Important

The information concerning the Estate Tax in this TSB-M is no longer current and is provided only for historical purposes.

For the most up-to-date information, see Estate tax.

The TSB-M begins on page 2 below.

Insert added on November 15, 2024.

TSB-M-95 (7)M
Estate and Gift Taxes
July 20, 1995

ESTATE & GIFT TAX CHANGES

The New York State Estate Tax (Article 26) and Gift Tax (Article 26-A) Laws were amended on June 9, 1994(C. 170, L. of 1994). The changes include:

- an increase in the maximum unified credit,
- an increase in the New York State estate tax filing threshold, and
- a credit against the New York State estate tax for certain closely held businesses.

Increase in the Maximum Unified Credit

Section 952(b) of the Estate Tax Law was amended to increase the maximum unified credit from $2,750 to $2,950. This increase applies to estates of decedents who died after June 9, 1994. A corresponding amendment was made to section 1002(a)(3)(A) of the Gift Tax Law, increasing the maximum credit to $2,950 for gifts made after December 31, 1993, provided the donor was alive on June 9, 1994.

The amount of unified credit allowed is calculated as follows:

- If the preliminary tentative tax is $2,950 or less, the credit is the same amount as the preliminary tentative tax.
- If the preliminary tentative tax is more than $2,950 but less than $5,400, the credit is $5,900 minus the preliminary tentative tax.
- If the preliminary tentative tax is $5,400 or more, the credit is $500.

Increase in Estate Tax Filing Threshold

The threshold at which estates must file returns has been increased from $108,333 to $115,000 for estates of decedents who died after June 9, 1994 (see section 971(a) of the Tax Law).

Credit for Certain Closely Held Businesses

Section 958-b was added to the Estate Tax Law to reduce the New York State estate tax liability of an estate of an individual who owned an interest in a closely held business at death. The credit is equal to 5% of the first $15 million of **qualified property** owned by the individual that vests in one or more **qualified heirs.** The credit applies to the estate of an individual who dies after June 9, 1994.

Qualified property means an interest in a closely held business included in the New York gross estate and may consist of:

- a sole proprietorship;
- an interest in a partnership, if:
  - the partnership has 15 or fewer partners, or
  - 20% or more of the total capital interest in the partnership is included in the decedent's federal gross estate;
- stock in a corporation carrying on a trade or business, if:
  - the corporation has 15 or fewer shareholders, **or**
  - 20% or more of the value of the voting stock of the corporation is included in the decedent's federal gross estate.

An interest in a closely held business included in determining the New York gross estate is not qualified property unless the estate would qualify for the installment payment of estate tax.

Any interest in a closely held business which has been taken into account in computing the marital deduction is not qualified property.

If the decedent's federal gross estate includes interests in two or more closely held businesses, all interests that consist of at least 20% of the total value of each separate business are combined and treated as an interest in a single business. Where the property was held by the decedent and the surviving spouse as community property, joint tenants, tenants by the entirety, or tenants in common, the surviving spouse's interest in each business is treated as property included in the decedent's federal gross estate for purposes of determining whether the 20% requirement is met.

In computing the credit, the value of the interest in a closely held business is the same value as reported in the New York State estate tax return.

Qualified heir means a member of the decedent's family who acquired the property from the decedent or to whom the property has passed. If a qualified heir disposes of any interest in qualified property to a member of his or her family, that member will be treated as the qualified heir with respect to that interest.

A member of the decedent's family includes:

- an ancestor of the decedent,
- the spouse of the decedent, or
- a lineal descendant (or the spouse of a lineal descendant) of the decedent, of the decedent's spouse, or of a parent of the decedent.

Legally adopted children of a decedent are treated as lineal descendants.

Any right in qualified property held by a qualified heir is treated as an unconditional and irrevocable right unless the heir refuses or otherwise does not accept the right. If there is a provision in the decedent's will that the right in qualified property terminates or fails if the heir dies within six months of the decedent, or in a common disaster resulting in both of their deaths, the right will be treated as irrevocably vested unless the termination or failure actually occurs.

Provision for Recapture of the Credit for Certain Closely Held Businesses

When an estate is allowed a credit against the estate tax for certain closely held businesses, some or all of the credit may be disallowed and additional tax may be due. This will be so if the value of all dispositions by the qualified heir(s) of a decedent's interest in a closely held business (qualified property), including money or other property withdrawn from a business, equals 50% or more of the decedent's interest in qualified property. Additional tax is due when 50% of the qualified property is disposed of within 3 years after the decedent's death and before the death of the qualified heir. The tax due is equal to the difference between the total tax actually paid and that which would have been due had the credit not been allowed. Further, the tax to be recaptured is apportioned to the number of months remaining in the three-year period after the disposition which gave rise to the tax liability.

