TRUSTS AND ESTATES

GOVERNOR CUOMO PROPOSES EXTENDING NEW YORK ESTATE TAX CLAWBACK ON GIFTS MADE WITHIN THREE YEARS OF DEATH

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After the Tax Cuts and Jobs Act of 2017 (the "2017 Act"), wealthy taxpayers have the opportunity to "lock in" the temporary increase in the federal estate and gift tax exemption by making large lifetime gifts. Governor Cuomo's Fiscal Year 2020 Executive Budget proposes extending a law that could subject such gifts to New York estate tax.

Background

The 2017 Act temporarily increased the federal estate and gift tax exemption, essentially doubling it: for 2019, the exemption is $11.4 million for individuals and $22.8 million for married couples. Under the 2017 Act, if Congress does not extend or make permanent the increase, the increase is scheduled to "sunset," with the exemption reverting to pre-increase levels on January 1, 2026. The exemption would probably then fall in the range of $6 million for individuals and $12 million for married couples.

Earlier this year, the IRS released proposed regulations that provide wealthy taxpayers with the opportunity to lock in the increased federal estate and gift tax exemption by making large lifetime gifts before the sunset occurs (or Congress rethinks the increase). With the proposed regulations, the IRS clarified that, in determining tax on post-2026 gifts or estates, the increase in federal estate and gift tax exemption will continue to apply to large lifetime gifts made by taxpayers now, even if a taxpayer dies after the exemption sunsets in 2026.

Meanwhile, in New York, the gifting environment was also becoming increasingly favorable for New York resident taxpayers at the beginning of the year. To understand how requires a quick primer on the New York estate tax. New York has its own estate tax, which is separate from the federal estate tax. In 2019, the New York estate tax exemption is $5,740,000 for individuals.

Under prior law (for ease of discussion, the "clawback law"), New York included the value of all taxable gifts made within three years of death in a New York resident decedent's estate if the decedent made the gifts after April 1, 2014 and before January 1, 2019. Essentially, a New York resident taxpayer was subject to New York estate tax not only on the value of his or her property in the state, but also on the value of all taxable gifts made within three years of death. The clawback law essentially treated the New York resident taxpayer as if he or she had not made the gifts.

With some exceptions, the value of gifts made within three years of death is not subject to federal estate tax. The clawback law was designed to defeat efforts to reduce or avoid New York estate tax on gifts proximate to death. The law applied to gifts made during the three-year window; it did not matter that the donor was healthy when he or she made the gift.

The clawback law expired on January 1, 2019, with the effect that the value of post-2019 taxable gifts made within three years of death would no longer be subject to New York estate tax after that date.

Therefore, under current law a wealthy New York resident taxpayer has a powerful incentive to make large gifts. A wealthy New Yorker could make a large lifetime gift and lock in the temporary increase in the federal estate and gift tax exemption without the value of the gift being subject to New York estate tax regardless of whether the taxpayer happened to die within three years of the gift. From the perspective of New York State, with the expiration of the clawback law, the value of such lifetime gifts would escape New York estate tax.

Alas, this did not escape Governor Cuomo's attention.

As part of his 2020 Budget, Governor Cuomo proposed extending the clawback law to January 1, 2026. And what date does this proposed extension coincide? January 1, 2026 is the date of the sunset in the temporary increase in federal estate and gift tax exemption. The effective date of the New York change is January 1, 2019; so, it is retroactive (we will not discuss the constitutional issue here).

What to Do Now

For those considering large gifts, even if the clawback law is extended, nothing changes from a federal estate tax perspective. A wealthy New York resident taxpayer who makes a large lifetime gift can still lock in the increase in the federal estate and gift tax exemption by doing so.

We are only talking about the New York estate tax here. If the clawback law is extended, the only thing that changes regarding lifetime gifts is the potential for New York estate tax.

It bears noting that most New York resident taxpayers (subject to some exceptions) will never be worse off by making such gifts. The worst case scenario is that such large gifts are subject to New York estate tax. And what would have happened if such gifts had not been made? The value of such gifts would have been subject to New York estate tax anyway, assuming that the taxpayer still owned the assets at the time of death.

Thus, for most wealthy New York resident taxpayers, a cost/benefit analysis probably still tilts in the favor of benefit here, even if the clawback law is extended.

From a practical perspective, however, if the clawback law is extended, those wealthy New York resident taxpayers who are considering large lifetime gifts may want to consider making them sooner rather than later. This may be especially true for older or ill taxpayers. The three-year clock starts running at the time a gift is made. Making a gift earlier may increase the likelihood that a taxpayer survives beyond three years, at which point the value of the gift escapes New York estate tax forever.

A taxpayer considering a taxable gift that might be caught by the clawback law (assuming it is extended) should consider the tax allocation clause in his or her Will or living trust. Thus, well-considered planning does not simply involve the gift itself.

If you would like more information on estate and gift tax exemptions, please contact a member of Harter Secrest & Emery LLP's Trusts and Estates Practice Group at 585.232.6500 or visit www.hselaw.com.

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