Living and Dying in New York

2014 Changes to New York's Tax Law

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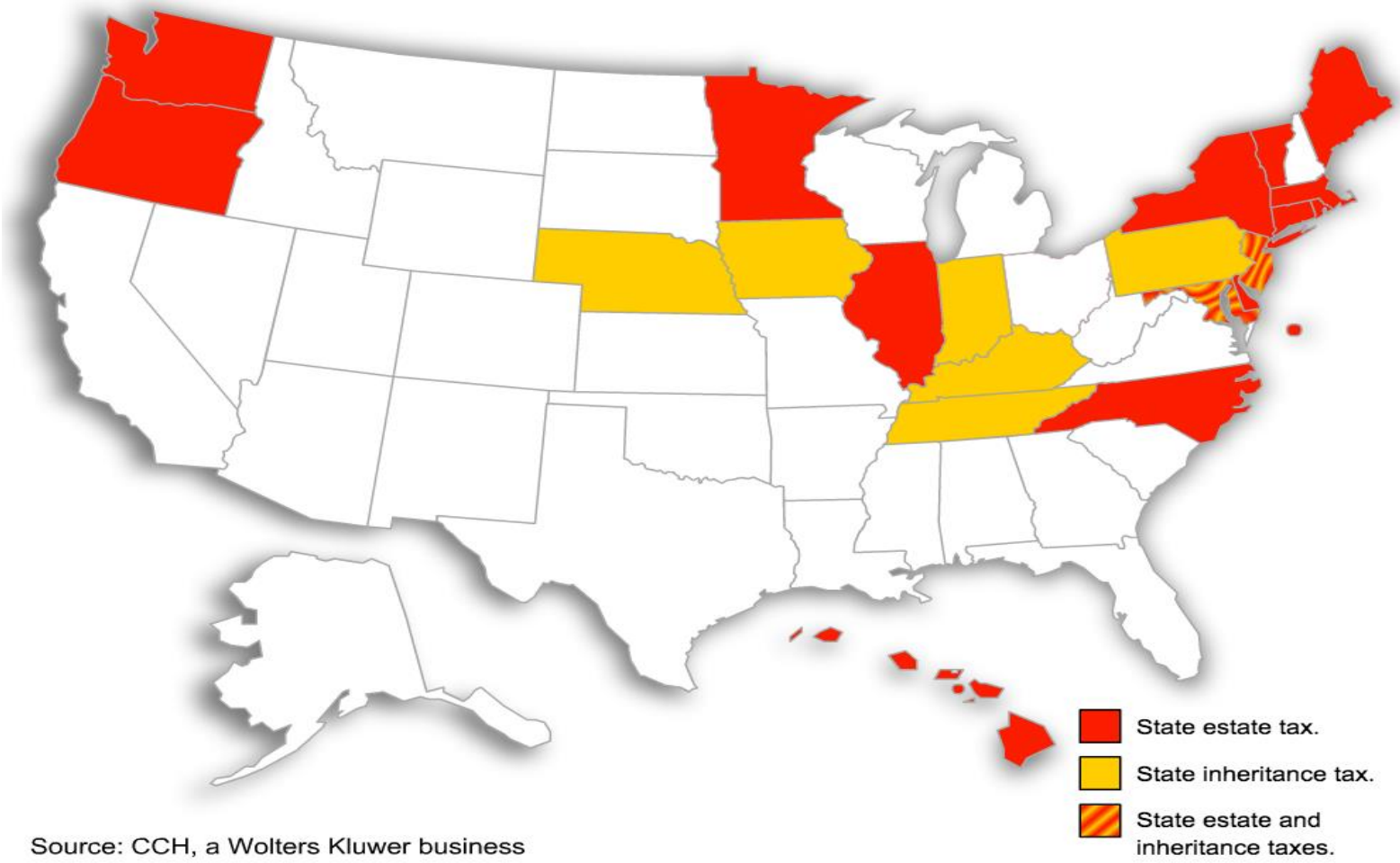
Estate and Inheritance Taxes
State of the States



Source: CCH, a Wolters Kluwer business

A Brief History of New York State's Gift & Estate Taxes

New York State has imposed some sort of death tax since about 1885

In 1963, New York enacted the estate tax pretty much as we know it today (under Article 26 of the State Tax Law)

