The Paradoxical Computation of New York Estate Tax*

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New York estate tax was supposed to be little more than an afterthought. Effective February 1, 2001, New York adopted a so-called "sop" or "pick up" tax equal to the maximum amount of the federal state death tax credit that had been permitted under Internal Revenue Code (IRC) § 2011.[1]

Under that credit, every dollar of estate tax paid to New York reduced the federal estate tax by a corresponding dollar. New York estate tax, therefore, did not increase an estate's overall estate tax burden.[2] As a result, many hoped that New York estate tax could safely be ignored in estate planning.

Alas, no sooner did New York's sop tax become effective than Congress enacted legislation to replace the state death tax credit with a state death tax deduction.[3] The deduction, if state death tax is paid, reduces the federal taxable estate but, unlike a credit, does not produce a dollar-for-dollar reduction in the amount of federal estate tax. An estate that pays federal estate tax, therefore, may need to pay an extra tax to New York.

Meanwhile, the federal estate tax exemption amount has more than quintupled even as the maximum New York estate tax exemption amount has remained frozen at $1 million. With the federal exemption already $5.25 million and scheduled to increase annually, very few New York estates will have any federal estate tax liability. However, many more will have to pay New York estate tax.

For all its increased salience, however, the New York estate tax is not well understood. Many attorneys, for example, overlook that adjusted taxable gifts,[4] although they may not save federal estate tax, are normally excluded from the New York estate tax base. Consequently, a New Yorker can achieve significant estate tax savings by making lifetime gifts. Indeed, as discussed below, even gifts made just prior to death can save a substantial amount of tax.

Paradoxically, however, although lifetime gifts save New York estate tax, they simultaneously reduce the maximum amount that can pass free of New York estate tax at death. Although the maximum New York exemption amount is $1 million,[5] the maximum amount that can pass free of New York estate tax may be less than $1 million if the decedent made lifetime gifts. In fact, as discussed below, the effective New York estate tax exemption amount may be as low as $100,000 if the decedent made $900,000 or more of adjusted taxable gifts.

This article corrects some common misconceptions regarding the computation of New York estate tax, and discusses certain planning implications of that computation. One such implication is that New Yorkers of even moderate wealth should consider making lifetime gifts, including "deathbed" gifts. Another is that a so-called "credit shelter trust" for the benefit of a surviving spouse, even if limited to the New York exemption amount, may be undesirable in many cases.

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Computation of New York Estate Tax: A Review

N.Y. Tax Law § 952 imposes an estate tax equal to the maximum federal state death tax credit under IRC § 2011. Although the state death tax credit was phased out and ultimately eliminated under the Economic Growth and Taxpayer Relief and Reconciliation Act of 2001 (EGTRRA), for purposes of N.Y. Tax Law article 26 (relating to estate tax), references to the IRC are to the IRC as amended through July 22, 1998 (the "pre-EGTRRA IRC").[6] Thus, unlike many "sop" taxes enacted in other states, the New York estate tax was not effectively eliminated by the abolition of the federal state death tax credit. Rather, the New York estate tax is equal to the "old" credit that was available just before IRC § 2011 was amended by EGTRRA.[7]

To understand the computation of New York estate tax, therefore, one must understand how the state death tax credit was calculated under the pre-EGTRRA IRC. Under pre-EGTRRA IRC § 2011, one began by subtracting $60,000 from the decedent's taxable estate. The result was called the "adjusted taxable estate." The next step was to compute a tentative credit using the schedule set forth in pre-EGTRRA IRC § 2011(b). The schedule is reprinted in Appendix A of this article. For example, if the taxable estate was $1 million (resulting in an adjusted taxable estate of $940,000), the tentative credit under pre-EGTRRA IRC § 2011(b) was $33,200.[8]

The computation of the credit did not end there. Under pre-EGTRRA IRC § 2011(f), the state death tax credit could not exceed the federal estate tax under

