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Significant Changes to New York Estate and Income Tax Law Effective April 1, 2014

Governor Cuomo recently signed into law changes to New York's estate and income taxes. As the headlines noted, the changes provide some welcome tax relief to many middle class New Yorkers. However, wealthy clients may see little benefit under the new rules, and the additional complexity means careful estate planning to maximize the available benefits and minimize estate and income taxes remains essential.

CHANGES TO TRANSFER TAXES (ESTATE, GIFT AND GENERATION-SKIPPING TAXES)

Increased basic estate tax exclusion amount

Prior to the new law, New York had a \$1,000,000 estate tax exclusion amount. Over the next few years, the New York estate tax exclusion amount is scheduled to increase as follows:

- For decedent's dying on or after April 1, 2014 but before April 1, 2015: \$2,062,500
- For decedent's dying on or after April 1, 2015 but before April 1, 2016: \$3,125,000
- For decedent's dying on or after April 1, 2016 but before April 1, 2017: \$4,187,500
- For decedent's dying on or after April 1, 2017 but before January 1, 2019: \$5,250,000

After January 1, 2019, the basic exclusion amount will be indexed from 2010, which should result in New York's exclusion amount being equal to the then current federal exclusion amount.

An estate tax "cliff"

Although the increase in New York's exclusion amount will result in fewer New York estates being subject to New York estate tax, the new tax law does not benefit larger estates. *The applicable credit amount is rapidly phased out and eliminated entirely if the New York taxable estate exceeds 105% of the basic exclusion amount.*

Accordingly, if a resident decedent's taxable estate exceeds the basic exclusion amount by more than 5% (a taxable estate of \$2,165,625 in 2014), the entire taxable estate will be subject to New York estate tax. Thus, for example, under the new law, a taxable estate of \$2,165,625 in 2014 will incur a New York estate tax of \$112,050.

Estate tax rates

For estates of decedent's dying on or after April 1, 2014, and before April 1, 2015, the highest estate tax rate remains 16%. Since the tax rates remain largely the same, the New York estate tax imposed on estates in excess of 105% of the exclusion will be the same under the new law as that imposed under the prior law (at least through March 31, 2015). Interestingly, there is no estate tax rate schedule for decedents dying after March 31, 2015, raising the obvious question of what changes may be made to the tax rates in advance of March 31, 2015.

Gifts

New York repealed its gift tax in 2000. The new tax law does not change this, but provides for an "add back" of taxable gifts made within three years of death (if not

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otherwise included in the federal gross estate) exclusive of gifts made (i) when the decedent was not a resident of New York; (ii) prior to April 1, 2014; or (iii) after December 31, 2018.

Repeal of GST Tax

New York's generation skipping transfer (GST) tax has been repealed. (The federal GST remains in effect, with a 40% tax rate.)

Portability and New York QTIP election

Under federal estate and gift tax rules married couples can transfer the unused exemption of one spouse to the surviving spouse at death (so-called "portability") and certain trusts can be set up for a surviving spouse which defer estate taxes until the death of the surviving spouse (so-called "QTIP" trusts). The new New York law does not provide for portability of New York's estate tax exemption, nor does it allow for a QTIP election which differs from the election made on the federal estate tax return (e.g., a separate New York QTIP election). So, for married couples, careful asset and estate planning is still necessary to make sure effective use can be made of each spouse's New York exemption amount.

CHANGES TO INCOME TAXATION OF CERTAIN TRUSTS

Generally, New York imposes an income tax on the income of "New York resident trusts" (such as, for example, irrevocable trusts created by a person who is a domiciliary of New York). However, a New York resident trust can qualify as exempt from New York income tax if (i) there are no New York trustees; (ii) there is no real or tangible property located in New York; and (iii) there is no New York source income (an "exempt resident trust").

The new law includes a "throwback" tax on distributions of accumulated income from exempt resident trusts if the trust (i) accumulates income during a year in which it is an "exempt resident trust" and (ii) accumulated income is distributed in a later year to a beneficiary who is a New York resident.

The tax does not apply to income (i) paid to a beneficiary prior to June 1, 2014, or (ii) earned by the trust in a taxable year beginning before January 1, 2014, or (iii) earned in a taxable year before the beneficiary became a New York resident.

The "throwback" tax also does not apply to non-resident trusts or to resident trusts which are incomplete gift non-grantor trusts (sometimes known as "INGs" or, if established under Delaware law, "DINGs"). Under the new law, incomplete gift non-grantor trusts are treated as grantor trusts for New York purposes.

CONCLUSION

In light of the changes to New York's estate tax, maximizing the use of New York's estate tax exemption is even more important, and, for larger estates, even more complicated, than before. Proper dispositive provisions and asset titling, as well as consideration of income tax issues and the larger federal estate tax exemption, are crucial. Further, taxable gifts must be given more careful consideration. You may want to consult with your Wiggin and Dana estate planning attorney as to whether any changes to your estate plan are warranted.

In addition, we suggest that you review with your tax advisors the administration and tax treatment of any New York trusts of which you are the grantor and/or beneficiary.

This publication is a summary of legal principles. Nothing in this article constitutes legal advice, which can only be obtained as a result of a personal consultation with an attorney. The information published here is believed accurate at the time of publication, but is subject to change and does not purport to be a complete statement of all relevant issues.