



## NY Estate Tax: Watch Out for the Cliff!

**O**n April 1, 2014, New York enacted legislation (the “2014 legislation”) providing for significant changes to the New York estate tax laws. Prior to the 2014 legislation, the New York estate tax exemption was \$1 million and New York applied a graduated estate tax rate schedule with a top rate of 16%. Meanwhile, the federal estate tax exemption was increased to \$5 million in 2011 and was indexed for inflation on an annual basis. With inflation adjustments, the federal exemption has climbed to \$5.43 million in 2015.

### Aligning the New York and Federal Estate Tax Exemptions

The 2014 legislation will eventually align the New York exemption with the federal exemption. The New York exemption was increased from \$1 million to \$2,062,500 as of April 1, 2014 and is currently scheduled for annual increases on April 1 of each year going forward between 2015 and 2017 (each increase will be approximately \$1 million).

For New York residents dying on or after January 1, 2019, the New York exemption will be equivalent to the federal exemption, as indexed for inflation. With annual inflation adjustments, projections show that the federal exemption will be close to \$6 million come 2019. At that time, the New York estate tax will not apply to most New Yorkers.

The 2014 legislation changed the New York estate tax rate schedule slightly for decedents dying before April 1, 2015, but kept the top rate of 16% intact.

### The “Cliff”

Unfortunately, the tax relief offered by the increased New York exemption will not be enjoyed by New York residents (or their heirs) with estates that have a value exceeding the exemption. Under the 2014 legislation, the New York exemption is quickly phased out for New York estates valued at between 100% and 105% of the exemption. Estates with a value which is equal to or



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more than 105% of the exemption fall off the cliff, so to speak, and lose the benefit of the New York exemption altogether. In other words, estates with a value which is equal to or more than 105% of the exemption are entirely taxable, all the way back down to dollar one.

For example, if a New Yorker dies before April 1 of this year owning an estate valued at \$2.2 million, New York will impose an estate tax of \$114,800 even though the estate’s value exceeds the exemption by only \$137,500 (an effective marginal rate of 83%).

### Add Back of Certain Lifetime Gifts

Under the old New York estate tax law, gifts made by a decedent during his or her lifetime were only included in the decedent’s gross estate for purposes of determining whether the estate exceeded the prior \$1 million exemption and was, therefore, taxable (the old New York estate tax, like the

current tax, was a “cliff” tax). For example, under the old law, if a decedent died owning a \$900,000 estate and had made a gift of \$200,000 during his or her lifetime, the decedent’s \$900,000 estate was taxable (because the value of the decedent’s estate, plus his or her lifetime gifts, exceeded the old \$1 million exemption).

Now, under the 2014 legislation, gifts made by a decedent on or after April 1, 2014 and before January 1, 2019 and within three years of death are included in the decedent’s gross estate and become taxable for New York estate tax purposes. For example, if a decedent dies before April 1 of this year with an estate worth \$2,062,500 (the current New York exemption) having made a \$200,000 gift on or after April 1, 2014 (within three years of death), New York will impose an estate tax on an estate worth \$2,262,500.

### Portability

The federal exemption is “portable” between spouses, meaning that the exemption available to the estate of the first spouse to die transfers to the surviving spouse. Unfortunately, the 2014 legislation did not make the New York exemption portable between spouses. Consequently, a trust (oftentimes referred to as a “credit shelter trust” or “bypass trust”) must be created and funded under the Will (or revocable trust) of the first spouse to die in order to use that spouse’s New York exemption, so that the surviving spouse is not left with only his or her individual New York exemption to shelter the value of the couple’s combined assets.

### 2015-2016 Budget Proposal

The current New York State budget proposal does not address the “cliff” or allow for the portability of the New York exemption between spouses. Nor does it change the lifetime gift add back provision. It only provides for the extended application of the current estate tax rate schedule to decedents



dying after March 31, 2015.

## Planning Considerations

In light of the changes made to the New York estate tax laws by the 2014 legislation, New York residents may wish to review their estate plans with the following considerations in mind:

■ New Yorkers owning estates valued at slightly more than 105% of the New York exemption should consider ways in which to reduce the value of their taxable estates to below that threshold in order to avoid the im-

pact of the estate tax “cliff” discussed above. Charitable bequests, which are deductible for estate tax purposes, might be one way to accomplish this goal.

■ Because the New York exemption is not portable between spouses, married couples should avail themselves of estate tax planning provisions in their Wills (or revocable trusts) designed to fund a credit shelter trust following the death of the first spouse to die so as to ensure the use of that spouse’s New York exemption.

■ New Yorkers who are intent on making

lifetime gifts between now and December 31, 2018 should consider the possibility that such gifts will be includible in their taxable estates if they die within three years of having made the gift.

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