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Changes to New York State Estate and Gift Tax Regimes

On March 31, 2014, Governor Andrew Cuomo signed legislation that significantly alters the New York State estate and gift tax laws - the first change since 1998. Under the old law, an estate was subject to NYS estate tax if the total gross estate exceeded \$1,000,000. Under federal law, an estate is subject to estate tax if the total gross estate, plus the federal adjusted taxable gifts, exceeds \$5,340,000 ("exemption amount") indexed for inflation. Thus, for NYS residents whose gross estates exceeded \$1,000,000 but were less than \$5,340,000, NYS estate tax was payable on the sum between \$1,000,000 and the federal exemption amount.

Governor Cuomo's legislation provides for an incremental increase of the NYS exemption amount that will eventually match the federal exemption amount. These changes were made to encourage wealthy New Yorkers to stay in New York rather than retiring to more tax-favorable jurisdictions.

So how does the new law work?

Before April 1, 2014, the amount that an individual could leave to his or her heirs without paying NYS estate tax was \$1,000,000. As of April 1, 2014, the exemption amount is increased to \$2,062,500 for those who pass away between April 1, 2014 and March 31, 2015. For those who pass away between April 1, 2015 and March 31, 2016, the exemption increases to \$3,125,000. The following year, the amount increases to \$4,187,500.

For those who pass away on or after April 1, 2017 but before January 1, 2019, the exemption amount is \$5,250,000. After January 1, 2019, the NYS exemption amount is scheduled to equal the federal estate tax exemption. The top NYS estate tax will remain 16%.

Watch out for the "Cliff"

For many New Yorkers, this increase in the exemption amount will offer significant estate tax savings. However, there are additional intricacies in the new law that are problematic. The legislation provides that the new NYS exemption amount is "phased out" for taxable estates valued at between 100% and 105% of the exemption amount. This means that if you die with an estate valued at just five percent (5%) more than

the exemption amount, you face a “cliff” and will be taxed on the full value of your estate, not just the amount exceeding the exemption amount.

For example, a New Yorker passes away on June 1, 2014 with an estate valued at \$2,200,000. The NYS exemption amount will be \$2,062,500. Because the value of the estate exceeds 105% of the exemption amount ($\$2,062,500 \times 105\% = \$2,165,625$), the estate is subject to NYS estate tax on the entire \$2,200,000. Due to changes in the tax bracket structure, the estate tax owed will be \$114,800, the same amount that would have been owed under the old law.

However, if that New Yorker had died with an estate valued at \$2,000,000, the estate would owe no NYS estate tax under the new law. Under the old law, a \$2,000,000 estate would have owed \$99,600 in NYS estate tax. The effects of the estate tax “cliff” are even more dramatic when one considers its impact on larger estates. Let’s assume a New Yorker dies on June 1, 2017 with a taxable estate of \$5,600,000. The exemption amount will have increased to \$5,250,000. Because the value of the estate exceeds 105% of the exemption amount ($\$5,250,000 \times 105\% = \$5,512,500$), the estate will be subject to NYS estate tax on the entire estate.

The NYS estate tax owed will be \$462,800. If the estate’s had been decreased by just \$350,000 (the difference between the exemption amount and the value of the estate), there would have been no NYS estate tax.

Gift Add-Back

As you read the second example, you may have thought, “Why not just give away \$350,000 if it will save \$462,800 in NYS taxes?” The new law contains a provision that is designed to close this loophole. NYS currently has no gift tax. Under the old law, gifts made during lifetime were not included by NYS in the calculation of the gross estate. However, the new law provides that gifts made within 3 years of death will be added back for purposes of calculating the gross estate. This add-back applies only to gifts made on or after April 1, 2014 and before January 1, 2019.

If an individual attempts to decrease the value of his estate by gifting, to save on NYS estate taxes, and dies within 3 years of the gift, the gift is included for purposes of calculating his gross estate.

Conclusion

The new law is complicated and already rumors abound as to whether the legislature will revisit these changes. Those of our readers who have taxable estates must know that there are estate planning tools that can be utilized to reduce or even eliminate estate taxes. If you are interested in learning about them, or if you have questions as to how the new laws might affect your existing estate plan, please contact us to arrange for a consultation.