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CLIENT MEMORANDUM

Federal and New York Estate and Gift Tax Rules

A. Federal Estate and Gift Tax Rules

1. Federal Estate Tax:

(a) Estate tax exemption and rate: The Federal estate tax exemption is currently \$5,450,000. The maximum Federal estate tax rate has been set at 40%. The unlimited marital deduction on outright transfers to spouses (and certain transfers in trust) remains in effect.

(b) Portability of unused estate tax exemption: If a spouse dies and does not fully utilize his or her Federal estate tax exemption, the unused exemption is portable to the surviving spouse. For example, if the first spouse has \$5,450,000 in assets and leaves it entirely to the surviving spouse, and the executor of the deceased spouse makes the appropriate election on the decedent's Federal estate tax return, the surviving spouse on his or her death will have what the law calls a "basic exclusion amount" of \$5,450,000, plus a "deceased spousal unused exclusion amount" of \$5,450,000, for a total exclusion of \$10,900,000. The deceased spouse exclusion can only be passed on to one spouse, not to another one if the survivor remarries. While the portability provision (which only came into effect a few years ago) has the potential to simplify estate planning for married couples with assets of under \$10,900,000, one must

still properly plan in order to avoid New York estate taxes on the first spouse's death as the New York exemption amount will not match the Federal exemption amount until 2019, and there is no portability in New York.

2. **Federal Gift Tax**: The lifetime gift exemption is currently \$5,450,000. The maximum gift tax rate has also been set at 40%. Any gifting of the lifetime exemption is taken into account when computing the donor's estate tax upon death. The Federal gift tax annual exclusion is currently \$14,000 per recipient.

3. **Generation-Skipping Transfer Tax**: The generation-skipping transfer tax ("GST") exemption now matches the Federal estate tax exemption. This exemption is currently \$5,450,000.

B. New York Estate and Gift Tax Rules

1. New York Estate Tax

(a) Estate tax exemption and rate: The New York estate tax exemption amount is currently \$4,187,500 and is increasing progressively. On and after January 1, 2019, the New York estate tax exemption will match the federal estate tax exemption. The top New York estate tax rate remains at 16%.

Surprisingly, not every New York estate will benefit from the increased exemption amounts because: (i) the benefit of the exemption is phased out for taxable estates between 100% and 105% of the exemption, and (ii) taxable estates of 105% or more of the exemption completely lose the benefit of the exemption.

The following chart reflects the increased exemption amounts, and the dollar amount at which it is completed phased out:

Date of Death	New York Exemption	Phaseout of Exemption
April 1, 2016 to March 31, 2017	\$4,187,500	\$4,396,875
April 1, 2017 to December 31, 2018	\$5,250,000	\$5,512,500
January 1, 2019 and thereafter	Matches the federal estate tax exemption (currently \$5,450,000, as indexed for inflation)	105% of federal exemption

The impact of exceeding 105% of the exemption amount can have substantial effect. A decedent with a New York taxable estate of \$4,396,875 (which is 105% of the basic exclusion amount of \$4,187,500) would pay New York estate tax of \$324,050. In effect, there is a New York estate tax of \$324,050 (or a marginal New York estate tax rate of nearly 155%) on the additional New York taxable estate of \$209,375 in excess of the basic exclusion amount of \$4,187,500.

(b) Lack of portability of unused New York estate tax exemption: Since New York does not allow for portability (i.e., the surviving spouse may not use the deceased spouse's unused New York estate tax exemption) the titling of assets between married couples takes on greater significance. To illustrate how titling can affect your estate taxes, consider the case of John and Jill. John owns \$8,375,000 in assets in his name, while John's wife, Jill, does not have any assets in her name. John dies on September 1, 2016, and bequeaths an amount up to the New York exemption amount (\$4,187,500) to a credit shelter trust for Jill's benefit which will be sheltered from estate tax on both John's and Jill's deaths. The remainder

of John's estate (\$4,187,500) passes to Jill outright. There is no New York estate tax (nor Federal estate tax) in either estate in this scenario as both estates are able to utilize the New York exemption to completely shelter all of the assets. If, however, all of the assets were in Jill's name, and she died later in 2016, after John, there would be a New York estate tax of \$826,400 upon her death. This result could have been completely avoided with advance planning.

