New York Estate Tax and Its Dreaded “Cliff”

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For deaths occurring after January 1, 2020, New York will tax estates valued at more than $5,850,000. Even if your estate is not large enough to owe federal estate tax (currently, the exemption amount is $11,580,000 for an individual), you may still owe an estate tax to the great state of New York. The New York estate tax rate ranges from 5% to 16% and is much lower than the federal estate tax rate, which is a whopping 40% on any amount over the exemption. Thanks to the unlimited marital deduction, most married couples do not owe any federal or state estate tax when the first spouse dies. But if you are unmarried and live in New York, you need to be aware of the dreaded New York estate tax “cliff.”

New York's estate tax regime is unlike the federal regime and other states. Under the federal estate tax regime and that of other states, if a decedent’s estate is large enough to be subject to estate tax, only the amount which exceeds the exemption amount is taxed. For example, if the federal exemption amount is $11,580,000, and the decedent’s taxable estate is valued at $12,000,000, then $420,000 would be subject to federal estate tax. In New York however, estates exceeding the New York estate tax exemption are subject to a cliff. Specifically, estates larger than 105% of the exemption amount will receive absolutely no exemption from New York estate taxes. In other words, when a New York estate exceeds the exempted amount by 5%
or more, the *entire* value of the estate is subject to New York estate tax.

Take the following hypothetical: A New York decedent dies in June 2020, leaving a taxable estate of $5,825,000. No federal or New York estate tax is due. However, if the estate was valued at $6,150,000, which exceeds the New York exemption amount by $300,000 (more than 5% over the exemption amount of $5,850,000) the New York estate tax due is $529,200. In other states, the estate would pay estate tax on the excess amount only. In New York, the estate pays estate tax on the *entire* $6,150,000. The heirs of the decedent’s estate would be in a better financial position if the estate was valued at only $5,850,000 (heirs receive $5,850,000), rather than $6,150,000 (heirs receive $5,620,500).

If your estate is hovering at or above the New York exemption amount and you plan to stay in New York, you may want to consider the following estate planning strategies to reduce your taxable estate:

- **Charitable bequests under your Will.** This is commonly referred to as a “Santa Clause” provision. You can reduce the harsh impact of the estate tax cliff by making conditional charitable bequests in your Will of the value in excess of the New York exemption amount. The bequests are structured so that they occur only if the excess going to charities is less than the New York estate tax that would be due if the gifts were not made.

  To illustrate: If an unmarried individual dies in New York in June 2020 with a taxable estate of $6,142,500, the $292,500 over the state exemption amount will trigger a New York estate tax of $528,240. Instead, if the individual left conditional bequests to charities, the charities would receive the amount over the New York estate tax exemption ($292,500) and no New York estate tax would be due, resulting in a savings of $235,740 which the non-charitable beneficiaries would receive.

  If the value of your estate is projected to be slightly above the New York estate tax exemption and subject to the New York estate tax cliff, it would be advisable to consider bequests to charities. By doing so, your heirs will actually receive more from your estate, and at the same time, you can benefit several charitable organizations of your choice.

- **Lifetime gifting.** Any individual may make lifetime gifts up to the federal estate and gift tax exemption amounts (in 2020, $11,580,000) before any federal gift tax is owed. While New York does not impose a gift tax, the value of nearly all gifts made by a New York decedent within a three year period of his or her death is included in the value of the estate for purposes of calculating New York estate tax liability.

  To illustrate: If an individual makes a $5,000,000 gift on June 1, 2020 and lives past June 1, 2023 (three years from the date of the gift), the $5,000,000 gift is excluded from his or her taxable New York estate, and no New York estate tax is due as the value of the taxable estate - $5,000,000 - is below the New York exemption. However, if the individual dies before June 1, 2023, the $5,000,000 gift is included in the value of his or her estate, resulting in a $10,000,000 New York taxable estate and New York
estate tax due on the entire value of the estate. The estate would be in the same position if the decedent did not make the $5,000,000 lifetime gift. If the decedent does outlive the three year period, his or her heirs are in a much better financial position because no New York estate tax would be due at the time of the decedent’s death.

It is important to be mindful of the New York estate tax and its steep tax cliff.

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