The amount of the additional estate tax to be paid is computed as follows:

$$\text{Additional Tax} = \begin{array}{l}\text{Additional Estate Tax that}\\ \text{Would have been due}\\ \text{Without the Original Credit}\end{array} \times \frac{\begin{array}{l}\text{36 Months, Less the Number of Complete}\\ \text{Months that Passed Between the Critical}\\ \text{Disposition and the Decedent's Death}\end{array}}{\text{36 Months}}$$

If the holder of a decedent's interest in a closely held business has not put any additional capital into that business, the aggregate percentage value of all qualified property disposed of from such business equals the

difference between 100% and the remaining percentage of the original interest after the latest withdrawal. The remaining percentage of the original interest after a withdrawal is computed as follows:

		Value of the Decedent's Remaining
Remaining Percentage	Remaining Percentage	Interest After the Withdrawal
of Original Interest After =	of Original Interest Before	x ....
A Withdrawal	The Withdrawal	Value of the Decedent's Remaining
		Interest Right Before the Withdrawal

If the holder of a decedent's interest in a closely held business has subsequently put additional capital into that business, all dispositions to that holder are first considered to come from the percentage of that holder's share of the business that is attributable to his subsequently invested capital.

The decedent's interest in all qualified property must be revalued as of each date of sale, exchange or other distribution of any interest or portion of an interest. This revaluation is necessary to determine if and when the aggregate value of all qualified property disposed of equals or exceeds 50% of the decedent's interest in qualified property. The value of the interest disposed of is reduced by the value of any *qualified replacement property* acquired by the qualified heir.

Interest, computed from the date of death, will be due on the additional tax. The qualified heir is personally liable for the additional tax imposed on his or her interest unless a surety bond or other security is furnished in an amount and for the period required by Section 996-a of the Estate Tax Law.

The term "qualified replacement property," as used in the recapture provision, refers to the acquisition off

- a sole proprietorship;
- an interest in a partnership having 15 or fewer partners;
- stock in a corporation carrying on a trade or business and having 15 or fewer shareholders, or
- money or other property attributable to an interest in the above.

To be considered qualified replacement property, the property must be acquired by the qualified heir within six months of the distribution, sale or exchange of qualified property. The term "qualified replacement property" also applies to property acquired to replace previously acquired replacement property.

EXAMPLE

A and B operated A & B Hardware Store, a partnership, with A having a 60% interest. A died on July 1, 1994, and left his interest in the partnership to his son C. For purposes of this example it is assumed that A's estate qualified for the installment payment of estate tax and that none of the interest in the partnership is included in the marital deduction. Because A was an individual who died after June 9, 1994, with an interest in a partnership with fifteen or fewer partners, and that interest was vested in a qualified heir, A's estate is entitled to an estate tax credit of 5% of the first $15 million of A's interest in the partnership.

On July 1, 1995, C, who has previously invested no additional money in the business, withdraws $300,000 from the business and, within six months, reinvests $100,000 of that withdrawal in new equipment for the business, which is qualified replacement property ($200,000 net withdrawal). Right before the withdrawal, the business is valued at $1,200,000, and the decedent's interest would have been valued at $720,000 ($1,200,000 x 60%). The value of the decedent's remaining interest after the withdrawal and after the reinvestment, (which is also C's interest) is $520,000 ($720,000 - $300,000 + $100,000). The net withdrawal amounts to a 27.8% disposition of the decedent's interest in qualified property, computed as follows:

Remaining Percentage of Original Interest After The Net Withdrawal	=	Remaining Percentage of Original Interest Before The Net Withdrawal	x Value of the Decedent's Remaining Interest After the Net Withdrawal / Value of the Decedent's Remaining Interest Right Before the Net Withdrawal
	=	100%	x $520,000/$720,000
	=	72.2%	

Aggregate Percentage Value of All Disposed Property = 100% - the Remaining Percentage

= 100% -72.2%

= 27.8%

Although the withdrawal is made within three years of A's death, the withdrawal does not result in a recapture of the credit because less than 50% of the decedent's interest in the partnership has been disposed of.

On July 1, 1996, C sold equipment and fixtures of the business for $200,000, which he keeps and does not reinvest in qualified replacement property within six months of the withdrawal. Before the sale, C's interest has grown in value from $520,000 on July 1, 1995, to $624,000 even though C has not put any additional capital into the business. After C's withdrawal of the sale proceeds, his interest in the business is $424,000.

The aggregate value of all qualified property disposed of is now calculated to be 50.9%,

Remaining Percentage of Original Interest After The Net Withdrawal	=	Remaining Percentage of Original Interest Before The Net Withdrawal	x Value of the Decedent's Remaining Interest After the Net Withdrawal / Value of the Decedent's Remaining Interest Right Before the Net Withdrawal
	=	72.2%	x $424,000/$ 624,000
	=	49.1%	

Aggregate Percentage Value of All Disposed Property = 100% - the Remaining Percentage

= 100% - 49.1%

= 50.9%

Because C has made one or more withdrawals within three years of A's death which has resulted in an aggregate of 50% or more of the decedent's interest in the partnership being disposed of, a recapture of the credit is required.

In this example, 24 complete months of the 36 months since the decedent's date of death have passed. Therefore, the additional tax due is (36-24)/36, or 1/3 of the additional estate tax that would have been due were it not for the credit originally taken.

The additional estate tax is due and payable on January 1, 1997, the date which is six months from the date of the disposition that resulted in the recapture. C, as the qualified heir, is personally liable for the additional estate tax. Since January 1, is a legal holiday, he should remit the additional estate tax by January 2, 1997, with an amended estate tax return and a worksheet showing how the additional tax was calculated.

However, if C were to invest the proceeds from the sale of July 1, 1996, in another closely held business within six months of the sale, the credit need not be recaptured. This is true because the investment in another closely held business is also considered qualified replacement property.