2. **New York Gift Tax:** Gifts made within three years of death will be added back to the value of the estate for purposes of the New York estate tax, if (i) the donor was a resident of New York at the time of the gift; (ii) the gift was made after April 1, 2014; and (iii) the gifted property was located within New York State. The add-back could potentially increase an estate's tax liability, especially if the estate is close to exceeding 105% of the New York exemption amount. Lifetime gifting still provides certain tax benefits. Gifted property will avoid New York estate tax (if the donor survives three years or the requirements listed above are not satisfied), will remove any appreciation from the estate and may further serve to reduce the estate tax if the gift lowers the estate to under 105% of the New York exemption amount.

3. **New York Generation-skipping Transfer Tax:** New York's generation-skipping transfer tax has been repealed.

C. **Ramifications of the Changes in the Law in Drafting Wills and Trusts**

1. **Gifts:** The Federal lifetime gifting exemption of \$5,450,000 in 2016 has opened up many possibilities. For example, individuals who have previously exhausted the former exemption amount may now make additional gifts to their children (or others), whether for tax

reasons or simply to allow the recipients to reap the benefit of current gifts. In the case of individuals who previously made loans to avoid the lifetime gifting limit, these loans may now be forgiven. If a married donor wishes to give away property but does not wish to lose the income, he or she can do so by transferring the assets to a lifetime credit shelter trust, of which the donor's spouse can be an income beneficiary, and the income will be available to the couple as long as the income beneficiary spouse is living. These are only a few of the opportunities for gifting which are now available. However, bear in mind that gifts utilizing the lifetime exemption are included in the tax base when calculating estate taxes on the donor's death. Also, there is no "step-up" in basis with respect to gifted property; the recipients have the same tax basis as the donor. But it is still beneficial to make gifts because any appreciation in value of the gifted property subsequent to the date of the gift, and all income earned on the gifted property, escapes estate taxation on the donor's death.

2. Wills and Trusts. The \$5,450,000 Federal estate tax exemption warrants reconsideration of current estate plans. Reconsideration is particularly appropriate for married couples whose assets are under \$10,900,000. In many cases, under the existing estate plan a client has bequeathed the exemption amount to a credit shelter trust for the benefit of the surviving spouse, or to children or grandchildren (outright or in trust), and the balance of the estate to the surviving spouse. With the increase in the exemption, some couples may not need to take full advantage of the increased exemption amount to avoid federal estate taxes, or may not wish to take full advantage of the exemption because this will significantly reduce the amount which will pass outright to the surviving spouse. Also, since the New York estate tax exemption is currently \$4,187,500 and will not match the Federal exemption amount until

2019, some couples may wish to avoid the additional New York estate tax which will be payable on the first spouse's death if full advantage is taken of the increased Federal exemption amount. However, a couple whose estate is not subject to Federal estate taxation may still wish to provide on the death of the first spouse for a bequest of the New York exemption amount in trust for the surviving spouse (or outright to, or in trust for, children) so as to reduce overall New York estate taxes. Wills which currently require the creation of a credit shelter trust can be revised to include provisions for a "disclaimer trust" which allows the surviving spouse, within nine months of the death of the first spouse, to determine how much of the first spouse's estate should be allocated to the credit shelter trust, based upon the size of the estate and the laws in effect at that time.

Although the Federal portability provision would seem to simplify estate planning, as mentioned above, New York does not allow portability of its estate tax exemption. For this and other reasons, there are still benefits to utilization of a credit shelter trust at the first death, including the sheltering of an extra \$4,187,500 from New York estate tax, the sheltering of appreciation on the assets in the credit shelter trust from estate taxation on the surviving spouse's death, the ability through use of a trust to sprinkle distributions to either the spouse or descendants, and the ability to apply the GST exemption to the credit shelter trust.