

2014 STATE TAX CHANGES

Insights on Recent New York Transfer and Fiduciary Tax Developments

April 11, 2014

On March 31, Governor Cuomo signed into law many of the changes to the New York transfer and fiduciary income tax proposed in his 2014-2015 state budget. Although the enacted legislation, effective April 1, 2014, tracks closely the original proposed version, the new law is slightly more favorable to taxpayers.

ENACTED CHANGES TO NEW YORK TRANSFER TAX

Estate Tax – In keeping with the original proposed amendments to the New York estate tax, the new law provides that certain estates are entitled to a credit equal to the estate tax imposed on estates no larger than the New York “basic exclusion amount,” effective for decedents dying on or after April 1, 2014. Thus, the maximum credit will increase from the tax imposed on \$1 million (i.e., the maximum credit since 2001) to the tax imposed on \$5,250,000. Starting in 2019, the basic exclusion amount will equal the federal applicable exclusion amount: \$5,000,000, as adjusted for inflation with reference to the consumer price index in 2010.

YEAR	BASIC EXCLUSION AMOUNT
4/1/2014 – 3/31/2015	\$2,062,500
4/1/2015 – 3/31/2016	\$3,125,500
4/1/2016 – 3/31/2017	\$4,187,500
4/1/2017 – 12/31/2018	\$5,250,000
1/1/2019 - ongoing	\$5,000,000 adjusted for inflation annually

Under the new law, the benefit of the increased basic exclusion amount is phased out for estates valued at more than 100% of the exclusion amount. Once the value of the estate reaches 105% of basic exclusion amount (the “cliff”), the entire estate is taxed at the applicable rates. For example, a \$4,187,500 taxable estate of a New York resident who dies on April 10, 2016 will not pay any New York estate tax. However, if the same decedent’s taxable estate were only 5% larger, or \$4,396,875, it would pay tax on the entire taxable estate, without any benefit from the increased credit.

In a departure from the original proposal, the highest tax rate remains 16% for the next year, rather than being lowered to 10%. Notably, the statute provides estate tax rates only for estates of decedents dying between April 1, 2014 and March 31, 2015, leaving open the possibility of lower (or higher) rates in the near future.

Decedent’s Estate Augmented by Lifetime Gifts – The proposed amendment to the definition of a decedent’s gross estate was designed to significantly increase the estate tax on New York estates by pulling in all of the decedent’s lifetime “New York gifts” made after March 31, 2014. A “New York gift” is either a gratuitous transfer made by a New York resident or a gratuitous transfer by a non-resident of real property or tangible personal property located in New York. Fortunately for taxable New York estates, the scope of the final legislation is much narrower than originally conceived, as the new law provides for inclusion of New York gifts made within a very limited time frame. Under the revised statute, a decedent’s New York gross estate will include only New York gifts made within three years of death, and only if the gift was made during the period spanning April 1, 2014 through December 31, 2018.



Generation Skipping Transfer Tax – As proposed, the New York generation-skipping transfer tax is repealed, effective for transfers on or after April 1, 2014.

ENACTED CHANGES TO NEW YORK FIDUCIARY INCOME TAX

Throwback Tax on Taxable Distributions to New York Resident Beneficiaries from New York Resident Trusts not Previously Taxed by New York – Under the proposed amendments to New York fiduciary income tax, distributions to a New York resident beneficiary from any trust (whether or not the trust was a resident of New York) would be subject to a throwback tax on previously undistributed income accumulated during any tax year starting after 2010. Under the throwback rules, a beneficiary's distribution is deemed to include income earned in prior years, and thereby increases the beneficiary's tax liability.

The final legislation limits the throwback tax to distributions by a New York resident trust to a New York resident beneficiary of income accumulated in tax years starting after December 31, 2013, where the undistributed income had never been subject to New York income taxation. In other words, the throwback tax will apply only to New York resident beneficiaries of trusts created by a New York resident grantor, where the trust is exempt from New York income taxation because it has no New York resident trustees, no New York source income, and no New York real estate or tangible personal property located in the state (a "New York Exempt Trust").

The throwback tax applies to all New York Exempt Trusts, regardless of when the trust was created. New York resident grantors should be made aware that, although the throwback tax diminishes the income tax benefit they anticipated from the creation of their New York Exempt Trusts, it does not entirely abrogate that income tax advantage, for the following reasons. First, under the throwback tax, only undistributed net income from a prior year that is paid to a New York resident beneficiary in a subsequent year will be subject to New York taxation – amounts that are not includible in the trust's distributable net income ("DNI") in a prior year will not be subject to throwback tax. Thus, in the case of a typical New York Exempt Trust which includes in DNI only ordinary income amounts, the throwback tax potentially subjects certain ordinary income to New York tax, but does not subject the trust's capital gains to New York income taxation. Second, since the New York throwback tax does not include an interest charge for the period between the trust's recognition of income and the New York resident beneficiary's receipt of that income, the trust and its beneficiaries enjoy deferral of New York income taxation. Finally, as noted above, the throwback tax only applies to distributions made to New York resident beneficiaries, and only to undistributed income accumulated during years in which the recipient was a New York resident beneficiary.

New York Grantor Trust Status for "ING Trusts" – The proposed legislation targeting taxation of the incomplete non-grantor trust ("ING Trust") was enacted with no substantive changes. Under the new law, an ING Trust (defined in the statute as a trust created by a New York resident, the funding of which is considered an incomplete gift under Internal Revenue Code Sec. 2511, but which is not taxable to the grantor under Internal Revenue Code Sec. 671-678), will be treated as a defective grantor trust for purposes of New York income taxation. The statute provides that any ING Trust that is "liquidated" (i.e., terminated via complete distribution of the trust estate) before June 1, 2014 will be exempt from New York grantor trust treatment. Distribution/appointment committees of ING Trusts need to be made aware of the new rule and the grace period for dissolving ING Trust now, so that they can consider whether to distribute all of the trust's assets prior to June 1, 2014. There is no one-size-fits all response: whether an ING Trust can or should be liquidated (either before or after June 1, 2014) must be determined on a case by case basis.

The recent New York transfer and fiduciary income tax developments are certainly noteworthy. Taxpayers should confer with their personal legal and tax advisors to evaluate the implications of these developments in their particular circumstances.

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