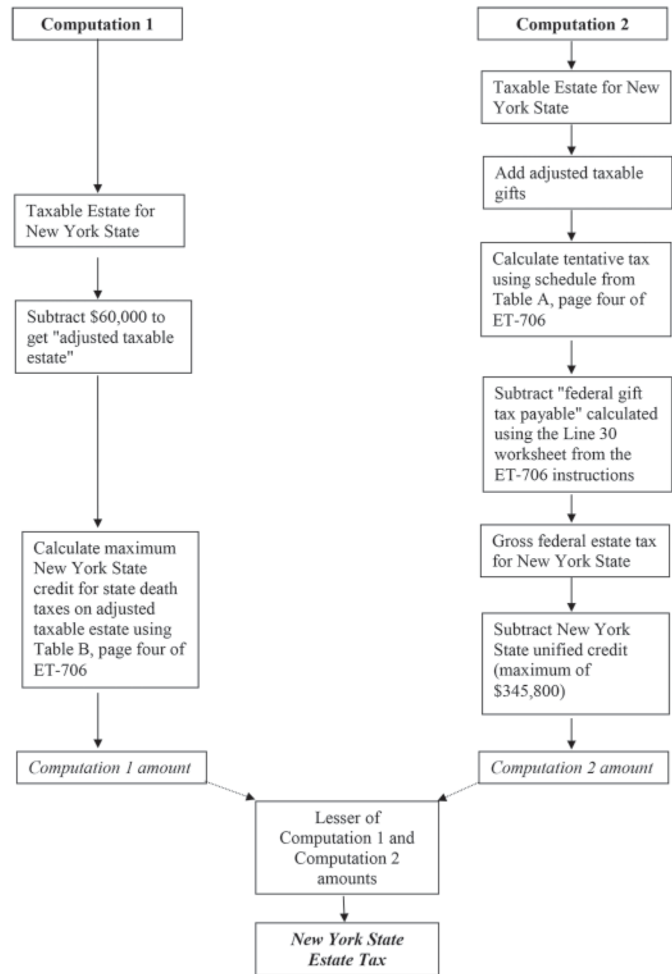
IRC § 2001(b), reduced by the unified credit. Thus, to derive the final amount of the credit, one had to calculate the "gross" federal estate tax (i.e., the tax before credits were subtracted) and then subtract the unified credit. The state death tax credit was only available if the tentative state death tax credit was less than the net federal estate tax.

In other words, pre-EGTRRA IRC §§ 2011(b) and 2011(f) divided the calculation of the state death tax credit into two separate computations, referred to herein as "Computation 1" and "Computation 2." Computation 1 is the tentative state death tax credit under pre-EGTRRA IRC § 2011(b). Computation 2 is the federal estate tax that would have been due under pre-EGTRRA IRC § 2001(b) after subtracting the unified credit. For purposes of the New York estate tax, N.Y. Tax Law § 951(a) stipulates that the unified credit is the amount that would be allowed if the applicable exclusion amount were $1 million. Under this definition, the New York unified credit is $345,800. This amount is subtracted from the hypothetical federal estate tax to obtain the result of Computation 2. New York estate tax is equal to the lesser of the Computation 1 and Computation 2 amounts.

The two computations are set forth in the New York State Estate Tax Return (ET-706) and corresponding instructions. Computation 2 happens to come first. On Line 29 of the ET-706, the tentative federal estate tax is calculated (at the 1998 rates) on the taxable estate for New York, plus adjusted taxable gifts. In accordance with pre-EGTRRA IRC § 2011(b)(2), the equivalent of a credit is then permitted on Line 30 for the federal gift tax that would have been payable on the decedent's taxable gifts, assuming a unified credit amount of $345,800. The New York unified credit ($345,800) is then subtracted from this tentative tax on Lines 32-35. The result is the Computation 2 amount, which is entered on line 35.

Computation 1 follows on line 36, which instructs the return preparer to calculate the maximum credit for state death taxes using Table B on page four of the return. Table B recapitulates the computation of the tentative state death tax credit under pre-EGTRRA IRC § 2011(b). If the maximum credit under Table B exceeds the amount on line 35, then the line 35 amount is entered on line 36 and also on line 1 of the ET-706. If, on the other hand, the maximum credit using Table B is less than the amount on line 35, then the maximum credit amount is entered on line 36 and again on line 1. With the exception of certain reductions for property located outside of New York State, the line 1 amount is the amount of New York estate tax due. Thus, to summarize, the New York estate tax equals the lesser of (1) the federal estate tax which would be due using 1998 rates and a unified credit of $345,800—i.e., the Computation 2 amount, and (2) the maximum credit for state death taxes under Table B—i.e., the Computation 1 amount.

The following flowchart illustrates the process for calculating New York estate tax:



How Gifts Save New York Estate Tax

Once the computation of New York estate tax is understood, it becomes clear that adjusted taxable gifts reduce the amount of New York estate tax that will be due at death. Suppose, for example, that a decedent dies with a taxable estate of $1.5 million having made no taxable gifts. In that case, the Computation 1 amount—i.e., the maximum state death tax credit under IRC § 2011(b)—will be $64,400. The Computation 2 amount—i.e., the hypothetical federal estate tax assuming a $1 million applicable exclusion amount—will be $210,000. Thus, the New York estate tax is $64,400, which is the lesser of the two amounts.

