New York Estate Tax Changes Provide Planning Opportunities

Major changes to New York Estate and Gift Tax were made by the Executive Budget adopted by the Legislature and effective April 1, 2014. Planning to take advantage of the New York changes is essential for persons with assets greater than $2,000,000.

Estate Tax Exclusion Increased

Under prior law, estates less than $1,000,000 were exempt from New York estate tax, whereas the Federal exemption is $5,340,000. The New York exclusion amount is now increased to $2,062,500 as of April 1, 2014, with gradual increases until the New York exclusion matches the Federal. The New York exclusion increases as follows:

<table>
<thead>
<tr>
<th>Death on or After: and Before:</th>
<th>Basic Exclusion Amount:</th>
</tr>
</thead>
<tbody>
<tr>
<td>April 1, 2014 and April 1, 2015</td>
<td>$2,062,500</td>
</tr>
<tr>
<td>April 1, 2015 and April 1, 2016</td>
<td>$3,125,000</td>
</tr>
<tr>
<td>April 1, 2016 and April 1, 2017</td>
<td>$4,187,500</td>
</tr>
<tr>
<td>April 1, 2017 and January 1, 2019</td>
<td>$5,250,000</td>
</tr>
</tbody>
</table>

After January 1, 2019, the New York exclusion is indexed for inflation in such a way that the New York exclusion will match the Federal exclusion.

There is a catch to the increased exclusion, however, referred to as the “cliff”. The cliff effect can be quite substantial. If the taxable estate exceeds 105% of the basic exclusion amount, the benefit of the exclusion is lost entirely. If the taxable estate is between 100% and 105% of the basic amount, the New York exclusion phases out gradually.

For example, if D dies after April 1, 2014, with a taxable estate of $2,062,500 there is no New York tax or Federal estate tax as the estate is also below the Federal exclusion. However, if D had a taxable estate of $2,169,265 (i.e. 105% of the New York exclusion), the New York tax would be $112,050.
If D dies after April 1, 2017, when the New York exclusion has increased to $5,250,000, with a taxable estate of $5,512,500 (again 105% of the New York exclusion), the New York tax would be $452,300.

A simple method to avoid the cliff would be to make a charitable gift of the amount needed to reduce the taxable estate below the exclusion amount for that year.

Gift Add Back

New York has no gift tax. However, the Budget Bill provides that taxable gifts made after April 1, 2014, by a New York resident and within 3 years of death, are added back to the taxable estate. Gifts within the $14,000 ($28,000 for a married couple) annual exclusion from Federal gift tax are not added back as taxable gifts for the New York tax. The effect is to increase the size of the New York taxable estate by the amount of any such gifts.

It appears that this add back includes the value of any taxable gifts made by a New York resident of real property or tangible personal property located outside of New York.

Portability

The Federal estate tax now includes a portability feature for married couples of the $5,340,000 estate and gift tax exclusion. New York has not adopted portability. Each of the couple has a $5,340,000 Federal exclusion. Portability applies when the first spouse dies. Any portion of the Federal exclusion that is not used on the tax return of the first spouse to die can be carried over to the surviving spouse. Provided the first spouse does not remarry,
the balance of the first spouse’s exclusion may be used on the second spouse’s Federal estate tax return.

For example, suppose A and B are married and each has an estate of $5,340,000. A dies April 2, 2015, leaving all $5,340,000 to B which qualifies for the marital deduction from estate tax. Thus, the taxable estate is zero and there is no tax. The entire $5,340,000 of the Federal exclusion carries over to B. Thus, if B dies with an estate of $10,680,000, there is no Federal estate tax on his estate by application of the combined exclusions. However, since New York has not adopted portability, when B dies there will be a New York tax of $1,175,600 on B’s $10,680,000 estate.

Instead, A’s Will could direct that $3,125,000 be put into a credit shelter trust, which is equal to the New York exclusion in 2015. The trust would provide income to B for life with remainder to the children of A and B upon B’s death. The credit shelter trust would reduce A’s estate to $2,215,000 ($5,340,000 less $3,125,000) and result in no Federal or New York tax in A’s estate by application of the Federal and New York exclusions. There would be a gift from A to B of $2,215,000, which qualifies for the marital deduction. Thus, upon B’s death, his New York and Federal taxable estate would be reduced to $7,555,000 ($5,340,000 plus $2,215,000 from A). There would be no Federal tax on B’s $7,555,000 estate because of the Federal exclusion (B’s carryover Federal exclusion of $5,340,000 plus $2,215,000 from A). The New York tax on B’s estate of $7,555,000 would be $712,680 rather than $1,175,600 on an estate of $10,860,000, resulting in a New York tax savings of $462,920 ($1,175,600 less $712,680).
GST Tax

The Federal GST tax applies when a gift is made that skips over a generation. If A dies leaving money or property to grandchildren, the GST tax applies because the generation of A’s children has been skipped over. The Federal $5,340,000 exclusion also applies for GST tax purposes.

The Budget Bill repealed the New York GST tax eliminating this New York tax concern for New York residents.

Conclusion

The changes in New York estate tax have greatly reduced estate tax for New Yorkers with total assets below the new exclusion limits. Gifts over $14,000 ($28,000 for a married couple) will require careful planning in light of the new New York add back.

Most importantly, planning to utilize a credit shelter trust is still recommended for estates that may be subject to New York estate tax because of New York’s failure to adopt the Federal portability rule. Planning will also be essential for New York estates to avoid the “cliff” by proper use of charitable giving or credit shelter to fully utilize the New York exclusion in the estates of married couples.