

## **NEW YORK STATE MAKES SIGNIFICANT CHANGES TO ESTATE AND TRUST TAX LAWS**

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On March 31, 2014, New York State Governor Andrew Cuomo signed the 2014-15 budget legislation (the Executive Budget), which made a number of significant changes to New York's estate and trust tax laws. This article discusses the highlights and the impact of some of these changes.

### ESTATE TAX EXCLUSION INCREASES

Before the new law, the New York estate tax exclusion amount was \$1,000,000, which was significantly below the current federal estate tax exclusion of \$5,340,000. Under the new law, the New York estate tax exclusion amount increases over time from April 1, 2014 until January 1, 2019.

Individuals dying between the following dates will have the following basic exclusions from New York State estate tax:

April 1, 2014 and before April 1, 2015	-	\$2,062,500
April 1, 2015 and before April 1, 2016	-	\$3,125,000
April 1, 2016 and before April 1, 2017	-	\$4,187,500
April 1, 2017 and before January 1, 2019	-	\$5,250,000

After January 1, 2019, the basic exclusion amount will be indexed for inflation from 2010. That should link the state exclusion amount to the federal exclusion amount in effect in 2019 and thereafter.

However, as a result of a "cliff" effect (discussed below) in the way New York calculates its estate tax under the new legislation, the increase in the New York estate tax exclusion amount fully benefits only those taxable estates equal to or less than the New York exclusion amount in effect at date of death.

### ESTATE TAX RATES

The top New York State estate tax rate remains at 16%; however, there has been a change in bracket structure. Consequently, taxable estates that exceed 105% of the New York basic exclusion amount will have the same tax they would have had under the old law.<sup>1</sup>

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<sup>1</sup> It also should be noted that the estate tax rates included in the 2014-15 Executive Budget only apply to decedents dying on or after April 1, 2014 and before April 1, 2015. There is no rate schedule for individuals dying after March 31, 2015. It is unclear whether this was an error that will require technical correction, or is a test period or compromise that will force the estate tax rate schedule to be revisited during next year's budget bill negotiations.

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### THE ESTATE TAX “CLIFF”

By virtue of the manner in which New York will calculate its estate tax, there is a rapid phase-out of the benefit of the basic exclusion amount once the New York taxable estate exceeds the basic exclusion amount in the year of death. As a result of a phase-out formula, there will be a rapidly increasing tax for each percent that the New York taxable estate exceeds the basic exclusion amount, and the benefit of the basic exclusion amount is phased-out completely (i.e., the entire taxable estate will be subject to New York estate tax) when the value of the decedent’s New York taxable estate exceeds 105% of the basic exclusion amount.

To demonstrate an example of this cliff effect, which can be dramatic: Assume an individual dies during the period (April 1, 2017 through December 31, 2018) when the basic exclusion amount will be 5,250,000 and has a New York taxable estate of \$5,512,500 (which exceeds the basic exclusion amount by \$262,500 (i.e., 5%) and is 105% of \$5,250,000). Such decedent would pay New York estate tax (under current estate tax rates) of \$452,300, while if the decedent had died with an estate valued at \$5,250,000, there would be no New York estate tax owed. Thus, there would be New York estate tax of \$452,300 (or a marginal New York estate tax rate of over 172%) on the additional New York taxable estate of \$262,500 in excess of the basic exclusion amount of \$5,250,000.

### GIFT ADD-BACK

New York has added a three-year look-back and add-back for gifts made on or after April 1, 2014 and before January 1, 2019.

The New York gross estate of a resident decedent will be increased by the amount of any taxable gifts not otherwise included in the decedent’s federal gross estate, made during the three-year period ending on the decedent’s date of death. This rule would not include any gift made: (1) when the decedent was not a resident of New York State; (2) before April 1, 2014; or (3) on or after January 1, 2019.

Since New York has not had a gift tax since 2000, the stated goal of this change was to close a perceived loophole and prevent deathbed gifts from escaping the New York estate tax, given that the gifted assets would reduce the size of the taxable estate for New York estate tax purposes.

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### THROWBACK TAX ON NEW YORK BENEFICIARIES OF EXEMPT RESIDENT TRUSTS

Under both the old and new law, while New York Resident trusts are generally subject to New York income tax, Resident trusts will be exempt if the following conditions are met: (1) all the trustees are domiciled in a state other than New York, (2) the entire corpus of the trust is located outside of New York, and (3) all income and gains of the trust are derived from or connected with sources outside of New York.

The new legislation seeks to prevent income earned by exempt resident trusts from escaping New York income tax by taxing distributions of certain accumulated trust income to New York resident beneficiaries as if the income earned in the trust had been subject to New York income tax during the year the income was accumulated. This “throwback” tax is imposed on the resident beneficiary and not on the trust.

Excluded from the new throwback tax are distributions of accumulated income by exempt resident trusts made before June 1, 2014, or distributions of income accumulated by exempt resident trusts in a tax year before the beneficiary first became a New York resident or in any tax year beginning before January 1, 2014.

The new throwback tax does not apply to accumulation distributions from non-resident trusts.

### ING TRUSTS

An ING trust is an incomplete gift non-grantor trust created by a New York resident in another state that does not impose an income tax on the trust. For gift tax purposes, the transfer of assets to the trust is considered incomplete thereby resulting in no current gift tax liability. Such a trust was designed to be a separate taxpayer for income tax purposes.

Under the new legislation, an ING trust will be decoupled from federal income tax treatment and will be taxed as a grantor trust for New York income tax purposes. Accordingly, the income and gains from the ING trust will be includible in the New York grantor’s income for New York income tax purposes, while the trust will remain a separate taxpayer (i.e., a non-grantor trust) for federal income tax purposes.

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### FOR MORE INFORMATION

If you have questions or would like more information about the changes in New York State's estate and trust tax laws, please contact:

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