

Estate Planning Considerations for New York Residential Real Estate

By **Elisa Shevlin Rizzo** and
John Voltaggio

It is sometimes said a person's home is their "castle." Few actually have moats, drawbridges or turrets, but for many homeowners, their residence is their largest asset. According to the most recent reports from the U.S. Census Bureau, between 2000 and early 2020, the national rate of homeownership has fluctuated from approximately 63% to 69% and home equity accounted for more than 34% of household net worth in 2015 and 2016 (Eggleston, Jonathan, and R. Munk, "Net Worth of Households: 2016," U.S. Census Bureau, 2019). Although homeownership rates in New York state (NYS) (50.9% in 1Q 2018) and New York City (NYC) (33%) lag the national average, real estate remains an important investment for many individuals, even during the current pandemic. As such, its value presents several estate planning and wealth transfer considerations surrounding a client's home or other residence that legal advisors must take into account.

ELISA SHEVLIN RIZZO is senior fiduciary officer and legal counsel, and JOHN VOLTAGGIO is managing director, at Northern Trust.



Estate and Gift Tax

Minimizing or deferring estate tax is top-of-mind for most individuals. As such, advisors should anticipate the impact of federal and/or NYS estate taxes on real property owners.

In 2020, U.S. taxpayers may transfer up to \$11.58 million, either during lifetime or at death, which is free from federal estate, gift and generation-skipping transfer tax. These increased exemptions were enacted in 2017 as part of the Act known as the Tax Cuts and Jobs Act (TCJA) that temporarily doubled the base exclusion of \$5 million under prior law to \$10 million

indexed for inflation (P.L. 115-97). Estates exceeding the federal exemption amount may be subject to federal estate tax at rates of up to 40%. In 2020, NYS residents and non-residents who own NYS-situs real property or tangible personal property whose estates exceed the NYS basic exclusion amount of \$5.85 million (\$5 million indexed for inflation) may also be subject to a separate NYS estate tax (NYS Tax Law §§952 (NYS residents) and 954 (non-residents)).

The difference between the federal and NYS estate tax exemptions means that owners of NYS real property may be subjected to

state estate taxation even though their estates would not be subject to federal estate tax. Furthermore, individuals whose NYS taxable estates exceed the NYS basic exclusion amount may be surprised to find that the benefits of the NYS estate tax exemption are gradually phased out for estates valued between 100% and 105% of the basic exclusion amount and that estates in excess of 105% of the exclusion amount lose the benefit of the NYS exclusion entirely and are subject to NYS estate tax on every dollar.

Title Review

Legal advisors should also review how a client's property is titled during life and how that ownership structure will impact the client's post-death objectives.

If property is owned by multiple owners, title to the property may take different forms. One form of joint ownership is a "tenancy in common" (TIC) whereby each co-owner is deemed to hold a one-half interest in the whole. With a TIC, the property interest of each co-owner passes as a part of his/her estate at death. Another form of joint ownership is "joint tenants with right of survivorship" (JTWROS) whereby the interest of a deceased owner passes automatically by operation of law to the co-owner. A third form of joint ownership is a "tenancy by the entirety" (TBE) which is similar to JTWROS but applies only to property held by married couples. EPTL §6-2.2 creates a presumption that real property or co-op shares made on or after Jan. 1, 1996 to a husband and wife create a tenancy by the entirety (TBE), unless otherwise specified in the deed. A transfer of real or personal property

to multiple people who are not married creates a TIC, unless JTWROS is expressly stated.

JTWROS or TBE might be the simplest option for transferring ownership to a surviving spouse but can be sub-optimal from an estate tax planning perspective. Prior to the 2010 Tax Act, which increased the federal estate tax exemptions and introduced the notion of "portability" (allowing a surviving spouse to use his/her deceased spouse's unused federal estate tax exemption, provided that the requisite election is made on a timely filed federal estate tax return, Form 706), it was common for spouses to change title from JTWROS or TBE to TIC, so that the decedent's half interest in jointly-held real property could be used to fund an estate tax sheltered trust for the decedent's heirs.

However, there is no portability either for federal GST purposes or for NYS estate tax purposes. Therefore, planning to shelter the GST exemption and the NYS estate tax exemption upon the death of the first spouse to die continues to be important for NYS real property owners who are looking to minimize the overall transfer tax burden on their estates. As a result, it may still be preferable for married couples to take title to NYS real property as TIC, so that any interest in jointly-held real property can pass to estate and GST-tax sheltered trusts created under the property owners' estate planning documents.

Ownership Structure and Entity Planning

Whether the owner plans to hold the property for his/her own use, or to gift or transfer the property to

his/her heirs, consider structuring ownership of a primary or vacation home in the name of an entity, such as a LLC or partnership.

