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Trusts and Estates Group Client Alert

New York Proposes Changes to the Application of Its Estate and GST Taxes and the Income Taxation of Trusts

On January 21, 2014, Governor Cuomo submitted his Executive Budget for 2014-2015 to the New York State Legislature - Budget Bill A8559. The Bill includes significant changes to New York's estate and generation skipping transfer taxes as well as the income taxation of certain trusts.

WINDOW CLOSING TO MAKE GIFTS THAT ESCAPE NEW YORK ESTATE TAX

The Bill proposes to include gifts made after March 31, 2014 in a New York resident decedent's estate for New York estate tax purposes, if the decedent was a New York resident at the time of the gifts. Currently, gifts made during lifetime essentially escape New York estate tax if properly structured. New York residents who wish to avoid New York estate tax on lifetime gifts should complete those gifts before April 1, 2014.

Please note that the potential estate tax savings from lifetime gifts should be balanced against other factors, including the potential loss of a "step up" in basis at death if gifts are made of appreciated assets.

INCREASED NEW YORK ESTATE TAX EXEMPTION AND DECREASED RATES

The Bill increases the New York estate tax exclusion amount in order to bring it largely into conformity with the federal estate tax exclusion amount. Over the next four years, the New York exclusion amount would be increased to \$5.25 million, with the exclusion amount indexed to inflation thereafter. Additionally, the Bill gradually decreases the top New York estate tax rate from 16% to 10% by 2017. Please note that New York has not enacted the "portability" provisions that, for federal estate tax purposes, permit a surviving spouse to "inherit" a decedent's unused estate tax exclusion amount.

If enacted, the Bill would take effect on April 1, 2014 and apply to estates of decedents dying on or after that date.

GENERATION SKIPPING TRANSFER TAX REPEALED

The Bill repeals New York's generation skipping transfer tax, which had limited application.

CHANGES TO INCOME TAXATION OF CERTAIN TRUSTS: "THROWBACK" TAX ON TRUST BENEFICIARIES

Trusts, known as "nonresident trusts," created by persons not domiciled in New York are generally exempt from New York income tax (other than on income from New York sources). Resident trusts are likewise exempt if they have no property located in New York, no New York trustees, and no income from New York sources. These rules have effectively made New York a state income tax haven for many trusts, even those with New York beneficiaries.

This Bill is designed to prevent income earned by nonresident trusts or exempt resident trusts from escaping New York income tax. In general, the legislation is intended to tax New York resident beneficiaries on the accumulated income, when distributed, of both nonresident trusts and exempt resident trusts. A beneficiary would be allowed under the Bill to disregard income earned in years before 2011 or in years prior to the beneficiary first becoming a New York resident. Distributions made on or before May 31, 2014 would be exempt under the proposal. The legislation is being revised to make technical corrections and may, perhaps, be further amended to reflect political compromises.

A New York "throwback" tax on accumulated income would increase reporting burdens on trustees and the potential income tax liabilities of New York resident beneficiaries.

INCOMPLETE GIFT NON-GRANTOR TRUST TAXATION

The Bill also proposes to tax all New York resident incomplete gift, non-grantor trusts (commonly referred to as DINGs or NINGs, depending on whether they were created in Delaware or Nevada) as grantor trusts for New York income tax purposes. Accordingly, the Bill, if enacted, would attribute all income of such a trust to the New York resident grantor for New York income tax purposes. The trust would continue to be treated as a separate taxpayer for federal income tax purposes. The Bill does not, however, apply to income from such a trust if liquidated before June 1, 2014.

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Please feel free to contact us if you have any questions regarding how these potential changes affect your current estate planning documents and possible planning opportunities for you.

TRUSTS AND ESTATES GROUP

Please feel free to discuss any aspects of this Client Alert with your regular Milbank contacts or any of the members of our Trusts and Estates Group.

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