New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

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Estate Tax
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1999 Estate and Gift Tax Amendments

This memorandum describes important 1999 legislative changes to the estate, gift, and generation skipping transfer taxes. Information relating to the following changes are included: armed services relief provisions; new family-owned business deduction; qualified conservation easement exclusion; closely held business interests; and generation skipping transfer tax information relating to a single trust being treated as two or more trusts.

Important tax relief provisions of Chapter 34 of the Laws of 1999

Tax relief granted to members of the Armed Forces serving as part of Operation Allied Force (Kosovo)

On April 26, 1999, Governor George E. Pataki signed into law Chapter 34 of the laws of 1999 ("the Act"). The Act conformed New York's tax relief provisions to the federal Internal Revenue Code tax relief provisions granted to members of the armed forces and support personnel serving in a *qualified hazardous duty area* as part of Operation Allied Force. The Act is deemed to have been in effect on the date hostilities commenced in Yugoslavia, March 24, 1999.

Serving in a *qualified hazardous duty area* means serving in the Republic of Yugoslavia (Serbia/Montenegro), Albania, the Adriatic Sea, and the northern Ionian Sea (above the 39th parallel) during the period for which any member of the armed forces is entitled to special pay under federal law for services performed in the area. The term also includes any area in which services are performed by an individual who is part of Operation Allied Force and who is outside the U.S. while deployed away from his or her permanent duty station.

Under these provisions, New York State will grant an extension of time to a covered person to file the New York State gift tax return until 180 days after the departure of such person from the qualified hazardous duty area, with no penalty or interest charged. The deadline for payment of the gift tax is also extended. During the same period, all New York State gift tax examinations or collections in reference to a covered person will be suspended. In addition, interest on overpayment of gift tax will be paid from the original due date of the gift tax return, if the return is filed by the extended due date.

The time to file gift tax returns and pay gift taxes are also extended throughout the period that a covered person is hospitalized due to injuries sustained while serving in a qualified hazardous duty area. In addition, these extensions remain in effect for 180 days after the hospitalization has ended. Neither penalty nor interest will be charged during such periods of hospitalization or the ensuing 180 days.

The spouse of a covered person is entitled to all of the above mentioned relief provisions.

Also, if a member of the armed forces or support personnel dies as a result of serving in a qualified hazardous duty area, no gift tax will be imposed for any tax year during which the decedent served in the area. Further, the New York State estate tax will be forgiven.

For more detailed information on these new armed services tax relief provisions for estate, gift, and personal income taxes relief provisions, see Important Notice N-99-9, *New York State Tax Information for Operation Allied Force (Kosovo) Personnel.*

(See Tax Law sections 696 and 990.)

Chapter 407 of the Laws of 1999 estate and gift taxes changes highlighted

On August 9, 1999, Governor George E. Pataki signed into law Chapter 407 of the laws of 1999 ("the Act"). The Act conformed, with modifications, the estate tax provisions of the New York State Tax Law to the federal Internal Revenue Code of 1986, and all amendments enacted on or before July 22, 1998. Highlights of those changes follow.

The new family-owned business deduction/repeal of the family-owned business exclusion

The family-owned business exclusion is repealed, and replaced by a deduction for family-owned business interests. The maximum deduction is $675,000.

The deduction may not be elected where either the credit for agricultural exemption or the credit for certain closely held business interests is elected. The application of these credits restricts the use of the family-owned business interest deduction in the same manner as the family-owned business exclusion was restricted under the old provisions.

The deduction applies whether or not a federal estate tax return is required to be filed. Where the estate is not required to file a federal estate tax return, the election to take the deduction must be made within the same time as would be required under the federal estate tax, had a federal estate tax return been required to be filed.

The family-owned business deduction is applicable to estates of individuals dying after December 31, 1997. However, the estates of individuals dying after December 31, 1997, but not later than September 8, 1999, may elect either the deduction or the exclusion.

(See Tax Law sections 954-c, 955, 958-a, 958-b.)

Change of time allowed to elect the exclusion for a qualified conservation easement

The time allowed to elect the qualified conservation easement exclusion has changed. To be timely, the exclusion must be elected on or before the due date, or extended due date, for filing the estate tax return. Previously, the exclusion could be elected on a late-filed return.

