New York Law Journal

Trusts&Estates

WWW.NYLJ.COM

An ALM Publication

VOLUME 260—NO. 49

MONDAY, SEPTEMBER 10, 2018

NY's Latest Legislative Session: What Passed, What Didn't, What's Next?

BY **SHARON L. KLEIN**

The 2017-18 legislative session recessed on June 20, 2018. It is instructive to review what passed before the recess, what failed to pass and what lies ahead when the 2019-2020 session begins in January 2019. Interestingly enough, a couple of noteworthy changes will occur because previously built-in sunset dates to existing statutes will take effect. Several other changes were enacted as part of the 2018-19 Executive Budget (the budget), signed by Governor Andrew Cuomo on April 12, 2018, including provisions intended to mitigate the impact of the Dec. 22, 2017 Federal Tax Cuts and Jobs Act (the Federal Tax Act).

Among the most significant developments for the session are the following:

Three-Year Gift Add-Back Slated to Expire

While New York does not impose a current gift tax, as a result of 2014-15 executive budget changes, the New York gross estate of a deceased resident will be increased by the amount of any taxable gift made within three years of death. Originally, this gift "add-back" was tied to the date of the gift only, not the date of death, and applied to gifts made before Jan. 1, 2019 if the decedent was a New York resident at the time the gift was made and at the time of death. As a result of a subsequent statutory amendment, the gift add-back does not apply to estates of individuals dying on or after Jan. 1, 2019 (N.Y. Tax Law §954(a)(3)). This means that, even if a gift is made before Jan. 1, 2019, it will not be brought back into the estate if the donor dies after Jan. 1, 2019.

Necessity for Creating QDOT Set to Return

In order for a disposition to a non-US citizen surviving spouse to qualify for the federal marital deduction, the disposition must pass in a Qualified Domestic Trust (QDOT). For estates below the federal filing threshold, the New York estate tax is based on the taxable estate computed on a pro-forma federal return. Although not required for New York purposes (there is no New York tax imposed on the termination of a QDOT or a principal distribution from a QDOT), dispositions to non-US citizen spouses had to be in QDOT form because federal elections on the pro-forma return flow through to the New York return. This artificial need to create a QDOT resulted in significant unnecessary administrative burdens and legal fees.

A law enacted in December 2013 eliminated the requirement to create a QDOT if no federal return was required to be filed and the disposition would otherwise have qualified for the federal estate tax marital deduction. That law currently sunsets on July 1, 2019 (N.Y. Tax Law

SHARON L. KLEIN *is president of the Eastern Region of Family Wealth at Wilmington Trust, N.A.* ALEX WAXENBERG, *a private client advisor at the firm, assisted in the preparation of this article. This article includes developments through August 31, 2018*

§951(b)). Before the raising of the federal exemption amount last year, the relief provided by the provision would not have been required in 2019, because that is when the New York and federal exemption amounts were slated to link. However, in light of the Federal Tax Act changes, there is continued disparity. If the 2019 sunset is not extended or eliminated, QDOTs will again have to be created on the pro-forma federal return for New York taxable estates under the enhanced federal filing threshold.

PHOTO: SHUTTERSTOCK

Budget Decouples Certain State and Federal Laws, Including for Alimony and Itemized Deductions (Enacted as part of Budget, April 12, 2018)

Under current law, alimony payments are characterized as taxable income to the recipient and deductible by the payer (IRC Sections 71(a) and 215(a)). With the spouse paying alimony likely to be in a higher income tax bracket than the recipient spouse, the recipient spouse potentially can pay taxes on the alimony at a lower rate. This bracket play often results in overall tax savings between the parties. Under the Federal Tax Act, alimony payments made pursuant to a divorce or separation agreement signed after Dec. 31, 2018 will no longer be treated as taxable income to the recipient or be deductible by the payer. The budget decouples from the federal treatment of alimony payments. Accordingly, alimony can be subtracted from federal adjusted gross income in computing New York taxable income (N.Y. Tax Law §612(2)).

The budget also eliminated the requirement to itemize individual deductions for federal purposes in order to itemize for New York purposes. This allows individuals to choose standard or itemized deductions for state purposes, regardless of their election for federal purposes (N.Y. Tax Law §615(a)).