In 2000, New York repealed its gift tax

Until Recently, the New York estate tax exemption was $1,000,000

For the tax year ending 12/31/2010, estate taxes accounted for nearly ¾'s of 1 percent of total state revenue – about $866,000,000

The New New York State Estate & Gift Tax

On April 1, 2014, Governor Cuomo signed into law new estate tax rules for New York ostensibly to reform the “move to die tax” and keep wealthy New Yorker’s in New York

The important goal of increasing the New York State estate tax exemption was accomplished, which now stands at $2,062,500 for anyone dying between 4/1/14 and 3/31/15. The exemption is scheduled, by 2019, to catch-up with the federal applicable exclusion, which now stands at $5,340,000 per person.

For decedents on or after...	And before...	The exclusion amount is…
April 1, 2014	April 1, 2015	$2,062,500
April 1, 2015	April 1, 2016	$3,125,000
April 1, 2016	April 1, 2017	$4,187,500
April 1, 2017	Jan. 1, 2019	$5,250,000
Jan. 1, 2019		Scheduled to equal the federal estate tax exemption (projected @ $5.9MM)

The New New York State Estate & Gift Tax Continued

Highlights:

- ✓ **Applicable as of April 1, 2014**
- ✓ **Exemption equivalent increased from $1,000,000 to $2,062,500**
- ✓ **Exemption equivalent increased to federal limit…phase-in to 2019**
- ✓ **Top rate remains at 16%**
- ✓ **Federal taxable gifts under IRC §2503 made within three years of death (if after 4/1/14 & before 1/1/19) are added back into the NY taxable estate**
- ✓ **Generation-skipping transfer tax repealed!**
- ✓ **Alternate valuation election allowed**
- ✓ **QTIP Election allowed**
- ✓ **No "portability"**
- ✓ **Still no gift tax!**

The New NY State Estate & Gift Tax Continued

The changes all seem good, but on closer look, some of the tax savings are illusory…

The Cornerstone

New York Tax Law §952(c)(3) provides *(emphasis added)*:

A credit of the applicable credit amount shall be allowed against the tax imposed by this section as provided in this subsection. In the case of a decedent whose New York taxable estate is less than or equal to the basic exclusion amount, the applicable credit amount shall be the amount of tax that would be due under subsection (b) of this section on such decedent's New York taxable estate. In the case of a decedent whose New York taxable estate exceeds the basic exclusion amount by an amount that *is less than or equal to five percent of such amount,* the applicable credit amount shall be the amount of tax that would be due under subsection (b) of this section if the amount on which the tax is to be computed were equal to the basic exclusion amount multiplied by one minus the fraction, the numerator of which is the decedent's New York taxable estate minus the basic exclusion amount, and the denominator of which is five percent of the basic exclusion amount**. Provided, however, that the credit allowed by this subsection shall not exceed the tax imposed by this section, and no credit shall be allowed to the estate of any decedent whose New York taxable estate exceeds one hundred five percent of the basic exclusion amount**.

-The Cliff-

The Cornerstone

New York taxable estates that are less than or equal to the New York estate tax exclusion amount will pay no tax

New York taxable estates that are between 100% and 105% of the exclusion amount will lose the benefit of the exclusion amount due to a phase out computation

New York taxable estates that exceed 105% of the basic exclusion amount will lose the benefit of the exclusion amount entirely

-The Cliff-

The Cornerstone

-The Cliff –

Assume a person dies on October 30, 2104 with an estate valued at $2,165,625. Since the new New York exemption amount is $2,062,500, and because the value of this estate equals or exceeds 105% of $2,062,500 ($2,062,500 x 105% = $2,165,625), the estate will be subject to New York estate tax on the entire amount ($2,165,625), which is $112,050, even though the taxable estate has exceeded the basic exclusion amount by only $103,125.

In contrast, if that same decedent had died on that same day with an estate valued at $2,062,500, the New York estate due would be **ZERO** – having an estate valued at $103,125 over the exemption amount caused a tax of $112,050!