Using an entity can simplify the owner's ability to transfer or gift a portion or all of the underlying real estate to heirs or trusts for the benefit of others/heirs. Gifts or transfers of minority interests in the entity may also be eligible for valuation discounts based on lack of marketability or lack of control. This may be particularly attractive to families who desire to pass a home or vacation property down to future generations. Multi-member LLCs can enhance asset protection as well.

When planning for non-resident NYS real property owners, the use of an entity may determine whether the property is subject to NYS estate taxation. Under NYS Tax Law §960, non-residents are generally not subject to NYS estate tax on intangible personal property. While NYS real property held in a single member LLC will be treated as real property subject to NYS estate taxation (TSB-A-15(1)M dated May 29, 2015 and TSB-A-16(3)M dated Aug. 26, 2016), an interest in a multi-member LLC or partnership that owns NYS-situs real property is treated as an intangible and will therefore escape NYS estate taxation at the member's death (TSB-A-10(1)M and TSB-A-11(1)M).

One caveat to the use of LLCs to hold NYS-situs real property is that as of Sept. 13, 2019, any LLC that is the buyer or seller of any one-to-four family residence or residential condominium must disclose the names, addresses and taxpayer identification numbers of all individual members, shareholders, partners or officers, whether

the transfer is for consideration, and whether it was made by gift or bequest (NY Tax Law §1409(a) and NYC Admin. Code §11-2105). These disclosure requirements may be challenging, particularly for complex LLC structures.

Lifetime Gifts and Asset Transfers

With no separate NYS gift tax, and federal transfer tax exemptions at historic highs (currently through Dec. 31, 2025, but potentially subject to change after the election), NY real property owners have a unique opportunity to reduce their taxable estates by making lifetime gifts. Strategies to consider include a direct gift of the property, a direct gift of an LLC interest that holds the property, or a sale of the property in exchange for a note. The current low interest rate environment makes certain strategies like Qualified Personal Residence Trusts (QPRT) less attractive at this time.

Gifts or transferring NYS real estate may help support the donor's argument that he/she has changed domicile from NYS to another state. Note that taxable gifts made within three years of death may be "clawed back" into the donor's estate for NYS estate tax purposes (NYS Tax Law §954(a)(2)).

When considering various gifting strategies, the owner should also assess the potential impact of any transfer tax costs. As a baseline, NYS imposes a transfer tax, payable by the grantor, on the conveyance of real property where the consideration exceeds \$500 (NY Tax Law §§1402, 1404). Generally, the transfer tax rate is 0.4% or 2% for every \$500 of consideration; however, beginning July 1, 2019,

supplemental tax of \$1.25 for each \$500, or fractional part thereof, is assessed on transfers of NYC residential real estate where the consideration is \$3 million or more, for an effective rate of 0.65% (NY Tax Law §1402, as amended by the 2020 NY Budget Act, Ch 59, Laws of 2019, S 1509C, Part 000). In addition, a separate "mansion tax" is imposed on transfers of residential real property where the total consideration is \$1 million or more. Under prior law, the "mansion tax" was a flat 1% for conveyances of \$1 million or more (NYS Tax Law §§1402-a and 1402-b). In 2019, NYS added a new additional supplemental progressive "mansion tax" that tops

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out at 2.9% when the consideration exceeds \$25 million; this now creates a maximum "mansion tax" of 3.9%. While the "mansion tax" is generally payable by the purchaser, the seller may be responsible if the purchaser fails to pay the tax. Conveyances of NYC residential real property are subject to further transfer taxes of 1% on property where the consideration is \$500,000 or less and 1.425% where the consideration exceeds \$500,000. While most gifts and bequests of real property are exempt from NYS and NYC transfer taxes, owners should be aware that certain transactions, such as a sale to a grantor trust, or the transfer of property subject to a mortgage, may trigger the application of the transfer tax.

Conservation Easements

Landowners with charitable intentions may consider entering into an agreement with a land trust or other unit of government to meet specific conservation objectives, typically by placing certain restrictions on the future subdivision and/or development of the land for commercial purposes. The landowner may receive a current federal and state income tax benefit in the process, mindful that the conservation easement may also negatively impact the potential value of the land because it limits future development. Landowners may consider a conservation easement in conjunction with a gift or transfer of the potentially reduced value of the property to heirs.

Additional Consideration

Before transferring New York real estate, individuals and their professional fiduciaries must consider the full spectrum of unique challenges, including concentration, cash flow, obtaining adequate survivorship or second-to-die life insurance for added liquidity and providing ongoing maintenance.