Table 1

Adjusted Taxable Gifts	Taxable Estate for New York State	Computation 1: Maximum State Death Tax Credit Under pre-EGTRRA IRC § 2011(b)	Computation 2: Hypothetical Federal Estate Tax Under Pre-EGTRRA Law Assuming a Federal Estate Tax Exemption of $1 million[9]	New York Estate Tax
$0	$5,000,000	$391,600	$2,045,000	$391,600
$1,000,000	$4,000,000	$280,400	$2,045,000	$280,400
$2,000,000	$3,000,000	$182,000	$1,610,000	$182,000
$3,000,000	$2,000,000	$99,600	$1,100,000	$99,600
$4,000,000	$1,000,000	$33,200	$1,045,000	$33,200
$4,900,000	$100,000	$0	$55,000	$0

Now suppose that the decedent gave away $500,000 during his or her lifetime in the form of adjusted taxable gifts and dies with a taxable estate of $1 million. The Computation 2 amount will be the same as before, i.e., $210,000. The Computation 1 amount, however, is now only $33,200. Thus, the New York estate tax is $33,200, or $31,200 less than the tax incurred if the decedent died with a taxable estate of $1.5 million. The $500,000 gift cuts the New York estate tax burden by nearly half.

There are essentially two reasons why, as the above example shows, adjusted taxable gifts save New York estate tax. First, adjusted taxable gifts are not included in the tax base under Computation 1. Rather, Computation 1 is based solely on the taxable estate. So long as Computation 1 results in a number that is lower than Computation 2, therefore, adjusted taxable gifts will reduce the amount of New York estate tax due.

Second, the Computation 1 amount is, in fact, normally less than the Computation 2 amount. After all, the federal government did not wish to shift 100% of its estate tax revenue to the states. On the contrary, the purpose of the state death tax credit was to shift some revenue to the states but keep the lion's share for the U.S. government. In other words, the tentative credit computed under pre-EGTRRA IRC § 2011(b) (Computation 1) was designed to be less than the federal estate tax due (Computation 2).

To illustrate, Table 1 (above) shows what happens if a New Yorker with $5 million of wealth gives away $0, $1 million, $2 million, $3 million, $4 million, or $4.9 million during lifetime via adjusted taxable gifts.

Note that there need not be any post-gift appreciation for the tax savings to be secured. Unlike in the case of the federal estate tax, adjusted taxable gifts are simply removed from the New York estate tax base under Computation 1.

The Effect of the New York Unified Credit

If the Computation 1 amount is normally less than the Computation 2 amount, and the New York estate tax is always the lesser of the two amounts, when will Computation 2 have any effect at all? The answer is that Computation 2 will be less than Computation 1 only if the decedent's taxable estate, plus adjusted taxable gifts, is between $100,000 and $1,093,785.30. In those situations, the Computation 1 amount (the maximum credit for state death taxes) will be greater than $0, while the Computation 2 amount (the hypothetical federal estate tax, reduced by the New York unified credit) will be $0 (or potentially greater than $0, if the taxable estate plus adjusted taxable gifts is between $1 million and $1,093,785.30, but still less than the Computation 1 amount). Thus, a taxpayer who never has more than $1 million of wealth will not save New York estate tax by making gifts. Regardless of whether he or she transfers wealth during lifetime or at death, the New York unified credit will ensure that the estate tax will always be $0 if he or she never had more than $1 million.

For a New Yorker with more than $1 million of wealth, by contrast, the New York unified credit turns out to be largely irrelevant. Because his or her wealth exceeds the maximum New York exemption amount, the Computation 2 amount will be greater than $0, regardless of whether the wealth is included in the taxable estate at death or added to the Computation 2 tax base as an adjusted taxable gift. The Computation 1 amount, however, will necessarily be less than the Computation 2 amount in nearly every case.[10] Thus, adjusted taxable gifts will still effectively reduce the amount of New York estate tax payable.

Deathbed Gifts

Even gifts made just prior to death can still save New York estate tax. It may be helpful to begin by reviewing why, by contrast, deathbed gifts do not generally save federal estate tax. There are essentially two reasons. First, lifetime taxable gifts, including those made before death, are added to the federal estate tax

base, either as adjusted taxable gifts or because they are included in the gross estate under one of the "string" sections of the IRC (i.e., IRC §§ 2035-42). Consequently, gifts made just before death will not save tax but will simply absorb more of the unified credit that is available to shield the taxable estate from tax.[11]

Second, any gift taxes paid on deathbed gifts are not removed from the federal estate tax base but added to the gross estate under IRC § 2035(b). That section requires inclusion in a decedent's gross estate of gift tax paid on gifts made within three years of death. Consequently, unless the donor survives three years from the date of the gift, his or her estate will pay estate tax on the gift taxes paid.

Neither of these reasons applies, however, in the case of New York estate tax, because of the way adjusted taxable gifts and gift taxes payable on deathbed gifts are factored into the computation of New York estate tax. As discussed, adjusted taxable gifts are not added to the Computation 1 tax base and therefore will normally escape New York estate tax. Unlike some states, New York does not currently impose estate tax on gifts made *causa mortis*. Nor does it have a "look-back" rule for gifts made within a certain period of time prior to death. Thus, as Computation 1 is normally less than Computation 2, adjusted taxable gifts, even if made just before death, reduce New York estate tax just as effectively as gifts made many years earlier.

