Matter of Seiden (Hogan)
2018 NY Slip Op 32541(U)
October 9, 2018
Surrogate's Court, New York County
Docket Number: 2014-4802/B
Judge: Rita M. Mella
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SURROGATE'S COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

New York County Surrogate's Court
Date: October 9, 2018

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Application of Sara Jane Hogan, as Executor, Seeking to Vacate and set aside a Determination of the New York State Department of Taxation and Finance Declaring an Estate Tax Deficiency in the Estate of

EVELYN SEIDEN,

Deceased.

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DECISION and ORDER
File No.: 2014-4802/B

M E L L A, S. :

This is a proceeding pursuant to New York Tax Law § 998 to vacate and set aside a Notice of Estate Tax Deficiency. The court is asked here to determine the effect of the federal estate tax repeal for the year 2010 on the New York estate tax attributable to "QTIP" trusts for surviving spouses of individuals who died in that year.

Decedent Evelyn Seiden (decedent, or wife) died in November 2014, predeceased in 2010 by her husband, Jules Seiden (husband). Decedent was the beneficiary of a trust under her husband's will that was eligible for estate tax treatment as Qualified Terminable Interest Property, known as a "QTIP" trust. In general, a QTIP trust qualifies for the marital deduction in the estate of the first spouse to die, despite the surviving spouse's lack of control over the remainder as would otherwise be required (*compare* IRC § 2056 [b] [5], *with* IRC § 2056 [b] [7] [B]).[1] To so qualify under the federal law the first estate must make a specific election on its

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[1] As aptly explained by the 9th Circuit federal appeals court,

> "The QTIP is an exception to an exception to an exception. In general, a tax is levied on the transfer of estates. § 2001. However, the marital deduction is an exception to this rule, and any interest in property which passes to a surviving spouse is not considered part of the decedent's gross estate. § 2056(a). Life estates and other terminable interests are an exception to the marital deduction. § 2056(b)(1). Finally, the QTIP regime is an exception to the terminable interest exception to the marital deduction. A QTIP is a terminable interest in property which has certain limiting characteristics: (1) the surviving spouse receives all of the income from the property for life, distributed at least annually (a "qualifying

federal estate tax return (IRC § 2056 [b] [7] [B] [i] [III]). A concomitant federal tax code provision, IRC § 2044, requires that trust property for which a marital deduction "was allowed" in this manner be included in the estate of the surviving spouse.

Due to the repeal of the federal estate tax for the year 2010, the estate of the husband in this case was not required to file, and did not file, a federal estate tax return.[2] The husband's executor was required to file, and did file, a New York estate tax return. On the New York return the executor elected QTIP treatment in the manner authorized by the New York State Department of Taxation of Finance (Tax Department) in its Technical Services Bureau Memorandum TSB -M-10(1)(M), Estate Tax, March 16, 2010 (TSB Memorandum). In accordance with those instructions, she filed a "pro forma" federal return with the New York return, indicating the election by listing the QTIP property in a space on the federal form

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income interest"); (2) no person can appoint any part of the property to any person other than the surviving spouse; and (3) the decedent's estate elects to treat the interest as a QTIP. § 2056(b)(7)(B). If an interest is a QTIP, the regime establishes a legal fiction: for the purposes of estate taxes, the entire property is treated as if it passed to the surviving spouse (and, consequently, nothing to the remainder [beneficiaries])—even though the surviving spouse actually possesses only the income interest. § 2056(b)(7)(A). Therefore, the marital deduction of § 2056(a) applies to the entire QTIP property and the property is not included in the gross estate of the decedent.

"The underlying premise of the QTIP regime is that the surviving spouse is deemed to receive and then give the entire QTIP property, rather than just the income interest. The purpose of the QTIP regime is to treat the two spouses as a single economic unit with respect to the QTIP property while still allowing the first-to-die spouse to control the eventual disposition of the property."

(*Estate of Morgens v C.I.R.*, 678 F3d 769, 771 [9th Cir 2012].)

[2] The federal estate tax for 2010 was repealed by Section 501 of the Economic Growth and Tax Relief Reconciliation Act of 2001. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 gave executors the option to apply the estate tax to the estates of decedents who died in 2010 in return for certain income tax benefits, but the husband's executor here did not exercise that option.

designated for that purpose.[3] The husband's estate took a marital deduction for the trust property in calculating the New York estate tax, and the Tax Department issued a closing letter accepting the return in 2012.