Under old provisions, the election was irrevocable. This meant that once the exclusion was elected on the return, the election could not be changed by filing an amended return. These new conforming provisions permit an executor to change the election, provided the change is made before the due date or extended due date for filing the estate tax return.

This amendment to the law is applicable to estates of individuals dying after December 31, 1997. However, the estates of individuals dying after December 31, 1997, but not later than September 8, 1999, may elect to apply the Tax Law without regard to these amendments.

(See I.R.C. section 2031(c)(6), Tax Law section 954-b.)

Clarification of the applicable interest rate for certain estates electing installment payments of the tax under Federal Internal Revenue Code section 6166

This amendment clarifies the interest rate to be applied where certain estates elect to defer payment of the tax under Federal Internal Revenue Code section 6166. Under section 6166, if more than 35% of the federal adjusted gross estate is comprised of closely held business interests (the "35% rule"), the estate qualifies to pay all or part of the estate tax in 2 to 10 equal installments. If the executor elects to pay the tax in installments, the first payment of the tax may be deferred for up to 5 years. These deferments are subject to a special 2% interest rate on the tax attributable to the first $1 million of qualified property. This portion is referred to as the "2% portion of the tax." Generally, the "2 percent portion of the tax" under the New York State Tax Law is defined as up to fifty-four thousand dollars in tax attributable to closely held business interests.

There are instances where the special 2% interest rate and deferment rules are inapplicable. Where an estate includes partnership interests, non-readily tradeable stock, or holding company stock, and any of these assets are used to meet the requirements of the 35% rule, the special 2% interest rate does not apply. In addition, these estates are not eligible to defer the first installment payment of the tax.

The practical impact of this exception for New York State estate tax purposes is this: where an estate elects to pay the tax in installments under section 997 of the Tax Law and any of these specific interests are included in the closely held business interest in order to meet the 35% rule, the special 2% rate is not applicable. While the Federal Internal Revenue Code applies a rate equal to 45 percent of the prevailing deficiency rate, New York State applies a rate equal to 100 percent of the prevailing deficiency rate.

Partnership interest, non-readily tradeable stock, and *holding company* are terms defined by the Federal Internal Revenue Code.

This amendment is applicable to estates of individuals dying after December 31, 1997.

(See I.R.C. sections 6166, 6166(b)(7) and (8), 6601(j), Tax Law sections 997(j)(4).)

Changes to the generation skipping transfer tax

The Act conformed the New York State generation skipping transfer tax law to the Internal Revenue Code of 1986, and all amendments enacted on or before July 22, 1998. Descriptions of those changes follow.

Effective August 9, 1999, and applicable to estates of individuals dying after August 5, 1997, the generation skipping transfer tax law is amended to clarify that the election to treat a qualified trust as a part of a decedent's estate under the federal income tax law only applies to the generation skipping transfer tax with respect to determining when a single trust may be treated as two or more trusts.

Under federal income tax law, a qualified revocable trust may be treated as part of an estate (and not as a separate trust), if both the executor (if any) and the trustee agree upon this treatment. Federal generation skipping transfer tax law defines the term "trust" for the purposes of generation skipping transfer tax as any arrangement (other than an estate) which, although not a trust, has substantially the same effect as a trust.

The Act further amended the generation skipping transfer tax law to broaden the circumstances under which a trust may be treated as two or more trusts. Under the old provisions, a single trust is treatable as two or more trusts only where there exists substantially separate and independent shares of different beneficiaries in a trust. For a portion to be treated as a separate share, that share must exist at the time of, and at all times after, the creation of the trust. The new law provides additional circumstances in which a single trust may be treated as two or more trusts. Under the new provisions, the portions of a trust attributable to different transferors are treated as separate trusts. The effect of this new provision is to allow multiple transferors forming a single trust to allocate their generation skipping tax exemption. Under the Act, a trust must be treated as part of an estate during any period that the trust is so treated under I.R.C. section 645.

(See Chapter 407 of the Laws of 1999, I.R.C. sections 644, 2652(b)(1), and 2654(b).)