Second, even though gift taxes payable on a deathbed gift are added to the taxable estate under IRC § 2035(b), the gift will still result in New York estate tax savings. Suppose, for example, that a decedent made a deathbed gift of $1 million and paid $400,000 of federal gift tax. The $400,000 will be added to the Computation 1 tax base and will increase the New York estate tax. However, the $1 million gift is not itself included in the Computation 1 tax base. Of the total $1.4 million, more than 70% escapes New York estate tax. At the highest New York estate tax bracket, the savings will be $160,000. Thus, even if a New Yorker pays federal gift tax on a deathbed gift, the gift can still save substantial New York estate tax.[12]

When Lifetime Gifts Do Not Save New York Estate Tax

In rare cases, even for a New Yorker with more than $1.1 million of wealth, an adjusted taxable gift will not produce tax savings. For example, suppose that a New York resident has $2 million and makes a lifetime gift of $1 million. By the time of the taxpayer's death, the property transferred by gift loses all of its value. The taxpayer dies with a taxable estate of $1 million and adjusted taxable gifts of $1 million. The New York estate tax is $33,200. Had the taxpayer retained the property and died with a $1 million taxable estate having made no taxable gifts, no New York estate tax would have been due.

Apart from that unusual circumstance, however, adjusted taxable gifts will almost always reduce New York estate tax if the decedent had more than $1 million of wealth.

How Lifetime Gifts Reduce the New York Exemption Amount

Perhaps counter-intuitively, although adjusted taxable gifts save New York estate tax, they also effectively reduce the amount that can pass free of New York estate tax at death. Technically, the New York unified credit is always $345,800. Unlike in the calculation of federal estate tax, however, the unified credit is not simply subtracted from the gross amount of New York estate tax. On the contrary, the New York unified credit is only subtracted in Computation 2 but plays no role in Computation 1. As adjusted taxable gifts are added to the tax base in Computation 2, they will absorb the unified credit, thereby reducing the size of the taxable estate that can pass free of tax under Computation 2.

Meanwhile, regardless of the amount of adjusted taxable gifts, a tax will still be generated under Computation 1 if the taxable estate is over $100,000. To illustrate, suppose that a New York resident makes $1 million in adjusted taxable gifts and dies with a taxable estate of $500,000. Although the taxable estate is less than $1 million, the sum of the taxable estate and adjusted taxable gifts is still $1.5 million. Thus, after subtracting the unified credit, Computation 2 produces a tentative tax of $210,000. Computation 1, meanwhile, produces a tentative tax of $10,800. The unified credit is not subtracted from the Computation 1 amount. Thus, $10,800 New York estate tax will be due.[13] The tax is significantly less than the $64,400 that would have been due if the decedent made no gifts and died with a taxable estate of $1.5 million. Nevertheless, the tax is not reduced to $0.

As the example shows, it is very difficult for a New Yorker with more than $1 million of wealth to avoid New York estate tax entirely (other than, of course, by transferring property in a form that qualifies for the estate tax marital or charitable deductions). The threshold above which Computation 1 produces a tentative tax is only $100,000. Consequently, so long as the sum of adjusted taxable gifts and the taxable estate exceeds $1 million, and thereby fully absorbs the New York unified credit under Computation 2, there will usually be some tax due under Computation 1.

The following table sets forth the largest taxable estate that will produce a New York estate tax of $0 assuming a given amount of total adjusted taxable gifts:

Table 2

If the decedent's total adjusted taxable gifts are:	Then the largest taxable estate that will not produce a New York estate tax is:
$0	$1 million
$100,000	$900,000
$200,000	$800,000
$300,000	$700,000
$400,000	$600,000
$500,000	$500,000
$600,000	$400,000
$700,000	$300,000
$800,000	$200,000
$900,000	$100,000
More than $900,000	$100,000

As Table 2 shows, as taxable gifts increase, the size of the taxable estate that can pass free of New York estate tax decreases. Once adjusted taxable gifts reach $900,000, the New York estate tax exemption amount is essentially reduced to $100,000 (but will not drop below $100,000, as that is the threshold at which the credit for state death tax begins to apply). If the taxpayer makes sufficient lifetime gifts to reduce his or her estate to $100,000 or less, New York estate tax will always be $0.

