

April 2, 2014

ESTATE AND INCOME TAX CHANGES IN 2014-2015 NEW YORK STATE BUDGET

Yesterday Governor Andrew Cuomo signed into law the 2014-2015 New York State Budget legislation (the “legislation”), which makes a number of significant changes to New York estate and income tax rules. Below is a summary of the main provisions that impact tax aspects of estate planning and trust administration.

- Increase in Estate Tax Exclusion Amount. The legislation increases the New York State estate tax exclusion to match the Federal estate tax exemption. Until now, the excludable amount was \$1 million per estate (compared to a Federal amount of \$5,340,000 per estate in 2014). That meant that the estates of New York decedents in excess of \$1 million were subject to New York estate tax (at rates up to 16%) even if no Federal estate tax was due. The new law will allow a significantly greater number of New York estates to avoid paying any estate tax. This change is intended to counter the trend of New Yorkers “fleeing” the State after retirement to states that do not impose an estate tax, such as Florida.

The increase in the exclusion is being phased in over five years based on the following schedule for decedents dying during the applicable periods, so that by January 2019 the exclusion will match the Federal exemption:

April 1, 2014 through March 31, 2015 - \$ 2,062,500

April 1, 2015 through March 31, 2016 - \$3,125,000

April 1, 2016 through March 31, 2017 - \$4,187,500

April 1, 2017 through December 31, 2018 - \$5,250,000

After January 1, 2019, indexed for inflation from 2010

- Inclusion of Lifetime Gifts in Taxable Estate. Under the legislation, the value of lifetime gifts made within three years of death will be brought back into the decedent’s estate for purposes of determining New York State estate tax liability. New York does not impose a tax on gifts made during life. The

change under the legislation is significant because it will result in some gifts being subject to tax, not in the form of a gift tax at the time of the gift but an estate tax on such gifts after death. However, the impact of the change is limited in scope because it applies only to gifts made (i) within three years of death and (ii) between April 1, 2014 and January 1, 2019. Accordingly, this change should not significantly impact general estate tax planning advice.

- Repeal of New York Generation-Skipping Transfer (“GST”) Tax. The New York State GST tax has been repealed. The GST tax previously applied to certain trusts, and recipients of trust distributions, to the extent that the trusts were held exclusively for, or distributions from the trusts were made to, “skip persons” (generally, individuals who are more than one generation below the generation of the grantor of the trust). The operation of the State GST tax was similar to the Federal GST tax, which is not affected by this repeal.
- Imposition of Income Tax on Beneficiaries of Certain Trusts. Under current law, certain trusts created by New York residents can avoid current New York income taxation as long as the trusts meet certain criteria, including having no New York trustees, no real or tangible personal property in the State and no New York source income. The legislation imposes an income tax on the accumulated income of such trusts once that income is distributed to New York beneficiaries, to the extent that the income was earned after January 1, 2014. Under the new law, New York resident trusts will be subject to return filing requirements when they make distributions to New York resident beneficiaries.

Note that the new law does *not* apply to grantor trusts, the income and gains of which are reported on the grantor’s personal income tax return at the time the income is earned. The rule also does not apply to nonresident trusts.

- Taxation of Incomplete Gift Non-Grantor Trusts. The legislation taxes Incomplete Gift Non-Grantor (“ING”) trusts as if they were grantor trusts on all income earned after January 1, 2014. In recent years, some New York resident taxpayers have used the ING trust strategy to avoid New York State income taxes on their personal income, typically capital gains, by creating a trust in a low or no income tax state in such a way that, after the funding of

the trust, the grantor still had access to the trust assets but was not taxed on its income and gains because the trust was treated as a standalone taxpayer (not subject to New York income tax). Under the legislation, all such trusts are now treated as grantor trusts for New York State income tax purposes, notwithstanding their classification as separate taxpayers for Federal tax purposes. Accordingly, all income, including capital gains, of such trusts will be subject to income tax in New York on the personal tax return of the New York resident grantor, as if such trust did not exist.

We are available to advise our clients in determining what the changes under the legislation mean for their particular situation, or to discuss any other estate planning matter.

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