Statute of Limitations on Amended Returns Extended (Enacted as part of Budget, April 12, 2018)

The statute of limitations has been extended for assessments based on changes or corrections reported on amended returns. Generally, the Department of Taxation and Finance (the Department) may now issue an assessment on an amended return until the later of:

• one year from the date the amended return was filed, or

• three years from the date the original return was filed.

This change applies to amended returns filed on or after April 12, 2018 (See TSB 18 (4) I, May 25, 2018; N.Y. Tax Law §683(c)(12) and 11-1783(c)(9)).

Previously, the Department generally had three years from the original filing date of the return to issue an assessment, and filing an amended return did not ordinarily extend the statute of limitations. According to the budgetary explanation, this encouraged the filing of questionable amended returns with refund requests close to the statutory deadline. The extension allows the Department the time necessary to audit these amended returns and make any additional assessments.

Favorable Statutory Residency Determination Overturned (Enacted as part Of Budget, April 12, 2018)

New York generally taxes residents on their worldwide income. There are two separate and independent bases on which an individual can be taxed as a resident: (1) the individual is domiciled in New York or (2) the individual is a nondomiciliary who satisfies the statutory residency test. That test has two prongs: The nondomiciliary must (a) maintain a permanent place of abode in New York and (b) spend more than 183 days in the state during the taxable year (N.Y. Tax Law §605(b)(1)).

In *Matter of Sobotka* (2015 WL 5096196 (N.Y. Div. Tax. App. 2015), a taxpayer became domiciled in New York on August 18, 2008 and was thus taxable as a resident for the period from Aug. 18 to Dec. 31, 2008. The Division of Taxation also determined that the taxpayer was a statutory resident, taxable for the whole year, based on the number of days the taxpayer spent in New York during 2008 in its entirety. The taxpayer argued that, because a statutory resident is defined as a nondomiciliary, the Division was precluded from counting the days in New York during which the taxpayer was a domiciliary.

The administrative law judge determined that the taxpayer had to satisfy both the day count (over 183 days) and the abode tests during the nondomiciliary period, which excludes days that fall within the domicile-based resident portion of the same year. This could be significant if a taxpayer receives a large payment or bonus during a non-domiciliary period (in January, for example), and is not taxable as a statutory resident for the year in question, potentially allowing that large payment to be excluded from his New York income.

The budget overturns the *Sabotka* determination prospectively. Beginning in 2019, all days during a given year that a taxpayer is present in New York will be counted in determining if that taxpayer is a statutory resident, irrespective of whether the taxpayer was domiciled in New York for a portion of the year (N.Y Tax Law §605(b)(1)).

Budget Seeks to Reduce Impact of Cap on State and Local Tax (SALT) Deductions (Enacted as part of Budget, April 12, 2018)

The Federal Tax Act limits an individual's deduction for SALT taxes to $10,000 for tax years beginning after Dec. 31, 2017, and before Jan. 1, 2026. In response, the budget introduced state proposals to provide relief.

State charitable funds. The budget creates two state-operated charitable funds, one for health, the other for education, effectively allowing taxpayers to make deductible charitable contributions instead of state tax payments (N. Y. Tax Law §606(iii)). Taxpayers can claim donations to these funds as itemized deductions for federal and state purposes, along with a state income tax credit equal to 85 percent of the donation amount for the tax year following the donation (N.Y. Tax Law §606(iii)). The budget also allows school districts and local governments to create charitable funds to finance their needs and would provide property owners with a local property tax credit of up to 95 percent of the donation (N.Y Tax Law §980-b).

Optional employer payroll program. The budget creates a new optional Employer Compensation Expense Program (ECEP) (N.Y. Tax Law Article §850-857). This complex program is intended to leverage the fact that payroll taxes remain deductible to employers. The program would convert income tax paid by employees to a payroll tax paid by employers. Beginning on Jan. 1, 2019, employers can elect to pay a new payroll tax on annual payroll expenses in excess of $40,000 per employee. The tax is phased in over three years starting in 2019 at 1.5 percent and will be 5 percent when fully phased in. Employees will receive a corresponding credit to offset their New York income tax (N.Y. Tax Law Article §850-857).

In TSB-M-18(4)I, issued May 25, 2018, the Department indicated that contributions to charitable gift fund accounts and the ECEP will be discussed in future guidance.

