

# Computation of Allowable Deductions for New York State Estate Tax—New Guidance

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## Introduction

On October 27, 2015, the New York State Department of Taxation and Finance issued Technical Memorandum TSB-M-15 (4) M, which provides guidance on the computation of allowable deductions for New York estate tax purposes. Under New York law, deductions must be related to the New York taxable estate to be taken on the New York estate tax return.

For a decedent who was a resident of New York State at the time of his or her death, this means that deductions relating to real or tangible personal property located outside of New York State may not be taken on the New York estate tax return. For a decedent who was a nonresident of New York State, deductions relating to real or tangible personal property located outside of New York State, and deductions relating to intangible personal property, may not be taken on the New York Estate Tax Return.

The Technical Memorandum clarifies that (i) for resident and nonresident estates, deductions both directly and indirectly relating to real or tangible personal property located outside New York State are disallowed, and (ii) for nonresident estates, deductions both directly and indirectly relating to intangible personal property are also disallowed. The Technical Memorandum also explains how to determine which deductions directly relate to property and how to calculate the amount of deductions which indirectly relate to property.

## Deductions Directly Relating to Real or Tangible Personal Property Outside New York

In both the analysis for resident and nonresident estates, deductions directly relating to real or tangible personal property outside New York are disallowed and must be computed. The first step is to identify tangible personal property and real property reported on the Federal estate tax return which is located outside of New York. Then, all deductions taken on the Federal estate tax return must be reviewed to identify those that directly relate to such property. Examples of deductions which directly relate to real or tangible personal property are: fees to appraise such property, real estate taxes, maintenance, utilities and insurance premiums relating to such property, claims against such property, commissions paid to sell such property,

charitable deductions for such property, mortgages secured by such property, and the amount of such property for which a marital deduction is taken on Schedule M of the Form 706.

## Deductions Directly Relating to Intangible Personal Property

In the analysis for nonresident estates, deductions directly relating to intangible personal property are disallowed and must be computed. The first step is to identify intangible personal property reported on the Federal estate tax return. Examples of intangible personal property are: stocks (including stock representing ownership of a cooperative apartment), bonds, cash, bank and brokerage accounts, and interests in closely held companies, partnerships and limited liability companies. The next step is to review all deductions taken on the Federal estate tax return to identify those which directly relate to the intangible personal property. Examples of deductions that directly relate to intangible personal property are: investment management fees, maintenance for a cooperative apartment, commissions and other expenses incurred to sell a cooperative apartment, check fees, and the amount of intangible personal property included in a marital deduction taken on Schedule M of the Form 706.

## Deductions Indirectly Relating to Real Property, Tangible Personal Property or Intangible Personal Property

In the analysis for a resident estate, deductions indirectly relating to real or tangible personal property located outside New York are disallowed. In order to determine which deductions indirectly relate to real or tangible personal property located outside of New York, all deductions which indirectly relate to any property must first be identified. Then, the total amount of deductions which indirectly relate to any property is multiplied by a fraction, the numerator of which is the value of real and tangible personal property located outside of New York and the denominator of which is the value of the Federal gross estate. The product of this computation yields the amount of Federal deductions that indirectly relate to real or tangible personal property outside New York and which are disallowed for a resident estate.

In the analysis for a nonresident estate, deductions indirectly relating to (i) real property or tangible personal property outside of New York, and (ii) all intangible personal property are disallowed. All deductions that indirectly relate to property must first be identified. Then, the total amount of deductions that indirectly relates to property is multiplied by a fraction, the numerator of which is the value of real property and tangible personal property located outside New York plus the value of all intangible personal property, and the denominator of which is the value of the Federal gross estate. The product of this computation yields the amount of Federal deductions that indirectly relates to real and tangible personal property outside New York and intangible personal property and which are disallowed for a nonresident estate.

Deductions that indirectly relate to property are those not directly related to real property (wherever located), tangible personal property (wherever located) or intangible personal property. Examples of deductions which indirectly relate to property are: executor's commissions, attorney's fees, accountant's fees, funeral expenses, and unsecured debts.

