



June 15, 2014

Dear Clients and Friends,

New York State recently enacted significant modifications to its estate tax regime which may impact your estate planning documents. The new law also made changes to the income taxation of certain New York resident trusts which were previously exempt from taxation.

### **Increased New York Estate Tax Exemption**

You may be aware that the current federal estate tax exemption is \$5,340,000 and is indexed for inflation. Prior to the April 1, 2014 effective date of the new tax law, the New York State estate tax exemption was only \$1,000,000 and was not indexed for inflation. The recent tax law will gradually increase the New York exemption (referred to in the statute as the “basic exclusion amount”) until it effectively matches the federal exemption amount for decedents dying after 2018. Estates that are at or below the basic exclusion amount will pay no New York estate tax.

The New York basic exclusion amount increased to \$2,062,500 effective April 1st. It will continue to increase as follows:

<u>Date of Death</u>	<u>New York “Basic Exclusion Amount”</u>
4/1/2015 to 3/31/2016	\$3,125,000
4/1/2016 to 3/31/2017	\$4,187,500
4/1/2017 to 12/31/2018	\$5,250,000
On or after 1/1/2019	Equals federal exemption amount

As noted above, the new law provides a tax credit which shields estates at or under the basic exclusion amount from paying New York estate tax. However, for estates valued between 100% and 105% of the basic exclusion amount, the tax credit is gradually phased out. Once an estate exceeds the basic exclusion amount by more than 5%, the benefit of the credit is entirely eliminated. Estates that exceed the basic exclusion amount may be subject to the “cliff” described below.

The following matters merit consideration in light of the changes to the estate tax:

- **Credit Shelter Trusts.** It has been a common estate planning practice to include trusts (“credit shelter trusts,” “by-pass” trusts” or “estate tax-exempt

trusts”) in the wills of married individuals to be funded at the death of the first spouse with the amount that can pass free of both New York and federal estate tax. The amount in the credit shelter trust will not be subject to tax at either spouse’s death.

Going forward, as the New York basic exclusion amount increases, a larger portion of the estate of the first spouse to die will be subject to the trust. If no changes are made to wills in which the trust for the surviving spouse is funded by reference to the New York exemption, the surviving spouse may receive little or no property outright from the deceased spouse’s estate. If your Will contains such a formula, depending on the size of your estate, you may want to revise it to “cap” the amount passing to the trust.

- The So-Called “Cliff”. As noted above, the new law is intended to entirely eliminate the benefit of the basic exclusion amount once the estate exceeds it by more than 5%. If a taxable estate exceeds the basic exclusion amount by a relatively small amount, the New York estate tax increases sharply, producing what has been, somewhat dramatically, referred to as the “cliff.” In certain cases, it may be advisable to include a charitable bequest in your Will to decrease the taxable estate and actually increase the amount passing to your family. This provision will, by its terms, take effect only if the amount of the charitable bequest will be less than the New York estate tax savings achieved. The cliff will not present an issue for estates that will be significantly under or over the basic exclusion amount at the decedent’s death.

### **Portability**

Despite various predictions prior to the enactment of the new law, New York did not copy federal law and adopt “portability.” Portability permits a decedent’s estate to take advantage of unused federal exemption from a predeceased spouse’s estate. The New York basic exclusion amount is not portable to the surviving spouse and will be lost if not used in the first spouse’s estate.

### **Gifts Made Within 3 Years of Death**

New York State has not had a state-level gift tax since 1999. Thus, it has been possible to reduce an estate’s New York State estate tax liability by making lifetime transfers. The new tax law complicates that by causing gifts made within three years of death and between April 1, 2014 and December 31, 2018 to be included in the donor’s “gross estate” for New York estate tax purposes. This “recapture rule” applies only if the donor was a New York resident at the time of gift.

Care should be taken when contemplating gifts between now and December 31, 2018. If such gift is otherwise advisable for estate planning purposes, the gift should be made with non-New York property to maximize the possibility of avoiding recapture.

**Income Taxation of New York Trusts**

Beneficiaries and trustees of New York trusts which have historically been exempt from the New York income tax should speak with their tax preparers to determine whether they might be subject to New York income tax going forward.

As always, your DD&C attorney will be glad to discuss how or if these changes apply to you, and how they might be used to your advantage in your estate plan.

Sincerely,

DAVIDSON, DAWSON & CLARK LLP

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