BEING $103,125 OVER THE CLIFF RESULTS IN EFFECTIVE MARGINAL RATE OF 109% OF THE AMOUNT OVER THE EXCLUSION

The Cornerstone

-The Cliff –

Assume a person dies on October 30, 2107 with an estate valued at $5,512,500. Since the new New York exemption amount is $5,250,000, and because the value of this estate equals or exceeds 105% of $5,250,000 ($5,250,000 x 105% = $5,381,250), the estate will be subject to New York estate tax on the entire amount ($5,250,000), which is $452,300, even though the taxable estate has exceeded the basic exclusion amount by only $262,500.

In contrast, if that same decedent had died on that same day with an estate valued at $5,250,000, the New York estate due would be **ZERO** – having an estate valued at $262,500 over the exemption amount caused a tax of $452,300!

BEING $262,500 OVER THE CLIFF RESULTS IN EFFECTIVE MARGINAL RATE OF 172% OF THE AMOUNT OVER THE EXCLUSION

The Gift Add-Back

The Governor's original proposal provided for an increase in the estate of a deceased resident by the amount of any taxable gift made on or after April 1, 2014, if the decedent was a New York resident at the time the gift was made.

As enacted, that proposal was scaled back to include an add-back to gifts made within three years of death that are made on or after April 1, 2014 and before January 1, 2019.

The bill was unclear with respect to gifts by a New York resident of out-of-state real property or tangible personal property although out-of-state real and tangible property were specifically excluded from the New York gross estate for New York estate tax purposes.

The Gift Add-Back

On August 25, 2014, in Technical Memorandum TSB-M-14(6)M, the New York State Department of Taxation and Finance clarified this ambiguity.

“Gifts are not added to the gross estate if they are consisted of real or tangible personal property having a location outside of New York State, or if the gift was made:

- When the individual was a non-resident of New York State;
  - Before April 1, 2014; or
  - On or after January 1, 2019”

The Gift Add-Back

For non-resident estates, the tax will be computed in the same manner as the New York taxable estate of a resident, except that it will not include:

- The value of any intangible personal property otherwise includible in the deceased individual's New York gross estate, and

- The amount of any gift otherwise includible in the New York gross estate of a resident, unless the gift was made while the nonresident individual was a resident of New York State and it consisted of real or tangible personal property having a location in New York State or intangible personal property employed in a business, trade, or profession carried on in New York.

- And also excludes works of art loaned to (or en route to or from) a public gallery or museum in New York State solely for exhibition purposes at the time of person's death, provided no part of the net earnings for the public gallery or museum inure to the benefit of any private stockholder or individual but will be considered located in New York solely for purposes of meeting the filing threshold.

Filing Requirements

Estates of residents must file a New York State estate tax return if:

- The federal gross estate, increased by the amount of any gifts includible in the New York gross estate, exceed the basic exclusion amount applicable to the date of death.

Estate of nonresidents must file a New York State estate tax return if:

- The federal gross estate, increased by the amount of any gifts includible in the New York gross estate, exceeds the basic exclusion amount applicable to the date of death; and
- The estate includes any real or tangible property located in New York.

The New New York State Estate & Gift Tax Continued

Alternate Valuation

If an estate elects alternate valuation for federal purposes, then the New York gross estate will be valued as of the alternate valuation date.

If a federal estate tax return is not required to be filed, but alternate valuation could have been elected, the estate may elect to use the alternate valuation for determining the value of the New York gross estate. However, this election will not be allowed unless it decreases the value of the New York gross estate AND the amount of tax imposed reduced by any credits available.

The election must be made by the due date for the filing of the return (with extensions) and once made, is irrevocable.

The New New York State Estate & Gift Tax Continued

QTIP Election

If a QTIP election is made for federal purposes, the election must also be made for New York State purposes. If no federal return is required to be filed, the executor may make a QTIP election on a pro forma federal return attached to the New York State return. The election once made is irrevocable.