The case here concerns the tax treatment of the trust in the estate of the wife, as the surviving spouse. Her executor excluded the value of the trust property on the federal estate tax return on the basis that no federal marital deduction had been claimed or "allowed" in the husband's estate, as is required to trigger inclusion in the second estate under IRC § 2044. The Internal Revenue Service issued a closing letter accepting the return as filed. The estate also excluded the trust property on decedent's New York estate tax return, taking the position that New York law defines its gross estate by reference to the federal gross estate, which clearly excludes the property. The Tax Department disagreed and assessed additional tax in the amount of $462,546.18,[4] all attributable to the QTIP trust. Decedent's estate seeks here to vacate the alleged deficiency. There are no disputed factual issues, and the parties have agreed that the court decide the matter on the papers submitted.

The Estate's Position

The estate argues that IRC § 2044 has no application to the wife's estate because, as stated above, no federal marital deduction was allowed in the estate of her pre-deceased husband. Since the trust property is not includible in her federal gross estate, it follows, the estate maintains, that the property is not includible in her New York gross estate, which is defined solely by reference to the federal definition. As provided in New York Tax Law (TL) § 954 (a):

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[3] Specifically, the trust property for which the election was made and which is referred to herein as the "QTIP" property was 78.4 percent of a trust designated as "Family Trust" under the husband's will.

[4] Including interest, the deficiency amounts to $529,342.86. Decedent's estate has paid the deficiency to stop the running of interest.

> "The New York gross estate of a deceased resident means his or her federal gross estate as defined in the internal revenue code (whether or not a federal estate tax return is required to be filed) . . . ."[5]

The Tax Department Position

The Tax Department contends that TL § 951 as it existed in 2010 requires a different result. That statute provided, "[A]ny reference to the Internal Revenue Code means the United States Internal Revenue Code of 1986, with all amendments enacted on or before July 22, 1998 . . . ." Thus, the Tax Department argues, the reference in TL § 954 (a) to the internal revenue code means the internal revenue code as it existed on July 22, 1998, when a federal marital deduction was "allowed," making IRC § 2044 operative under New York's tax regime to require inclusion of the trust property in the second estate.

Discussion

The Tax Department analysis is incorrect. First, the relevant tax law is that which existed in 2014, when decedent died, and not in 2010, because it is the tax on the wife's estate that concerns us here. In 2014, TL § 951 (a) was rewritten to change references to the federal tax law from that in effect on July 22, 1998, to the law as in effect on January 1, 2014. The statute as amended was made applicable to estates of persons, like decedent, who died after April 1, 2014 (L 2014, ch 59, pt X, §§ 1, 11). Under the federal tax law in effect on January 1, 2014, no marital deduction was "allowed" for decedents dying in 2010.[6]

Second, even under the law as it existed prior to 2014, no federal marital deduction was "allowed" in the husband's estate. To be "allowed" as QTIP property, it is necessary that the

[5] The statute includes modifications to the federal definition concerning out-of-state property, limited powers of appointment, and taxable gifts, not relevant here.
[6] As noted above, executors had the option of electing certain income tax benefits in lieu of the benefits of estate tax repeal, but no such election was made here.

executor make a particular election on the federal estate tax return. IRC § 2056 (b) (7) clearly states:

> "(i) . . . The term 'qualified terminable interest property' means property—
>
> . . .
>
> "(III) to which an election under this paragraph applies.
>
> . . .
>
> "(v) Election
> An election under this paragraph with respect to any property shall be made by the executor on the [federal estate tax return] . . . ."

See Estate of Morgens v C.I.R. (133 TC 402, 410-411 [2009], *affd* 678 F3d 769 [9th Cir 2012]) where the Tax Court stated:

> "Three requirements must be met for terminable interest property to qualify as QTIP: (1) The property passes from the decedent, (2) the surviving spouse has a qualifying income interest for life in the property, and (3) *the executor of the estate of the first spouse to die makes an affirmative election to designate the property as QTIP.* Sec.2056(b)(7)(B)" (*emphasis added*).[7]

The husband's executor did not make the required election in this case. Therefore, IRC §2044 does not apply, the QTIP property is not included in the wife's federal gross estate, and the property is not included in the New York gross estate as defined in TL § 954 (a).

