

April 29, 2014

New York Adopts Significant Changes to Its Estate Tax and Trust Income Taxation Laws

In response to concerns about the long term effects of high taxes on New York State's economic health and competitiveness, Governor Cuomo last year established a commission charged with identifying ways of reducing the state and local tax burden imposed on Empire State residents and businesses. Based on the commission's report but with several important changes, the New York State 2014-15 Budget, signed into law on March 31, enacts significant changes to a variety of New York taxes. This Alert highlights changes to the New York estate and gift tax laws, along with two changes relating to income taxation of certain trusts.

Estate Taxes. Since the year 2000, the Federal estate and gift exemption amounts have risen steadily and significantly, with the 2014 amount set at \$5.34 million, to be adjusted annually for inflation. During the same period New York taxpayers have been subject to a fixed \$1 million estate tax exemption.

- **Increasing Exemption Amount.** Under the new law, as of April 1, 2014, for a decedent dying on or after April 1, 2014 and before April 1, 2015, the exemption (referred to in the statute as the "Basic Exclusion Amount") has been increased from \$1,000,000 to \$2,062,500, meaning that property up to \$2,062,500 in value is permitted to pass free of NYS estate tax. The Basic Exclusion Amount under the new law is scheduled to increase as set forth in the table appearing below.
- **Exemption Phase-Out "Cliff."** While the rising exclusion amount is good news for New York taxpayers, the law provides minimal or no benefit for those estates that exceed the tax threshold. Under the new law, if the New York taxable estate exceeds the Basic Exclusion Amount by more than 5%, no credit against the estate tax is provided and the entire taxable estate will be subject to NYS estate tax. Estates that are greater than the Basic Exclusion Amount but less than the full phase out amount receive a credit against the estate tax that rapidly diminishes as the full phase out amount is reached.

Year	Basic Exclusion Amount	Phase-Out "Cliff" Amount
April 1, 2014	\$2,062,500	\$2,165,625
April 1, 2015	\$3,125,000	\$3,281,250
April 1, 2016	\$4,187,500	\$4,396,875
April 1, 2017	\$5,250,000	\$5,512,500
January 1, 2019	Federal Exemption Amount, Adjusted Annually for Inflation	

New York Adopts Significant Changes to Its Estate Tax and Trust Income Taxation Laws

- **Examples.** The stark operation of the “cliff” may be revealed by the following simple examples.
 - ◆ Two New York residents die between April 1, 2014 and March 31, 2015, one with a taxable estate of \$2,062,500 and the other with a taxable estate of \$2,165,625. The decedent with a \$2,062,500 taxable estate would not be subject to estate tax (such an estate would have generated an estate tax of \$104,100 under prior law). The decedent with a taxable estate of \$2,165,625 would be subject to an estate tax of \$112,050 (the same estate tax that would have been generated under the prior law). Accordingly an increase in the taxable estate of \$103,125 results in an estate tax increase from \$0 to \$112,050.
 - ◆ Two New York residents die between April 1, 2017 and December 31, 2018, one with a taxable estate of \$5,250,000 and the other with a taxable estate of \$5,512,500. The decedent with a \$5,250,000 taxable estate would not be subject to estate tax (such an estate would have generated an estate tax of \$420,800 under prior law). The decedent with a taxable estate of \$5,512,500 would be subject to an estate tax of \$452,300 (the same estate tax that would have been generated under the prior law). Accordingly an increase in the taxable estate of \$262,500 results in an estate tax increase from \$0 to \$452,300. This example is subject to a potentially significant caveat, in that it assumes the estate tax rates and brackets will remain unchanged from those currently in effect. However the rate table that is included in the new law covers only the period between April 1, 2014 and March 31, 2015 and accordingly new legislation that either extends the existing rates, or establishes different rates, must be enacted within the year.

As shown, the new law will provide significant tax relief to estates that are in excess of the old taxable threshold of \$1 million but below the Basic Exclusion Amount, and provides no tax relief for those estates that exceed the Basic Exclusion Amount by more than 5%.