Planning Implications

1. Make Lifetime Gifts to Save New York Estate Tax

As discussed, a New York resident can significantly reduce his or her New York estate tax burden by making lifetime gifts. Even New York residents whose wealth does not exceed the federal estate tax exemption amount should consider making lifetime gifts, including gifts made just prior to death, in order to reduce their New York estate tax liability. The savings are enhanced if the property transferred by gift appreciates in value before the donor's death. However, adjusted taxable gifts can reduce New York estate tax even with no post-gift appreciation.

Making a gift in order to pass on future appreciation may be desirable if an individual's wealth does not currently exceed the maximum $1 million New York estate tax exemption amount. In that case, the value of his or her wealth for New York estate tax purposes can effectively be "frozen" by making gifts of assets likely to appreciate in value. If the individual's taxable estate plus adjusted taxable gifts is less than $1 million, New York estate tax will be avoided, even if the assets transferred during lifetime have appreciated significantly by the time of his or her death.

As is always the case when planning with lifetime gifts, however, consideration should be given to the fact that property transferred by lifetime gift does not receive the "step up" in basis applicable to property included in the decedent's gross estate.[14] The loss of a change in basis at death may cause significant capital gains tax if the appreciated property is later sold by the donee. That said, even accounting for the loss of the step up in basis, it will in many cases still be advantageous to make lifetime gifts. The income tax costs of lifetime gifts should always factor into the analysis of whether to make lifetime gifts and in identifying which assets to transfer.

2. Using Portability to Save New York Estate Tax

As the authors have noted elsewhere,[15] the new "portability" provisions of the IRC, which permit a surviving spouse to inherit the unused federal estate tax exemption of his or her predeceased spouse (the "first decedent"), enable married New Yorkers to achieve two objectives that had previously been seen (by many) as irreconcilable: deferring the payment of both federal and New York estate tax until the surviving spouse's death yet preserving the unused federal estate tax exemption of the first decedent.[16] For example, the first decedent may leave his or her entire estate to the surviving spouse in a form that qualifies for the estate tax marital deduction. Neither federal nor New York estate tax will be due, as the marital deduction will reduce the first decedent's taxable estate to zero.[17] Meanwhile, if the first decedent's executors make a portability election on a timely filed federal estate tax return, the first decedent's unused estate tax exemption is preserved for use by the surviving spouse.

Unlike the federal estate tax exemption, however, the first decedent's New York exemption cannot be inherited by the surviving spouse. Consequently, many planners continue to recommend that the first decedent bequeath an amount equal to the first decedent's New York exemption to a so-called "credit shelter trust" that, although for the benefit of the surviving spouse, does not qualify for the marital deduction. At the surviving spouse's death, the credit shelter trust will pass outside of his or her gross estate. In this manner, the first decedent's New York exemption is not lost or "wasted" but can be used to shield property from New York estate tax at the survivor's death.

A credit shelter trust, however, even if limited to the New York exemption amount, may not always be desirable. As discussed, if the first decedent made $900,000 or more of adjusted taxable gifts, the maxi-

mum taxable estate that can pass free of New York estate tax at the first decedent's death is only $100,000. The amount actually passing to the credit shelter trust may be even less if the first decedent makes pre-residuary bequests that do not qualify for the estate tax marital or charitable deductions. A credit shelter trust worth less than $100,000 may be uneconomical to administer. It may also complicate the administration of the first decedent's estate, by requiring revaluation of assets upon funding or recalculation from time to time of the beneficiaries' respective shares of principal and income. In some cases, the costs of creating and administering a very small credit shelter trust may exceed the potential estate tax savings.

At the same time, a credit shelter trust is not always needed to cause assets to pass free of New York estate tax at the surviving spouse's death. Like assets held in a credit shelter trust, assets transferred via adjusted taxable gifts are excluded from the Computation 1 tax base. Thus, the surviving spouse can effectively remove property inherited from the first decedent from the New York estate tax base by making adjusted taxable gifts. Such gifts will be shielded from federal gift tax by the survivor's own "basic" exemption amount and the additional exemption inherited from the first decedent, if a portability election was made. They will also reduce the total amount of New York estate tax, just as if they had passed outside of the survivor's taxable estate in the form of a credit shelter trust.[18] Finally, gifts have other significant estate tax planning advantages over a testamentary credit shelter trust. For example, unlike a testamentary credit shelter trust, a lifetime gift can be made to a trust that is structured as a so-called "grantor trust" for income tax purposes. The trust may then earn tax-free returns even as the donor's estate is depleted by the income tax liability.[19]

To be sure, the surviving spouse may not wish to relinquish access to and control over his or her wealth, including property passing from the first decedent. To address this concern, the survivor could wait to make gifts until his or her own death is imminent. On the other hand, the surviving spouse may not be able to predict when that will be. Further, by the time the survivor is prepared to make the gifts, his or her wealth may have increased significantly in value.