#### Example 1

Assume a resident of New York has a Federal gross estate of \$20 million, which consists of \$5 million of real and tangible personal property in New York, \$2 million of real and tangible personal property in Florida, and \$13 million of securities and cash. All real and tangible personal property is bequeathed to the decedent's spouse, \$4 million is bequeathed to a family trust, and the residuary estate is bequeathed to the surviving spouse. Deductions taken on the Federal estate tax return total \$16 million and include: \$30,000 of funeral expenses, \$100,000 of legal fees, \$40,000 of New York real estate tax, \$20,000 of Florida real estate tax, \$4,000 of fees to appraise New York property, \$2,000 of fees to appraise Florida property, and a marital deduction of \$15,804,000.

Deductions directly relating to real or tangible personal property are computed as follows: real and tangible personal property located outside of New York consist of \$2 million of property in Florida. Deductions directly relating to the Florida property are: \$20,000 of real estate tax, \$2,000 of appraisal fees and a marital deduction of \$2 million. None of these deductions may be taken on the New York return.

Next, deductions indirectly relating to real or tangible personal property located outside of New York must be computed. The total amount of deductions which indirectly relate to any property are: funeral expenses of \$30,000 and legal fees of \$100,000, for a

total of \$130,000. The amount of the deductions that indirectly relate to real and tangible personal property located outside of New York is computed in accordance with the following formula:

In this example there is a total of \$2,035,000 dis-

Total amount of deductions indirectly relating to any property	X	Value of real and tangible personal <u>property outside NY</u> Federal gross estate	=	Deductions indirectly relating to real and tangible personal property located outside NY
\$130,000		X <u>\$2 million</u> \$20 million		= \$13,000

allowed deductions comprised of \$2,022,000 (those directly relating to real or tangible personal property outside NY) and \$13,000 (those indirectly relating to real and tangible personal property outside NY).

#### Example 2

Assume a nonresident of New York has a Federal gross estate of \$100 million. There is a house in Connecticut worth \$2 million, artwork in Connecticut worth \$5 million, a cooperative apartment in New York worth \$10 million, artwork in the New York apartment worth \$50 million, and cash and securities worth \$33 million. The estate is taxable. Deductions taken on the Form 706 are: funeral expenses of \$40,000, legal fees of \$500,000, commissions to sell art in Connecticut of \$500,000, commissions to sell art in New York of \$2.5 million, broker's commissions to sell the New York apartment of \$500,000, Connecticut real estate taxes of \$20,000, maintenance on the New York apartment of \$100,000 and investment management fees of \$30,000.

Deductions directly relating to real or tangible personal property located outside of New York are: commissions for the sale of art in Connecticut of \$500,000 and Connecticut real estate taxes of \$20,000. These deductions total \$520,000 and are disallowed.

Deductions directly relating to intangible personal property are: broker's commissions of \$500,000, maintenance on the New York apartment of \$100,000 and investment management fees of \$30,000. These deductions total \$630,000 and are disallowed.

Deductions indirectly relating to property (those which do not directly relate to property) are: funeral expenses of \$40,000 and legal fees of \$500,000. The

amount of deductions indirectly relating to real and tangible personal property located outside New York and intangible personal property is computed in accordance with the following formula:

Total amount of deductions indirectly relating to any property	X	Value of real and tangible personal property outside NY plus intangible personal <u>property</u>  Federal gross estate	=	Deductions indirectly relating to real and tangible personal property outside NY and to intangible personal property
\$540,000	X	<u>\$50 million</u> \$100 million	=	\$270,000

In this example there is a total of \$1,420,000 disallowed deductions comprised of \$520,000 (directly relating to real and tangible personal property outside

New York), \$630,000 (directly relating to intangible personal property), and \$270,000 (indirectly relating to real and tangible personal property outside New York and to intangible personal property). The Federal deductions must be reduced by \$1,420,000 when computing the New York taxable estate.

### Conclusion

The new guidance on computation of allowable deductions applies to New York estate tax returns filed for decedents dying on or after April 1, 2014 and, in particular, to decedents who were New York residents with real or tangible personal property located outside of New York or who were nonresidents of New York. Returns filed before the issuance of the Technical Memorandum must be amended if they do not comply. The state in which a New York resident owns real or tangible personal property (or in the case of a nonresident of New York, the state in which he or she resides) may have a different rule for determining its state's estate tax.

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