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Recent Changes to New York's Estate and Trust Income Tax Laws

By David R. Schoenhaar, Esq.


David R. Schoenhaar

Effective April 1, 2014, as part of the implementation of the 2014-2015 budget, the legislature and Governor Cuomo made significant changes to New York's estate tax and trust income tax laws. According to Governor Cuomo, a key objective is to provide tax relief to New Yorkers and prevent them from migrating to states with more generous estate tax laws. This Alert provides a summary of key provisions of the new law.

Estate Tax Exclusion Increased

The most significant change implemented with the new law is the increase in New York's basic exclusion amount. Prior to the new law, this amount had long been $1 million per decedent. As of April 1, 2014, the amount has more than doubled to $2,062,500 and is scheduled to increase over the next few years so that by January 1, 2019, it will equal the federal exemption amount (projected to be approximately $6 million). The chart below sets forth the scheduled increases:

Date of Death	Exclusion Amount
April 1, 2014 to March 31, 2015	$2,062,500
April 1, 2015 to March 31, 2016	$3,125,000
April 1, 2016 to March 31, 2017	$4,187,500
April 1, 2017 to December 31, 2018	$5,250,000

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Mr. Schoenhaar can be reached at 516-663-6588 or click here to email him.

Mr. Feigenbaum can be reached at 516-663-6540 or click here to email him.

Mr. Farinacci can be reached at

January 1, 2019 and Thereafter	Same as Federal Exemption

This change is generally positive for New Yorkers and will result in many more estates being below the threshold which triggers an estate tax. However, for more wealthy New Yorkers, the exclusion rapidly phases out and results in a "tax cliff" as a taxable estate exceeds the exclusion amount at the time of death.

Applying the new law and assuming a date of death of January 1, 2015, when the exclusion is $2,062,500, there are essentially three scenarios that can apply to a New York decedent. They are as follows:

1. For a decedent with a taxable estate that is less than or equal to the exclusion amount, the credit is equal to the computed tax that would otherwise be due under the tax tables. There is no estate tax as the credit washes out the computed tax.
2. For a decedent with a taxable estate that exceeds the exclusion amount by less than 105%, the credit begins to phase out causing an increasing tax as the size of the taxable estate approaches 105% of the exclusion amount.
3. For a decedent with a taxable estate that equals or exceeds 105% of the exclusion amount (*i.e.* a taxable estate of $2,165,625 or more), no credit is allowed, which results in a complete phase out of the exclusion and the entire estate is taxed according to the tax tables.

Gross Estate Expanded

With the passage of the new law, New York still does not impose a gift tax. However, the new law provides that certain lifetime gifts are included when computing a New York resident's gross estate at death. These gifts consist of those made by the decedent: (i) when the decedent was a resident of New York, (ii) within three years of decedent's death, and (iii) between April 1, 2014 and December 31, 2018. Accordingly, estate tax implications must now be considered when making lifetime gifts to reduce an estate below the New York exclusion amount.

Portability

Despite the significant changes to New York's estate tax, the new law failed to implement portability which applies for federal estate tax purposes since 2011. In general, portability enables the estate of a surviving spouse to utilize the unused estate tax exemption of the first spouse's estate. Since this is not available in New York, it continues to be important for New York spouses to balance their estates and to pass assets to each other utilizing a credit shelter or bypass trust.

Trust Income Tax Loopholes Closed

516-663-6628 or click here to email him.

The new law also imposes an income tax for certain trusts. An Incomplete Gift Non-Grantor Trust ("ING") is one such trust affected by the new law. An ING is an irrevocable domestic asset protection trust utilized not only for asset protection but also to minimize or avoid New York state income tax. Recognizing this loophole, the new law provides that an ING will be treated as a grantor trust for New York income tax purposes. Accordingly, a New York grantor will now be required to report an ING's income on the grantor's individual tax return and will be responsible for the income tax liability.

The other type of trust affected by the new law is a New York resident trust. Under prior law, these trusts escaped income tax if during a particular year (i) no trustees were domiciled in New York, (ii) no real or tangible trust property was located in New York, and (iii) there was no New York source trust income. Now, subject to certain exclusions, a "throwback tax" on the accumulated income earned after January 1, 2014 will now be imposed on any income distributed after June 1, 2014 to a beneficiary who is then a New York resident. In addition to imposing a new tax, advisors and trustees will have the additional responsibility to account for the throwback tax and prepare informational returns to ensure compliance.

Conclusion

Given these significant tax changes, New Yorkers should consult with their estate planning attorney and accountant to determine how the new law affects their estate planning.

David R. Schoenhaar, Esq. is a member of the Trusts & Estates Department at Ruskin Moscou Faltischek, P.C., where his practice focuses in the area of trust and estate planning and litigation.

Ruskin Moscou Faltischek, P.C. | East Tower, 15th Floor | 1425 RXR Plaza, Uniondale, NY 11556 | 516.663.6600