Those drawbacks can be overcome with proper planning. For example, rather than make a gift of conventional assets, such as cash or securities, the surviving spouse can make a gift of an income interest in one or more qualified terminable interest property (QTIP) trusts created by the first decedent.[20] A gift of an income interest in a QTIP trust will cause the surviving spouse to be deemed to have transferred principal under IRC § 2519.[21] Although QTIP trusts are normally included in the survivor's gross estate under IRC § 2044, that section does not apply if there was a deemed transfer of principal under IRC § 2519. In addition, it seems that the surviving spouse may, without significant risk of gross estate inclusion under other sections of the IRC, continue to receive principal of the QTIP trust at the discretion of an independent trustee.[22] In other words, both future income and appreciation can pass free of both federal and state estate tax at the surviving spouse's death, even though the surviving spouse retains beneficial access to trust principal. Depending on the size of the QTIP trust, a deemed gift under IRC § 2519 can "painlessly" remove more property from the survivor's gross estate than a credit shelter trust that is limited to the first decedent's New York exemption amount.

It should be noted that an estate plan relying on the portability election involves certain potential risks. One is that the surviving spouse may remarry and survive his or her second spouse prior to making lifetime gifts. In that case, the survivor will lose the exemption amount inherited from the first decedent.[23] Such a plan may also not be appropriate in a blended family situation, because it relies on the surviving spouse to make gifts to the first decedent's descendants, and could lead to potential disputes over making the portability election. However, for couples who view these risks as minimal, electing portability and allowing the surviving spouse to make lifetime gifts could result in significant savings in New York estate tax.

Conclusion

Even for experienced attorneys, the calculation of New York estate tax is counterintuitive. As we have seen, although adjusted taxable gifts effectively reduce the maximum taxable estate that can pass free of New York estate tax at death, they nevertheless nearly always save New York estate tax. Estate planners should advise New York resident clients to consider making gifts, regardless of whether their wealth exceeds the federal exemption amount. Finally, a credit shelter trust may not be appropriate for many married New Yorkers, as there are alternative techniques for achieving the same or even better results.

*As this issue went to press, the New York State Tax Reform and Fairness Commission formed by Governor Cuomo released its Final Report (the "Report"). The Report recommends significant reforms to the New York estate tax, including reinstating a New York gift tax in order to remedy the fact that, as discussed in this article, "taxpayers can easily reduce or avoid the [New York] estate tax by making lifetime gifts…." *See* Report at 20. In advising their clients, planners should take into consideration the possible effect of these or other future reforms to the New York wealth transfer tax system.

