



April 25, 2014

CLIENT ALERT

NEW YORK STATE TAX LAW CHANGES AFFECTING TRUSTS AND ESTATES

The recently enacted New York State budget legislation makes important changes to New York's estate tax law and to the income taxation of certain trusts. These changes provide estate tax relief for some New Yorkers whose assets exceed \$1,000,000 in value, but very wealthy New Yorkers will not see a reduction in their estate taxes.

Increased New York Estate Tax Exclusion

Before April 1, 2014, New York State residents whose estates exceeded \$1,000,000 were subject to New York estate tax on the property owned by them on the date of their death. Effective April 1, 2014, the New York State estate tax basic exclusion amount – the amount that may pass to heirs without New York estate tax – has been increased to \$2,062,500, and is scheduled to increase by \$1,062,500 every year for the next three years. Beginning on January 1, 2019, the basic exclusion amount will equal the federal exemption amount.

To summarize:

<u>Date of Death</u>	<u>Basic Exclusion Amount</u>
From April 1, 2014 to March 31, 2015	\$2,062,500
From April 1, 2015 to March 31, 2016	\$3,125,000
From April 1, 2016 to March 31, 2017	\$4,187,500
From April 1, 2017 to December 31, 2018	\$5,250,000
From January 1, 2019	The federal exemption amount (currently \$5,340,000, indexed for inflation)

The New York estate tax rates are unchanged. The maximum rate (on taxable estates of more than \$10,100,000) remains at sixteen percent.

Estates that Exceed the Basic Exclusion Amount – Phase Out of Exclusion

Once the value of the taxable estate exceeds the basic exclusion amount, the exclusion is rapidly phased out, and for estates that exceed the basic exclusion amount by 5 percent or more, there is no exclusion at all (i.e., the entire estate is subject to New York State estate tax, not just the excess over the basic exclusion amount).

Gifts Made Within Three Years of Death

To discourage New York residents from making so-called "death-bed" gifts to reduce their taxable estates, lifetime gifts made within three years of the date of death (and after March 31, 2014 and before January 1, 2019) are added to assets owned at death for the purpose of determining the amount subject to New York estate tax. This rule does not apply to gifts that qualify for the Federal annual exclusion (currently, \$14,000 per donee), payments of tuition or medical expenses or gifts made while the donor was not a New York resident.

Using a Credit Shelter Trust to Preserve the New York Estate Tax Exclusion

To minimize New York estate tax, married couples with combined assets that exceed the basic exclusion amount should arrange their estate plans to make maximum use of the exclusions of both spouses. Unlike the federal estate tax, which enables any exemption that is not used by the first spouse to die to be added to the exemption available to the estate of the second spouse to die, the New York State estate tax law does not make unused exclusion in the first estate available to be used by the second estate. To ensure that the New York State exclusion of the first spouse to die is most effectively utilized, it may still be advisable for some married couples in New York to include in their wills, or allow a surviving spouse to elect to create, a credit

shelter trust (also known as a bypass trust) to obtain the lowest combined federal and New York taxes and, in some cases, to divide their assets between them so that each spouse has enough property in his or her name to fully utilize the available exclusion.

Estate Tax Savings versus Capital Gains Tax Savings

For married couples whose property includes highly appreciated assets such as real estate or securities, the decision whether to fund a credit shelter trust when the first spouse dies may not be an easy one. It will be necessary to compare the New York estate tax savings to be gained by placing the assets in the credit shelter trust with the potential capital gains tax savings if the property is given to the surviving spouse outright (or held in a marital trust for the spouse's benefit) so that an increased tax basis, known as a step-up, can be used for purposes of reducing capital gains tax on assets sold after the death of the surviving spouse. Wills of New York residents should be drafted to provide sufficient flexibility to enable a surviving spouse or executor to choose between these two approaches.

Income Taxation of Trusts

Previously, a New York resident could create a trust that would avoid New York State income tax where: (i) there were no New York resident trustees, (ii) there was no income or gain derived from New York sources, and (iii) there was no real estate or tangible personal property located in New York State (a "New York exempt trust"). Under the new law, distributions made from New York exempt trusts to New York State resident beneficiaries may now be subject to New York State income tax, and in some cases, all the income from these trusts will be taxable to the grantor.

If you would like to discuss your estate plan or the effect of the New York State tax laws on you, please feel free to contact us.

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