

Waiver of Penalty and Interest on Taxable Recoveries Associated with Causes of Action

On July 13, 1999, Governor George E. Pataki signed into law Chapter 232 of the Laws of 1999, directing the Commissioner of Taxation and Finance to waive penalties and interest on estate tax associated with a cause of action that was pending at the time of death or that was related to the decedent's death. The waiver is applicable from the date that the New York State estate tax return disclosing the cause of action is filed. Penalty and interest may not be waived for periods beyond one year after the date of the final judgment or settlement of the cause of action. This provision is effective for the estates of individuals dying on or after July 13, 1999. The new law amends section 976 of the Tax Law, by adding new subsection (e).

The federal Internal Revenue Code, as conformed to by the New York State Tax Law, provides that the value of any cause of action, if pending at the time of a decedent's death, must be estimated and included in the federal gross estate, as reported on the federal estate tax return; therefore, disclosure and valuation of causes of action pending at the time of death are required on the New York State estate tax return. (See Federal Estate Tax Regulations section 20.2033-1.)

The principal effect of the new law is to provide for the waiver of penalties and interest for late payment of estate tax that is attributable to a cause of action disclosed on the New York State estate tax return. The waiver of penalty and interest will apply to a period of up to one year from the date of the final judgment or settlement of the cause of action. This law provides relief to executors who represent estates engaged in litigation, which may yield no final judgment or settlement for several years after the original due date for payment of the tax. Where the estate receives payment of the final judgment or settlement, it must make payment of the tax within a reasonable period of time of receipt of payment. Where the tax is paid within 90 days of receipt of payment by the estate, the payment of tax will be presumed to have been paid within a reasonable period of time. However, in no event will penalty and interest be waived for a period beyond one year after the date of the final judgment or settlement.

The law also facilitates compliance with the valuation and disclosure requirements because executors no longer need to be concerned with New York State-imposed penalties and interest related to inadvertent undervaluation of a cause of action. Timely disclosure on the estate tax return of pending causes of action or those relating to a decedent's death will ensure waiver of penalty and interest on that tax which is the direct result of the cause of action. Penalty and interest may not be waived for periods beyond one year after the date of the final judgment or settlement of the cause of action. For the purposes of computing any applicable penalty and interest, the Tax Department will compute such tax as the difference between the estate tax computed on the estate, including the value of the cause of action, and the estate tax excluding the value of the cause of action. Where the estate is not otherwise required to file a return, and a cause of action is pending at the time of death or thereafter contemplated, it remains necessary for the estate to file a timely return and disclose the cause of action to avoid all possible penalties and interest on the tax associated with the cause of action.

Failure to disclose a cause of action on the estate tax return may result in the assessment of

penalty and interest on any unpaid tax. If a return has been filed and the executor failed to disclose a cause of action possessed by the decedent at the time of death or pending at the time of death, the return must be amended to disclose the cause of action. Any penalties and interest that may accrue on and after the date of filing the amended return will be waived, subject to the one year limitation described above.

Any part of a final judgment or settlement that is paid to compensate heirs for a decedent's wrongful death is not a taxable recovery; therefore, a wrongful death recovery is not includible in the decedent's New York adjusted gross estate.