Endnotes

1. For an interesting history of the New York estate tax, see E. Schwab, *New Federal Law Impacts New York's Estate Tax*, N.Y.L.J., Apr. 16, 2001, p. 23, col. 5.
2. It should be noted that the state death tax credit did not always provide a complete offset against the total tax burden for state death taxes paid. If the taxable estate included items of income in respect of a decedent (IRD), which are included in the income of the recipient of such items under IRC § 691, the state death tax credit effectively increased the income tax burden of the IRD recipients by reducing the corresponding deduction for estate tax attributable to the items of IRD under IRC § 691(c). For purposes of that deduction, the "estate tax" attributable to the items of IRD refers to the federal estate tax, reduced by any credits against such tax, including the state death tax credit prior to its termination.
3. The deduction is found in IRC § 2058. IRC § 2011(f) now provides that the state death tax credit does not apply to estates of decedents dying after December 31, 2004.
4. IRC § 2001(b) defines "adjusted taxable gifts" as gifts made after 1976 that are not included in the decedent's gross estate. So long as a post-1976 gift is not pulled back into the decedent's gross estate under IRC §§ 2035-42 (often referred to as the "string" sections, which can cause property transferred during lifetime to be included in the decedent's gross estate), it will be treated as an adjusted taxable gift for estate tax purposes.
5. As of the time of this writing, a bill is pending in the New York State Assembly (S. 3035) that would increase the maximum New York exemption amount to $5 million by 2016. However, it would not change the manner in which New York estate tax is calculated, nor would it cause the New York exemption to match the federal exemption.
6. See N.Y. Tax Law § 951(a).
7. The prior version of IRC § 2011 is helpfully reprinted in the appendix to N.Y. Tax Law art. 26.
8. This amount equals $27,600 + 5.6% x ($940,000 - $840,000), as calculated in accordance with the schedule set forth in Appendix A.
9. As the table shows, the Computation 2 amount decreases if the decedent made adjusted taxable gifts in excess of $1 million. The reason for the decrease is that the Computation 2 amount, which represents the hypothetical federal estate tax that would be due under the pre-EGTRRA IRC, is reduced under pre-EGTRRA IRC § 2001(b)(2) by the amount of federal gift tax "which would have been payable" on the decedent's taxable gifts. With a unified credit amount of only $345,800, the decedent's lifetime taxable gifts, if greater than $1 million, would have caused gift tax to have been payable, which in turn reduces the hypothetical amount of federal estate tax which would have been due under the pre-EGTRRA IRC (i.e., the Computation 2 amount). To be sure, given that the actual federal lifetime gift tax exemption amount now exceeds $5 million, the decedent may have paid no federal gift tax at all (or far less gift tax than would have been due if the unified credit had been only $345,800). As the Tax Court held in Estate of Smith v. Commissioner, 94 T.C. 872 (1990), however, it is irrelevant whether gift tax was actually paid or not for purposes of the computing the effective credit for gift tax "which would have been payable" under IRC § 2001(b)(2). The instructions to ET-706 acknowledge this conclusion in the Line 30 worksheet, which states that "[t]ax payable as used here is a hypothetical amount and does not necessarily reflect tax actually paid." But see Pennell & Baskies, *Does the Gift by Promise Plan Work?* (LISI Estate Planning Newsletter #2022) (November 6, 2012) (arguing, but without distinguishing Smith, that gift tax must actually be paid in order for the effective credit for gift tax payable under IRC § 2001(b)(2) to be available).
10. For a New Yorker who has between $1 million and $1,093,785.30 in wealth, the hypothetical federal estate tax, after taking the New York unified credit into account, will be greater than $0. However, that hypothetical federal estate tax (i.e., the Computation 2 amount) will still be lower than the tentative state death credit under Computation 1. According to the authors' calculations, the "threshold" at which the hypothetical federal estate tax under Computation 2 (assuming that lifetime gifts do not exceed $1 million) equals the tentative state death tax credit under Computation 2 is $1,093,785.30.
11. If gift tax is payable on the gifts, the gifts will still be included in the estate tax base as adjusted taxable gifts (or under one of the IRC's "string" sections). However, the donor's estate will receive the equivalent of a credit for the gift tax payable under IRC § 2001(b)(2). For a discussion of the mechanics of this credit, see A. Bramwell, *Gift-by-Promise Plan Works as Advertised* (LISI Estate Planning Newsletter #2033), Dec. 3, 2012.
12. Although references to the IRC in N.Y. Tax Law art. 26 are generally deemed to be references to the pre-EGTRRA IRC, New York does not appear to require, for purposes of IRC § 2035(b), a hypothetical computation of federal gift tax payable under the pre-EGTRRA IRC. Thus, it seems that the New York gross estate only includes federal gift tax on gifts made within three years of death to the extent that gift tax was actually payable under the (post-EGTRRA) IRC. It does not appear to include gift tax that hypothetically would have been payable on lifetime gifts under the pre-EGTRRA IRC. *Cf.* N.Y. Tax Law § 961(a)(1) (providing that a final federal determination of the inclusion of an item in the gross estate shall also determine whether it is included for New York estate tax purposes). By contrast, as discussed *supra* note 10, the computation of the effective credit under IRC § 2001(b)(2) for gift tax "which would have been payable" *does* require a hypothetical computation of gift tax, even if none was actually paid.
13. A similar example is provided in J. Blattmachr & M. Gans, *The Quadripartite Will: Decoupling and the Next Generation of Instruments*, 32 Estate Planning 3 (April 2005), which contains an excellent discussion of the effect of lifetime gifts on the New York exemption amount.
14. IRC § 1014 generally provides (subject to exceptions, such as for income in respect of a decedent) that property acquired from a decedent shall have a basis equal to the fair market value of the property at the date of the decedent's death. In contrast, a donee's basis in gifted property is generally equal to the donor's basis in such property at the time of the gift. IRC § 1015.
15. A. Bramwell & V. Kanaga, *The Section 2519 Portability Solution*, Trusts & Estates (June 2012); A. Bramwell, *How to Use Portability to Avoid (Not Just Defer) State Death Taxes* (LISI Estate Planning Newsletter #1991), July 24, 2012; J. Blattmachr, A. Bramwell & D. Zeydel, *Portability or No: The Death of the Credit Shelter Trust?*, 118 Journal of Taxation 5 (May 2013).
16. *But see* J. Blattmachr & M. Gans, *supra* note 13 (offering a technique for avoiding New York estate tax on the amount of the first decedent's federal exemption using Rev. Proc. 2001-38).
17. The first decedent's GST exemption under IRC § 2631 is not "wasted" so long as his or her assets pass, for example, to a "reverse" QTIP trust for the benefit of the surviving spouse to which the first decedent's GST exemption is allocated. IRC § 2652(a)(3).
18. Gifts will not reduce New York estate tax, however, if the sum of the survivor's taxable estate and adjusted taxable gifts would, but for the assets inherited from the first decedent, have been less than $1 million. Thus, a credit shelter trust may be preferable if the survivor's wealth is less than $1 million. Flexibility may be preserved through disclaimers and/or partial QTIP elections, including QTIP elections subject to "Clayton" provisions. *See generally* J. Blattmachr, A. Bramwell & D. Zeydel, *supra* note 15.
19. *See* Rev. Rul. 2004-64 (ruling that the payment of income tax by the grantor of a grantor trust does not constitute an additional gift to the trust because the income tax liability was that of the grantor, not the trust).

