

Changes to the Taxation of New York Estates and Trusts

Governor Cuomo recently signed legislation that makes significant changes to New York's taxation of trusts and estates. These reforms were enacted to stem the perceived exodus of wealthy New Yorkers to other jurisdictions for tax motivated reasons. While the changes provide some tax relief for many New Yorkers, they may prove to have the opposite effect for affluent New Yorkers.

Estate and Gift Tax Changes

A. New York's Estate Tax

The new law increases the New York estate tax exemption amount, which was previously \$1 million per person, over the course of the next five years. On and after January 1, 2019, the New York estate tax exemption will match the federal estate tax exemption. The top New York estate tax rate remains at 16%.

Surprisingly, the New York exemption is not available to every New York estate as (i) the benefit of the exemption is phased out for taxable estates between 100% and 105% of the exemption, and (ii) taxable estates of 105% or more of the exemption completely lose the benefit of the exemption thus subjecting the entire estate to New York estate tax. The following chart shows the increasing amount of the New York exemption, and the dollar amount at which it is completed phased out:

Date of Death	New York Exemption	Full Phaseout of Exemption
April 1, 2014 to March 31, 2015	\$2,062,500	\$2,165,625
April 1, 2015 to March 31, 2016	\$3,125,500	\$3,281,250
April 1, 2016 to March 31, 2017	\$4,187,500	\$4,396,875
April 1, 2017 to December 31, 2018	\$5,250,000	\$5,512,500
January 1, 2019 and thereafter	Scheduled to match the federal estate tax exemption which is currently \$5,340,000 but increases each year for inflation	105% of Federal Exemption

The impact of exceeding 105% of the exemption amount is striking. For example, although a May 2016 taxable estate of \$4,187,500 would not generate New York estate tax, if the taxable estate totaled \$4,405,758 (an increase of only \$142,121), the New York estate tax would be \$325,045.

The improper titling of assets can have a dramatic effect under the new law, particularly since New York does not allow the surviving spouse to use the deceased spouse's unused New York estate tax exemption. This concept, known as "portability", is available for federal estate tax purposes, but New York has failed to adopt portability for purposes of the New York estate tax. For example, consider the following common scenario:

John owns \$4,125,000 in assets. John's wife, Jane, does not have any assets in her own name. John predeceases Jane in 2014 and leaves a will that passes an amount up to the New York exemption amount (\$2,062,500) to a credit shelter trust for Jane's lifetime benefit. The remainder of John's estate (\$2,062,500) passes to Jane outright. There is no New York estate tax in either estate in this scenario as both estates are able to utilize the New York exemption to completely shelter all of the assets. If, however, all of the assets were in Jane's name, rather than in John's name, and she died later in 2014, after John, there would be a New York estate tax of \$293,600 upon her death.

These examples demonstrate why New Yorkers must review their estate plans to ensure that their documents are up to date and that their assets are appropriately titled.

B. Look Back for Lifetime Gifts

Under the old law, lifetime gifts were not subject to New York gift tax (since New York had no gift tax) or included in the calculations used to determine a New York decedent's taxable estate. Under the new law, gifts made within three years of death will be added back to the value of the estate for tax purposes. The add back could potentially increase an estate's tax liability, especially if the estate is close to exceeding 105% of the New York exemption amount.

Certain gifts are excluded from the three-year look back: (1) gifts made when the decedent was not a New York resident; (2) gifts made by a New York resident before April 1, 2014, or on or after January 1, 2019; and (3) gifts that are otherwise includible in the decedent's estate under federal estate tax law (for example, because the donor didn't give up sufficient dominion and control over the gifted property).

Despite these new provisions, there is plenty to gain from lifetime gifting. Gifted property will avoid New York estate tax (if the donor survives three years), will remove any appreciation from the estate and may further serve to reduce the estate tax if the gift brings the estate under 105% of the New York exemption amount.

C. Other Transfer Tax Changes

The new law repeals the New York generation-skipping transfer tax and provides relief for surviving non-citizen spouses. When there is no requirement to file a federal estate tax return, a

marital deduction for New York estate tax purposes is now allowed for non-citizen spouses without having to utilize a so-called "qualified domestic trust".

Trust Income Tax Changes

A. Incomplete Non-Grantor Trusts

A trust established by a New York resident in which the grantor retained a beneficial interest was frequently formed outside of New York to avoid New York income tax. These trusts have commonly been called Incomplete Non-Grantor Trusts or "INGs". Effective January 1, 2014, New York will tax INGAs as "grantor trusts" for New York income tax purposes, meaning that the grantor will be subject to New York income tax on all income earned by the trust whether or not the income is actually distributed on a current basis.

B. Exempt New York Resident Trusts

Previously, non-grantor trusts created by New York residents that have no New York resident trustee, no assets located in New York and no New York source income were deemed exempt and paid no New York income tax. The new law provides that a New York beneficiary receiving a distribution of accumulated income from an exempt New York resident trust will, on a going forward basis, start to be taxed on that income when it's distributed to the beneficiary. This applies to income earned in taxable years beginning on or after January 1, 2014.

Given the significant changes summarized herein, we urge you to contact your estate planning attorney to schedule an appointment to review how these changes may affect you.

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