Significant Changes to New York Estate and Income Tax Enacted

We previously alerted you to proposed legislation affecting New York estate tax law, the tax treatment of gifts by New York residents, and New York income taxation of certain trusts. This month Governor Cuomo signed final legislation into law, which included some changes from the initial proposal. Some of the important provisions of the final legislation are highlighted below.

Provisions of interest to all New Yorkers

1) Increase in New York Estate Tax Exemption Amount:

The New York estate tax exemption (i.e., the amount an individual may pass at death free of New York estate tax), which was previously $1,000,000 per individual, has been immediately increased to $2,062,500 for individuals dying on or after April 1, 2014, and is scheduled to increase each year over the next five years so that it is equal to the Federal estate tax unified credit amount (currently, $5,340,000 per individual and indexed for inflation) for estates of individuals dying on or after January 1, 2019.

The New York estate tax exemption is phased out for taxable estates valued above the exemption amount, and no exemption is available for taxable estates valued above 105% of the exemption amount.

While proposed legislation would have reduced the top New York estate tax rate, the final legislation preserves the current maximum rate of 16%. (The maximum rate is reached for individuals with taxable estates exceeding $10,100,000.)

The effect of the new law is that an individual who will have a taxable estate valued below 105% of the increased exemption amount should have a lower New York estate tax burden than under the prior law. An individual who will have a taxable estate valued above that threshold will not receive the benefit of the New York exemption amount, but, because of the way the estate tax is calculated, should generally pay the same amount of New York estate tax as under the prior law. The increased exemption amount should provide some tax savings for married couples above that threshold. However, proper planning – including careful titling and ownership of assets between married couples – will be necessary to realize the full benefits of the increased exemption amount.

2) Certain Lifetime Gifts Subject to New York Estate Tax

Under the new law, taxable gifts made by an individual within three years of death are added back to the individual's estate for purposes of calculating the New York estate tax, effectively taxing those gifts for New York purposes upon death. New York does not otherwise impose a gift or estate tax on lifetime gifts.

The new rule is limited in its application, and affects only gifts made between April 1, 2014, and January 1, 2019, by an individual who was a resident of New York at the time of the gift. In addition, annual exclusion gifts and qualified gifts for medical or educational purposes would not be implicated by this new rule.

3) New York Generation-Skipping Transfer ("GST") Tax Repealed

The new law repeals the New York GST Tax, which had limited application.

Provisions related to trusts with New York grantors or New York beneficiaries

4) New Income Tax Imposed on New York Beneficiaries for Certain Trust Distributions

New York law has long provided that certain trusts – though considered New York resident trusts for income tax purposes – may be exempt from paying New York state and city income taxes because they satisfy three conditions: (i) all trustees are domiciled outside New York, (ii) all trust property is located outside New York, and (iii) the trusts have no New York source income. This exemption remains, but under the new law, a new state (and, if applicable, city) income tax may be imposed on a New York resident beneficiary of such an exempt resident trust who receives a trust distribution if, in prior years, the trust had accumulated rather than distributed its income. Various exceptions to the new rule apply, including distributions of income that was earned by the trust before 2014, and distributions made to the beneficiary before June 1, 2014.

The new income tax on New York beneficiaries should not affect widely used grantor trusts, the income of which is taxable to the trust's grantor.

5) New York Income Tax Imposed on Grantors of "ING Trusts"

The new law will cause the income of so-called Irrevocable Non-Grantor Trusts, or "ING Trusts," to be subject to New York state (and, if applicable, city) income taxes. These trusts had previously not been subject to New York state or city income taxes.

* * * * *

Careful estate planning is important for clients and their families to ensure that their goals are realized in a tax-efficient manner. If you have any questions about how the new law may impact you as a New York resident or as a trust grantor, trustee, or beneficiary, please contact us.

This alert is for general informational purposes only and should not be construed as specific legal advice. If you would like more information about this alert, please contact one of the following attorneys or call your regular Patterson contact.

Christopher C. Angell	212.336.2770	ccangell@pbwt.com
Michael S. Arlein	212.336.2588	msarlein@pbwt.com
Hugh J. Freund	212.336.2370	hjfreund@pbwt.com
Carolyn B. Handler	212.336.2480	cbhandler@pbwt.com
John Sare	212.336.2760	jsare@pbwt.com
Catherine Grevers Schmidt	212.336.2116	cgschmidt@pbwt.com

Patterson Belknap Webb & Tyler LLP

1133 Avenue of the Americas New York, NY 10036-6710 212.336.2000 www.pbwt.com