20. This type of planning is explained in further detail in A. Bramwell & V. Kanaga, *supra* note 15; *A. Bramwell & V. Kanaga on PLR 201243004*, (LISI Estate Planning Newsletter #2040), Dec. 20, 2012, and J. Blattmachr, A. Bramwell & D. Zeydel, *supra* note 15. *See also* A. Bramwell, *Using Section 2519 to Enhance Estate Planning with QTIPs*, 38 Estate Planning 10 (Oct. 2011).

21. The survivor should not have a power over the trust, such as a special power of appointment, that may cause the deemed gift of principal to be incomplete for gift tax purposes. Cf. Treas. Reg. 25.2511-2(b).

22. *See* Rev. Rul. 2004-64, for example, in which the IRS ruled that a trustee's discretion to reimburse the grantor for income tax due on the income of a grantor trust did not, absent other facts (such as an implied understanding between the grantor and the trustee), cause inclusion under IRC § 2036(a)(1), even though the trustee had the discretion to make a payment in satisfaction of an obligation of the grantor. *See also* Priv. Ltr. Rul. 200944002 (Oct. 2009) (stating "the trustee's discretionary authority to distribute income and/or principal to [the grantor], does not, by itself, cause the [t]rust corpus to be includible in [the grantor's] gross estate under § 2036"). Also note that the surviving spouse should not have a power of appointment over the corpus of the QTIP trust(s), in order to avoid inclusion under IRC §§ 2036(a)(2) or 2038. Finally, the surviving spouse should not have a power to participate in decisions to distribute principal, even if limited to a standard. *Cf. Estate of Sullivan*, T.C. Memo 1993-531 (holding that the principal of a trust was included in the decedent's gross estate where the decedent retained a power to make distributions that, although limited to a standard, could be used to satisfy his own support obligations).

23. IRC § 2010(c)(4)(B) (providing that, with respect to a surviving spouse, the "deceased spousal unused exclusion amount" is the lesser of (a) the basic exclusion amount, or (b) the remaining applicable exclusion amount of the "*last such deceased spouse* of such surviving spouse") (emphasis added).

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APPENDIX A

Tentative Credit under Pre-EGTRRA IRC § 2011(b)

If the adjusted taxable estate is:	The maximum tax credit shall be:
Not over $90,000	8/10ths of 1% of the amount by which the adjusted taxable estate exceeds $40,000
Over $90,000 but not over $140,000	$400 plus 1.6% of the excess over $90,000
Over $140,000 but not over $240,000	$1,200 plus 2.4% of the excess over $140,000
Over $240,000 but not over $440,000	$3,600 plus 3.2% of the excess over $240,000
Over $440,000 but not over $640,000	$10,000 plus 4% of the excess over $440,000
Over $640,000 but not over $840,000	$18,000 plus 4.8% of the excess over $640,000
Over $840,000 but not over $1,040,000	$27,600 plus 5.6% of the excess over $840,000
Over $1,040,000 but not over $1,540,000	$38,800 plus 6.4% of the excess over $1,040,000
Over $1,540,000 but not over $2,040,000	$70,800 plus 7.2% of the excess over $1,540,000
Over $2,040,000 but not over $2,540,000	$106,800 plus 8% of the excess over $2,040,000
Over $2,540,000 but not over $3,040,000	$146,800 plus 8.8% of the excess over $2,540,000
Over $3,040,000 but not over $3,540,000	$190,800 plus 9.6% of the excess over $3,040,000
Over $3,540,000 but not over $4,040,000	$238,800 plus 10.4% of the excess over $3,540,000
Over $4,040,000 but not over $5,040,000	$290,800 plus 11.2% of the excess over $4,040,000
Over $5,040,000 but not over $6,040,000	$402,800 plus 12% of the excess over $5,040,000
Over $6,040,000 but not over $7,040,000	$522,800 plus 12.8% of the excess over $6,040,000
Over $7,040,000 but not over $8,040,000	$650,800 plus 13.6% of the excess over $7,040,000
Over $8,040,000 but not over $9,040,000	$786,800 plus 14.4% of the excess over $8,040,000
Over $9,040,000 but not over $10,040,000	$930,800 plus 15.2% of the excess over $9,040,000
Over $10,040,000	$1,082,800 plus 16% of the excess over $10,040,000

For purposes of this section, the term "adjusted taxable estate" means the taxable estate reduced by $60,000.