tax on the transfer, from any deceased individual who at his or her death was a resident of New York State in the amount of the maximum state death tax credit allowable under the Internal Revenue Code (IRC) with all amendments through July 22, 1998 (Tax Law sections 951[a]; 952[a]). The amount of the state death tax credit, in turn, depends on the amount of the Federal adjusted taxable estate, which is equal to the taxable estate minus $60,000 (IRC section 2011[b]). A decedent's taxable estate is equal to the decedent's gross estate minus any applicable deductions (IRC section 2051). Section 2031 of the IRC provides that, for federal estate tax purposes, the value of the gross estate is to be determined by including to the extent set forth in part III of subchapter A (i.e., IRC sections 2031 through 2046) the value, at the time of death, of all the decedent's property, real or personal, tangible or intangible, wherever situated. The regulations to the IRC provide that the value of the property includible in the gross estate is its fair market value at the date of the decedent's death (unless the executor elects another value under § 2032 or § 2032A) (Treas. Reg. section 20.2031-1[b]). The regulation further specifies that fair market value is "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell, and both having reasonable knowledge of relevant facts." This regulation does not identify the exact moment in time at which the willing buyer/willing seller test is to be applied.

One formulation of the appropriate time to apply the willing buyer/willing seller test is "the instant before transfer, so that the amount of tax depends on the value of the transferred property in the hands of the transferor rather than its value in the hands of the transferee" (*Citizens Bank & Trust Co. v. C.I.R.*, 839 F.2d 1249, 1251 [7th Cir 1988]). Another description of the proper moment at which to apply the test is the following:

> Brief as is the instant of death, the court must pinpoint its valuation at this instant- the moment of truth, when the ownership of the decedent ends and the ownership of the successors begins. It is a

> fallacy, therefore, to argue value before- or- after death on the notion that valuation must be determined by the value either of the interest that ceases or of the interest that begins. Instead, the valuation is determined by the interest that passes, and the value of the interest before or after death is pertinent only as it serves to indicate the value at death.

(*United States v. Land*, 303 F.2d 170, 172 [5th Cir. 1962] Cert. denied 371 U.S. 862). Whatever the exact formulation, the courts and other authorities are unanimous that section 2031 does not take into account changes in the value of an asset caused by the will's disposition of the asset (see, e.g., *Estate of Propstra v. United States*, 680 F.2d 1248 [9th Cir. 1981 [husband and wife owned a 55% share of real property as community property; the value of the decedent husband's undivided interest in the real property was held to be entitled to a minority discount even though his will conveyed the interest to his wife]; *Estate of Curry v. United States*, 706 F.2d 1424, 1427 [7th Cir.1983][holding that nonvoting stock owned by decedent should be given the same per-share value as decedent's voting stock in the same corporation because the fair market value of property in the gross estate is to be viewed "as it exists in the hands of the estate" and not as it may be "fortuitously balkanized through a chain of post-death transactions"]; *Ahmanson Foundation v. United States*, 674 F.2d 761, 767-69 [9th Cir. 1981] [decedent owned all 100 shares of the common stock of a corporation, consisting of one share of voting stock and 99 shares of nonvoting stock, bequeathing the nonvoting stock to a charitable foundation and the single voting share in trust for his son; Ninth Circuit held that the 100 shares should be valued as a unit representing full ownership and control of the corporation, rejecting estate's argument that "the valuation of property in the gross estate must take into account any changes in value brought about by the fact of the distribution itself"]; *Estate of Foy Proctor*, Tax Court Memo 1994—208, 67 TCM 2943 [May 11, 1994][decedent's will transfers his real property to a university but gives the property's current tenant the right to rent the property at fair market value for the tenant's life; Tax Court held that the value of the property was to be valued as unencumbered fee simple interest]; Stephens, et. al., Federal Estate and Gift Taxation [8th Ed. 2002], section 4.02(2)(a), at 4-13["because the interest of the decedent's beneficiaries have not yet vested in the assets at the moment of death, valuation does not consider the ultimate disposition (or recipient) of the assets"]).

The policy of valuing the assets in the gross estate without regard to the identity of the testator's legatees is consistent with the nature of the estate tax, which is a tax on the testator's passing of property at death and not on the testator's legatees (*Ahmanson*, *supra*, 674 F.2d at 768, citing *Ithaca Trust Co. v. United States*, 279 U.S. 151, 155 (1929). Moreover, as the *Ahmanson* court pointed out, the policy reasons for this view are strong:

> To take into account for valuation purposes the fact that the testator's unitary holding has become divided in the hands of two or more beneficiaries would invite abuse. For instance, a testator with two equally valuable pieces of real property could give equal undivided shares in each to both of two beneficiaries. Because undivided shares of real property frequently sell at a discount, the total value of the gross estate, under the [taxpayer's] disaggregation theory, would be less than the value of the two parcels in the hands of the testator. The two beneficiaries could later exchange shares, each ending up the outright owner of a parcel. We may imagine that this would accomplish the original purpose of the testator, with a considerable tax savings. Estate planners would implement such a tax-avoidance scheme whenever at least one of the assets in the gross estate has a diminished value if divided among two or more beneficiaries. As there is nothing in either the language of the statutes or the underlying theory of the estate tax that requires the existence of this loophole, we shall not impute it to Congress.

(*Ahmanson*, *supra*, 674 F.2d at 768).

In sum, based on the Federal precedent discussed above, Petitioner is not entitled to apply a valuation discount to the New York real property based on the life estate granted by the decedent's will.

DATED: October 21, 2010

/S/
DANIEL SMIRLOCK
Deputy Commissioner and Counsel

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