Note, however, that the IRS was expected to challenge the characterization of transfers to the charitable funds and ECEP, and practitioners were reticent to recommend them while awaiting clarity on that front. Notably, the charitable options require payments in excess of the tax liability because less than 100 percent of the payment is deductible, and if challenged successfully by the IRS, interest and penalties would be potentially payable. Specifically, on May 23, 2018, the IRS and Treasury Department issued Notice 2018-54, announcing that proposed regulations will be issued addressing the deductibility of payments by taxpayers to funds controlled by state and local governments that the transferor can treat in whole or in part as satisfying state and local tax obligations.

According to the notice, despite state efforts to "circumvent the new statutory limitation on state and local tax deductions, taxpayers should be mindful that federal law controls the proper characterization of payments for federal income tax purposes." The proposed regulations "will make clear that the requirements of the Internal Revenue Code, informed by substance-over-form principles, govern the federal income tax treatment of such transfers." Proposed regulations were in fact issued on August 27, 2018 (REG-112176-18). They provide that taxpayers must reduce their charitable deductions by the amount of any state or local tax credit they receive or expect to receive, if that credit exceeds 15% of the contribution.

In the latest attempt to preserve the deductibility of state income taxes, the Department recently released a discussion draft (comments were due July 16) for a proposed unincorporated business tax, with a corresponding set of tax credits for partners of partnerships doing business in New York (https://tax.ny.gov/pdf/stats/stat_pit/pit/unincorporated-business-tax-discussion-draft-summary.pdf).

Proposed 17 percent Tax on Carried Interest Income (Cut from Final Budget)

The governor originally proposed closing the so-called "carried interest tax loophole," which allows hedge fund managers and private equity investors to treat carried interests as capital gains, rather than as ordinary income. Further, when these fees are characterized as capital gains, New York cannot tax that income when earned in New York by a non-resident. The proposal would have subjected those interests to a special 17 percent carried interest fairness fee. In order to prevent New York being at a competitive disadvantage, the proposal would have taken effect only if substantially similar legislation was enacted in Connecticut, Massachusetts, and New Jersey. The proposal was omitted from the final budget.

Proposal to Revise Commissions of Individual Trustees of Charitable Trusts (Introduced in House and Senate, Died)

Individual trustees of wholly charitable trusts and trustees of non-charitable trusts are compensated differently under current law. A proposal that failed to pass (NY-S6765, NY-A9764) would have provided commissions to individual trustees of wholly charitable trusts at the same rates as individual trustees of non-charitable trusts, with a reduced rate of 80 percent of the rates for a non-charitable trust with a principal value of up to $20 million, and a reduced rate of 50 percent on the principal value in excess of $20 million. As with non-charitable trusts, the charitable trust commissions would have been payable one-third from income and two-thirds from principal.

Under Surrogate's Court Procedure Act Section 2309(5), a trustee of a wholly charitable trust is entitled only to 6 percent of the annual income collected. As per the example set forth in the memorandum in support of the proposal, if a non-charitable trust has $1 million of assets, the trustee's annual statutory commissions would be $6,900, regardless of how much income was generated. If a wholly charitable trust has $1 million of assets that generates $1,000 of income throughout the year, the trustee will be entitled only to $600 for his annual commissions.

As asserted in the memorandum, this discrepancy in compensation is unwarranted considering that the duties of trustees of wholly charitable and non-charitable trusts are comparable, and additionally a charitable trustee is accountable not only to the charities but also the attorney general.

Under the total return concept embodied in the prudent investor rule, the existing compensation structure for a trustee of a wholly charitable trust also creates a potential conflict of interest because a trustee of a wholly charitable trust is incentivized to maximize income.

Next?

After many years in the making, it is anticipated that a New York Trust Code, which would modernize and harmonize New York law in a centralized code, will be considered in the next legislative session.

This article is for general information only and is not intended as an offer or solicitation for the sale of any financial product, service or other professional advice. Professional advice always requires consideration of individual circumstances. Wilmington Trust is a registered service mark. Wilmington Trust Corporation is a wholly owned subsidiary of M&T Bank Corporation (M&T).

WILMINGTON TRUST

Sharon L. Klein

President, Eastern Region,
Family Wealth

Wilmington Trust, N.A.
350 Park Avenue, 9th Floor
New York, NY 10022

(P) 212-415-0531 | (F) 212-415-0514

sklein@wilmingtontrust.com
www.wilmingtontrust.com