The Tax Department also maintains that the TSB Memorandum referred to above is controlling and dispositive of the issue. The memorandum specifically states that if (as here) an election was made on a New York return to qualify trust property for QTIP treatment, "the value of the QTIP property for which the election was made must be included in the estate of the surviving spouse." This memorandum, however, is merely a statement of the Tax Department's

[7] *Accord Terrell v Sullivan*, 2015 WL 2473178, *3 (Super Ct Conn, Jud Dist of New Britain, Tax and Administrative Appeals Session, Apr 29, 2015, No. CV136020308) ("Since January 1, 1982, federal law has *allowed* a marital deduction [*if an appropriate election is filed*] for certain trusts even though the surviving spouse only has life use in the trust assets" [*emphasis added*]).

position and has no legal effect. The role of memoranda such as this is explained in TL §171 [Rule Twenty-third]:

> "Technical memoranda issued by the department shall advise and inform taxpayers and others of existing interpretations of laws and regulations by the department or changes to the statutory or case law of interest to the public."

The memoranda "do not have legal force or effect, do not set precedent and are not binding" (20 NYCRR 2375.6 [c]). *See Matter of AIL Systems, Inc.*, NY St Tax Appeals Trib DTA No. 819303, May 4, 2006, *available at* https://www.dta.ny.gov/pdf/archive/Decisions 819303.dec.pdf:

> "Technical Service Bureau Memoranda are merely informational statements issued by the Division [of Taxation] to disseminate current policies and guidelines and are advisory in nature, have no legal force or effect, are not binding and do not rise to the level of promulgated rule or regulation."

The memorandum cites IRC § 2044 and Tax Law § 954, but, as discussed above, neither of these sections supports the policy it announces. The Tax Department cannot use a TSB memorandum to override statutory provisions.

The Tax Department argues further that the "duty of consistency" doctrine prevents the wife's estate from taking one position on its tax return when the husband's estate had taken another. This doctrine is a form of estoppel, intended to prevent a taxpayer from benefiting from its error or omission on a tax return, only to take a contrary position on a subsequent return after the statute of limitations has expired on the first. The flaw in this argument is twofold: the husband's estate did not make an error or omission, and the wife's estate has not taken a contrary position. Both estates followed the law in effect at the time of their decedents' respective deaths. In a related argument the Tax Department attempts to show that it "relied" to its detriment on the husband's estate return by allowing the statute of limitations to run on the claim for a marital

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deduction. But that claim was entirely lawful, and the Tax Department cites no authority for how it might properly have denied that deduction.

The Tax Department also argues that the New York State legislature always intended that marital deduction property be taxed in the estate of the second spouse to die. The estate correctly responds that it is entitled to rely on the plain language of the statute, without resort to speculation about what the legislature intended. As the Court of Appeals stated in *Branford House, Inc. v Michetti* (81 NY2d 681, 686 [1993]),

> "Generally, a court may not assume the existence of legislative error and change the plain language of a statute to make it conform to an alleged intent."

It is true that a court may "correct" a legislative error in certain cases, but only "if it is established unquestionably that (1) the true legislative intent is contrary to the statutory language, and (2) the mistake is due to inadvertence or clerical error" (*id.*). The Tax Department has established neither of these elements. In fact, the legislature has amended the Tax Law in other ways to take account of the federal changes (including § 951, as discussed above, and § 955 [c]), but, in the eight years since the repeal of federal tax for the year 2010, has not acted to change the effect of the repeal on QTIP property in the circumstances of this case. The court also notes "the general rule" that "tax statutes are to be strictly construed with any doubt resolved in favor of the taxpayer" (*Compass Adjusters & Investigators v Commissioner of Taxation & Fin. of State of N.Y.*, 197 AD2d 38, 42 [3d Dept 1994]; *see also Matter of Gallatin*, 188 Misc 54, 55 [Sur Ct, Orange County 1946], *affd* 273 AD 870 [2d Dept 1948], *affd* 298 NY 812 [1949] ["In construing tax statutes it has been held that the literal meaning of the words is important, for such statutes are not to be extended by implication"]).[8]

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[8] This rule of construction applies to statutes that impose tax, such as that under consideration here, and is to be distinguished from laws relating to the collection of tax, not an

Lastly, the Tax Department posits that a decision vacating the deficiency in this case will "open the floodgates" to tax avoidance. As the estate points out, however, the legislature could still amend the Tax Law to apply to future estates. Moreover, it is not guaranteed that all or even part of any QTIP trust would be subject to New York estate tax at the death of the surviving spouse under present law. The trust property might decrease in value; it might be distributed and spent down; or the surviving spouse might change domicile to another state.

For the foregoing reasons, the petition is granted and the Notice of Deficiency is hereby vacated. This decision constitutes the order of the court.

Clerk to notify.

Dated: October 9 , 2018

SURROGATE

issue in this case (*Matter of Roosevelt Raceway, Inc. v Bedell*, 24 Misc 2d 374 [Sup Ct, Nassau County 1960], *affd* 12 AD2d 787 [2nd Dept 1961]).