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CHANGES IN NEW YORK GIFT AND ESTATE LAW BRING GOOD NEWS TO NEW YORK RESIDENTS

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Changes in New York gift and estate tax law that take effect in January and February 2000 will benefit you financially.

Estate Tax Changes.

Effective for decedents dying on or after February 1, 2000, New York's current stand-alone estate tax will be replaced by a so-called "sop" tax -- one that exactly matches the federal estate tax credit allowed for the payment of state death taxes. Thus, the top combined New York and federal estate tax bracket will be 55%, instead of the 60% combined bracket formerly in place.

Gift Tax Changes.

If you are a New York resident and make -- or contemplate making -- gifts, the changes are very good news.

Effective for gifts made on or after January 1, 2000, New York's gift tax will be abolished. Thus, the effective maximum gift tax will be 55%, instead of the top 76% combined bracket formerly in place for gifts.

Our Personal Representation Department has many years of experience in structuring gifts and providing clients with sophisticated strategies to reduce the gift tax liability. The tax advantage of lifetime giving illustrated below can be leveraged by the use of any one of a number of "discount" giving strategies involving family limited partnerships, LLCs, grantor retained annuity trusts (GRATs), qualified personal residence trusts (QPRTs), charitable lead annuity trusts (CLATs), long-term generation-skipping "dynasty" trusts and gifts of undivided fractional interests. The multiplier effect of such leveraging can be extremely powerful, making lifetime giving all that more attractive. We would be pleased to meet with you to discuss these and other ideas.

With the cost of lifetime giving now reduced dramatically for New Yorkers, we feel that this is a good time to review the arithmetic of the transfer tax advantage that lifetime giving has always held over a gift made by a Will. This advantage stems from the fact that lifetime gifts are taxed on a tax *exclusive* basis (i.e., no gift tax is paid on the monies used to satisfy gift tax liabilities), while estates are taxed on a tax *inclusive* basis (i.e., estate taxes are levied *both* on the amounts passing to beneficiaries *and* the amounts used to satisfy the estate tax liabilities themselves). You should know that the result of this disparity at a 55% transfer tax bracket is that a lifetime gift generates gift taxes of 55% of the value of the gift, while a bequest generates estate taxes of 122% of the value of the bequest, making the tax cost of a gift made by a Will 2.22 times as great as the tax cost of a lifetime gift.

An illustration may be useful. Let us assume a client with assets of $20 million, whose past gifts already put him in the highest 55% estate and gift tax bracket, and who is considering whether to make a further lifetime gift to a child of assets worth $1 million or to leave these assets to the child as part of his estate, which will pass in its entirety to the child under the client's Will. Let

us further presume to know that the client will live another 15 years, and that the after-tax total rate of return on all assets (whether in the child's or parent's hands) during that period is 8% each year.

How does the child fare after the parent's death if the parent makes the $1 million gift now? Alternatively, how does the child fare if the parent foregoes the current gift, leaving the parent's entire estate, net of estate taxes, to the child?

1. **Scenario I – Current Gift of $1 million**

(a) Estate Component

	$ 20,000,000	Current Net Worth
Less:	(1,000,000)	Parent's Gift
	(550,000)	Gift Tax at 55%
	$18,450,000	Parent's Net Worth After Gift

Compounds at 8% a year for 15 years, growing to an Estate of:

	$ 58,526,500	Estate
Less:	(32,189,575)	Estate Tax at 55%
	$26,336,925	Net Amount Passing to Child from Parent's Estate

(b) Gift Component

$1,000,000 compounded at 8% a year for 15 years grows to $3,172,170 in child's hands

(c) Total to Child

$ 26,336,925	Estate Component
3,172,170	Gift Component
$ 29,509,095	**Total in Child's Hands**

2. **Scenario II – No Current Gift**

$20,000,000 compounded at 8% a year for 15 years grows to an Estate of:

$ 63,443,400	Estate
(34,893,870)	Estate Tax at 55%
$ 28,549,530	**Total in Child's Hands**

3. **After-tax Advantage to Child from Lifetime Gift = $ 959,565.**[*]

If the parent were to die within three years of making the $1 million gift contemplated above, Section 2035(c) of the Internal Revenue Code would require that the $550,000 paid in gift taxes (but not the $1 million gift) be included in the parent's estate for estate tax purposes, such that the net effect would be to tax the gift arrangement on a tax *inclusive* basis as if the gift had been a legacy left to the child under the parent's Will. Parent and child would thus be no worse off for the gift having been made.

Of course, income tax consequences must also be taken into account. Property passing by Will receives a step-up in basis to date of death value, while gifts receive a carryover basis, with adjustment for gift taxes paid. If property is highly appreciated, the difference in basis could significantly reduce the transfer tax savings of making an outright gift.

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The foregoing memorandum provides only a general overview of the changes in New York gift and estate tax law. It is not intended to provide legal advice, and no legal or business decision should be based on its content.

[*] This amount precisely reflects the benefit of the tax exclusive nature of the gift tax; it equals (with minor rounding) 55% (i.e., the estate tax cost) of the 15 year compounded future value of the $550,000 gift tax liability under Scenario I.