“Portability”

Under federal estate tax rules, a surviving spouse may make an election on the federal estate tax return to use his or her deceased spouse’s un-used federal exemption – allowing him or her to take the exemption with them

This concept is known as “portability”

New York <u>does not</u> allow a surviving spouse to use the deceased spouses un-used New York estate tax exemption – this makes titling of assets among a husband and wife particularly important for New York estate tax purposes

The New New York State Estate & Gift Tax Continued

Other Federal Elections

Elections made or waived on a federal return are binding on a New York State estate tax return. If a federal return is required to be filed and the right to any federal estate tax deduction is waived, it is also waived for New York estate tax purposes. A federal return is considered "required to be filed" when a decedent's gross estate exceeds the federal filing requirement AND also when the federal return is the only means for claiming certain tax treatment, such as portability of a deceased spouse's unified credit for federal purposes.

If a fiduciary claims administration expenses as a deduction for federal estate tax purposes, they must also be taken as a deduction on the New York State return. If a fiduciary claims administration expenses as an income tax deduction for federal purposes, they must also be claimed as income tax deductions for New York purposes.

The New New York State Estate & Gift Tax Continued

The Good News!

The New York State Generation Skipping Tax has been repealed!

There is still no New York State Gift Tax!

Plan For It…

If your clients are near or at “the cliff”, take steps to reduce their NY taxable estate ✓

-The Gift Tax –

New York remains a no gift tax state – but now there’s a new twist (see below) ✓

-Federal Taxable Gifts Made Within Three (3) Years of Death –

(Between April 1, 2014 & December 31, 2018)

The new law requires federal taxable gifts made by a New York decedent between April 1st, 2014 and December 31st, 2018 to be added back into their estate for New York estate tax purposes (really?!)

Plan for it by making annual exclusion gifts, or charitable gifts which are not subject to gift tax

Plan For It…

-The Generation-Skipping Transfer Tax –

This tax, which ***had*** applied to distributions from, and terminations of a New York trust to a *Skip-Person* (a person more than one generation below you, as in a grandchild) has been repealed!

Plan for it by making annual exclusion gifts to skip persons

Now is a perfect time to get your estate plan in order

- Bottom Line –

Most of the planning techniques that were useful prior to NY's tax reform are still useful planning techniques today

Make full use of federal annual exclusion gifts – spouses can give away $28,000

Spouses should maximizing use of the NY increased exemption amounts – titling of assets particularly important in NY since no "Portability"

Utilize GRITs to transfer low basis property at reduced gift tax

The interest rates that the IRS uses to value many transfers for estate and gift tax purposes continue to be near their historic lows

SCINS allow property to be "sold" by taking back a note that self-cancels

Sales to IDGTs allow transfers at reduced gift tax cost

Intra-family loans look good - short term rates (5/2014) are below ½ %

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Other Aspects of the New New York Tax Law

The Throwback Tax

New York imposes an income tax on the income of a “resident trust.” A resident trust includes a trust created by a New York resident decedent, an irrevocable trust created by a New York domiciliary or a trust that became irrevocable while the settlor was a New York domiciliary.

A resident trust will not be subject to New York State income tax if:

- All trustees are domiciled outside New York
- The entire corpus, including real and personal property is located outside New York; and
- All income and gains of the trust are derived from sources outside New York

Other Aspects of the New New York Tax Law

However…

New York now imposes a “throwback tax”

For trusts qualifying for the New York Resident Trust Exemption

Income distributed to a New York resident beneficiary

Not previously taxed by New York

Accumulated during taxable years beginning on or after January 1, 2014 for which there was a New York resident beneficiary who was at least 21 years of age.

Other Aspects of the New New York Tax Law

Distributions from the following types of trusts are subject to the Throwback Tax?

- Non-resident trusts (i.e., a trust whose grantor is not domiciled in New York at the time the trust became irrevocable)

- Exempt resident trusts (trusts that are exempt from New York income tax because there are no NY trustees, assets or source income

- Incomplete gift, non-grantor or “ING” trusts (i.e., certain trusts that are specifically structured (i) so that the settlor’s transfer of property to the trust is an incomplete gift and (ii) to avoid grantor trust status under Sections 671 through 678 of the Internal Revenue Code) are now decoupled from the federal law and treated as grantor trusts for New York income tax purposes. These trusts were usually created in Delaware or Nevada (states that impose no income tax) and were structured to be incomplete gifts for income tax purposes to avoid the gift tax but could be treated as a separate taxpayer for income tax purpose with the goal for a NY resident to structure it in a jurisdiction that didn’t impose an income tax.