- **Marital Deduction.** As under the Federal estate tax system, New York law allows an unlimited marital deduction for qualifying transfers to a spouse, that is, transfers that are made (i) outright to the spouse; or (ii) to certain types of qualifying trusts, typically a “qualified terminable interest property trust” (“QTIP Trust”). Under the new law, a provision is added relating to the Federal and NYS elections for QTIP trusts. If an estate files a Federal estate tax return and on that return a QTIP election is made for a QTIP Trust, the executor must make a consistent QTIP election on the NYS estate tax return. If the estate is not required to file a Federal estate tax return, the estate may make an independent QTIP election on the NYS estate tax return.
- **Spousal Portability.** Under Federal tax law, any Federal exemption that remains unused at the death of a spouse is generally available for use by a surviving spouse, as an addition to the surviving spouse’s Federal exemption. New York’s new law does not include spousal portability provisions for its estate tax exemption.
- **Gift Taxes.** Under Federal law, the gift and estate tax exemptions operate under a unified system. That is, taxable gifts made during lifetime will reduce the amount of the Federal exemption that is available at death. In contrast, New York repealed its gift tax in 2000 and it has not been revived under the new law. Although New York does not impose a gift tax on gifts made by a taxpayer during lifetime, the new law implements a significant temporary change. Gifts made within three (3) years of death will be included in the gross estate of a New York resident decedent, if the gift is made between April 1, 2014 and December 31, 2018, and the decedent was a New York resident at the time of the gift. Accordingly, for those NYS taxpayers whose estates exceed the Basic Exclusion Amount, lifetime gifting can reduce the NYS estate tax that will be due upon death, provided the gift is completed more than three years prior to death. Potential estate tax savings must be weighed in making gifts, particularly since the recipient of a gift receives the donor’s income tax basis in the gifted assets, while the recipient of assets passing at death receives an income tax basis which is stepped-up to the date of death value.
- **Top Marginal Rate.** The top NYS estate tax rate remains set at 16%.

New York Adopts Significant Changes to Its Estate Tax and Trust Income Taxation Laws

- **Generation Skipping Transfer Tax.** The new law repeals the New York GST tax for transfers after March 31, 2014.

Changes Relating to Income Taxation of Certain Trusts.

- **Exempt Resident Trusts.** The new law seeks to close a perceived “loophole” in the income taxation of certain trusts created by New York grantors, which have not previously been subject to New York income taxation. Under prior law, the income distributed to a New York resident by a trust created by a New York grantor would not be subject to income taxation provided all of the trustees of the trust were domiciled out of state, the trust had no New York source income, and no trust assets situated in New York. Under the new law, trust distributions to a New York resident beneficiary will be subject to an accumulation or “throwback” tax on previously undistributed accumulated income which is distributed to New York residents in a tax year beginning on or after January 1, 2014.
- **Incomplete Gift Non-Grantor Trusts (INGs).** An ING Trust is a trust established outside of New York in a more favorable tax jurisdiction, designed so that contributions to the trust are incomplete gifts for gift tax purposes but completed gifts for income tax purposes and are implemented for the purpose of shifting state income tax to the more favorable tax jurisdiction. The new law provides that ING Trusts will be treated as defective grantor trusts for New York income tax purposes, and thus taxable to the grantor, for taxable years beginning on or after January 1, 2014. However, the statute provides that ING Trusts which are terminated prior to June 1, 2014 will be exempt from grantor trust treatment.

The tax law changes brought under the new legislation are significant. Please do not hesitate to contact us to review the matters discussed in this Alert and any impact that the new law may have on your estate plan.

Our Trusts and Estates Law practice group includes the following attorneys:

Patricia Galteri
pgalteri@msek.com
(516) 592-5790

Carmela T. Montesano
cmontesano@msek.com
(516) 592-5720

Nathaniel L. Corwin
ncorwin@msek.com
(516) 592-5740

Jayson J.R. Choi
jchoi@msek.com
(516) 592-5799

This Client Alert is published by Meyer, Suozzi, English & Klein, P.C. for the benefit of clients, friends and fellow professionals on matters of interest. The information contained herein is not to be construed as legal advice or opinion. We provide such advice or opinion only after being engaged to do so with respect to particular facts and circumstances. Attorney Advertising.

**MEYER, SUOZZI,
ENGLISH & KLEIN, P.C.**
COUNSELORS AT LAW
www.msek.com

IRS Circular 230 Disclosure: Any tax advice contained in this communication (including any attachments or enclosures) was not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code, or (ii) promoting, marketing or recommending to another party any matters in this communication. (The foregoing disclaimer has been affixed pursuant to U.S. Treasury regulations governing tax practitioners.)