The Cobblestone Planner

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Significant Changes to New York's Estate & Gift Tax Laws

Governor Cuomo's budget approved earlier this year made meaningful changes to the New York estate and gift tax structure. Most significantly, the new legislation increases the estate tax exemption amount incrementally until 2019 when it will mirror the federal exemption amount. The exemption amount is noteworthy as it represents the amount that a decedent can leave to his or her heirs without incurring an estate tax. Prior to April 1, 2014 the New York estate exemption amount was $1,000,000. As of April 1, 2014 the exemption amount increased to $2,062,500. Thereafter, it increases in stages until January 1, 2019 when the New York estate tax exemption amount will match the federal exemption and there will no longer be a dichotomy between the two (see table below). At that point, both the federal and New York State estate tax exemption amounts will be indexed for inflation so they will remain "joined at the hip" barring further legislative changes.

This is a material benefit to many New York State residents as the higher exemption amount will shield a larger number of taxpayers from New York's estate tax. Unfortunately, the legislation does not benefit wealthier New York State residents as the exemption begins to phase out once the taxable estate exceeds the exemption amount. The exemption is completely phased out once the taxable estate exceeds 105% of the exemption amount (see table below). As a result, while estates below the increased exemption amount benefit greatly from the new legislation, estates that exceed 105% of the exemption amount will incur exactly the same tax burden they faced under the previous law.

This anomaly has been referred to as the "cliff" by commentators, as being even one dollar over the 105% threshold can lead to significant tax ramifications. For example, were a New York resident to die on December 1, 2014 with a taxable estate of $2,062,500, no New York State estate tax would be due since the estate is equal to or less than the exemption amount. However, were that same resident to die with a taxable estate of $2,165,625 (105% of the exemption amount), an estate tax of $112,050 would be imposed. The inclusion of the additional $103,125 results in a tax of $112,050 equating to a marginal tax rate of 108.65%! In 2018, when the exemption amount is $5,250,000, a resident faces a 172.30% marginal rate if he

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2015 Inflation Factors

The IRS has recently announced numerous inflation adjustments with regard to retirement plan savings and estate and gift tax exemptions. Some of the more popular limitations/exemptions for 2015 are as follows:

1. $18,000 maximum salary deferral to a 401(k) or 403(b) plan (up from $17,500);
2. $6,000 catch up contributions to 401(k) plans or 403(b) plans for individuals age 50 and older (up from $5,500);
3. $12,500 maximum salary deferral to a SIMPLE plan (up from $12,000);
4. $53,000 maximum contributions to SEP IRA accounts and Solo 401(k) accounts (up from $52,000);
5. $5,500 maximum contributions to IRA accounts and $1,000 catch up contributions for individuals age 50 and over (same as 2014);
6. $5,430,000 federal estate tax exemption (up from $5,340,000);
7. $14,000 annual gift tax exclusion (same as 2014).
8. 1.7% cost of living adjustment for social security benefits

Changes to New York State Estate Tax Exemption Amount

Period	New York State Estate Tax Exemption Amount	105 %Threshold
Prior to April 1, 2014	$1,000,000	N/A
April 1, 2014 - March 31, 2015	$2,062,500	$2,165,625
April 1, 2015 - March 31, 2016	$3,125,000	$3,281,250
April 1, 2016 - March 31, 2017	$4,187,500	$4,396,875
April 1, 2017 - December 31, 2018	$5,250,000	$5,512,500
After December 31, 2018	Same as Federal	Federal Exemption + 5%

New York Estate Tax (continued)

or she were to die with an estate equaling 105% of the exemption amount. Therefore, proper planning continues to be very important for New York residents whose estates exceed the exemption amount. For example, individuals whose estates fall within the exemption amount and the 105% threshold should consider including charitable gifting in their estate plan to reduce the taxable estate below the exemption amount. By doing so they not only eliminate the estate tax liability but also redirect funds to charities that otherwise would have gone to the taxing authorities.

The legislation made (or failed to make) other changes to the New York estate tax regime including:

1) For the period April 1, 2014 through December 31, 2018, taxpayers must add back to their New York estate taxable gifts made within three years of death.
2) While a reduction of the top estate tax rate from 16% to 10% was proposed, this proposal was not enacted as part of the legislation. The top estate tax rate remains 16% (on estates over $10,100,000). Interestingly, the tax rates included in the legislation only cover the period from April 1, 2014 through March 31, 2015, leading to speculation from practitioners that a proposal to reduce the maximum estate tax rate may resurface.
3) Somewhat surprisingly, the legislation failed to follow the federal lead allowing "spousal portability" of a spouse's estate tax exemption amount. "Spousal portability" allows a surviving spouse to utilize any unused exemption of the predeceased spouse and provides a great deal of flexibility when it comes to estate planning. For now, while the federal estate tax allows for such planning, New York does not.

Year-End Tax Planning

With year-end upon us it makes sense to review your current income tax situation and consider steps to reduce your 2014 tax liability (see "Planning Pointers" below). Admittedly, this can be difficult as the 2014 tax rules still have not been finalized. In fact, we expect Congress to enact new tax legislation soon reinstating numerous tax provisions that expired at the end of 2013. Among the provisions we expect to get extended retroactively to January 1, 2014 are:

1) the Charitable IRA Rollover provision allowing tax-free distributions up to $100,000 for direct payouts from IRAs to charity for taxpayers 70 1/2 or older
2) deduction for state sales taxes in lieu of income taxes
3) the above-the-line deduction for tuition and related expenses up to $4,000
4) enhanced Section 179 expensing by businesses
5) bonus first year depreciation for assets placed in service by a business.

As you review your individual tax situation a couple of important thresholds to keep in mind are:

1) Taxpayers in the 15% tax bracket (or lower) pay 0% tax on long-term capital gains and qualified dividends. Single and joint filing taxpayers qualify for the 0% tax rate if their ***taxable income*** is equal to or less than $36,900 and or $73,800 respectively. While tax planning often involves the deferral of income, if you estimate your taxable income will be below these thresholds, then recognizing additional long-term gains can make sense as it maximizes the utilization of the 0% tax rate.
2) Single and joint filing taxpayers are subject to the 3.8% surtax on net investment income once their modified adjusted gross income exceeds $200,000 and $250,000 respectively. If possible, taxpayers should try to keep their income below these levels to avoid the imposition of this surtax.
3) Single and joint filing taxpayers can make Roth IRA contributions if they have earned income and gross income that does not exceed $129,000 and $191,000 respectively. If you are eligible to make a full or partial Roth IRA contribution, you should seriously consider doing so by April 15, 2015.

Planning Pointers—Year-End Checklist

As 2014 comes to a close the following items should be reviewed to ensure you are taking advantage of potential planning opportunities where applicable:

1. **Accelerate Deductions and/or Defer Income - Consider these opportunities to reduce tax liability.**
2. **IRA or other retirement accounts - Have you funded your retirement accounts for 2014?**
3. **Health Savings Accounts - Have you maximized your 2014 contributions?**
4. **Required Minimum Distribution ("RMD") - Have you taken your RMD for 2014?**
5. **Review Capital Gains - Review year-to-date capital gains and losses and consider loss carryovers, if any.**
6. **Charitable Giving -If making year-end gifts to charities, consider utilizing appreciated securities that you have owned for more than a year.**
7. **Consider AMT - Consider the impact of the Alternative Minimum Tax on your tax situation.**
8. **Annual Gifting - Have you utilized your $14,000 per donee annual exclusion amount including contributions to 529 Plans?**