

## New Yorkers Face Higher Taxes Under Budget Deal

APRIL 30, 2021

In early April, New York State leaders reached an agreement for the State's Fiscal Year 2022 budget (the Budget Act), which ushers in significant changes to the New York Tax Law. The bulk of those changes will impact individual taxpayers and trusts and not impose new taxes on businesses.<sup>[1]</sup> Most important—and nine months after Governor Andrew Cuomo put out a plea for New Yorkers to return—are the Budget Act's increases to personal income tax rates that will see some New York residents paying *the* highest income tax rates in the nation.<sup>[2]</sup>

### Individual Tax Rate Increases and Tax Brackets

The Budget Act increases the personal income tax rate to 9.65% from 8.82% for individuals reporting over approximately \$1.1 million in taxable income and for persons filing jointly reporting over approximately \$2.15 million in taxable income.<sup>[3]</sup>

Two new tax brackets are set to go into effect under the Budget Act. For taxpayers reporting more than \$5 million in taxable income, the rate is 10.3%. Those taxpayers reporting more than \$25 million in taxable income will be subject to the new top marginal income tax rate of 10.9%. The rate increases sunset in 2027.

On top of these rate increases, New York City taxpayers must also contend with the City's top rate of 3.876%. Individual residents of New York City reporting over approximately \$1.1 million in taxable income and those filing joint returns reporting over \$2.15 million in taxable income are thus saddled with a combined personal income tax rate of 13.526%. New York City taxpayers reporting more than \$5 million in taxable income will have a combined personal income tax rate of 14.176%. And taxpayers reporting more than \$25 million in taxable income will be subject to a combined rate of 14.776%.

### Changing Domicile for an Individual

New Yorkers looking to change their domicile/residence should be cognizant of the two tests employed by the New York Department of Taxation and Finance (DTF) to determine an individual's residency: (1) the Domicile Test and (2) the Statutory Residence Test.

Under the Domicile Test, the DTF looks to five subjective factors:

1. Home—weighing the individual’s use and maintenance of a New York residence versus the use and maintenance of an out-of-state residence (whether owned, rented, or otherwise);
2. Active Business Involvement—looking to where the individual was employed and earned income, whether they made business decisions for or managed a business located in New York;
3. Time Spent—where the individual spent the majority of their time;
4. Heart/Sentimental Items—where the individual maintained keepsakes, furniture, pets, etc.; and
5. Family Connections—where the individual’s immediate family (spouses and minor children) was located.

Under the Statutory Residence Test—which, as the name suggests, is based on statute rather than subjective evaluation—an individual may be considered a statutory resident of New York if they are not domiciled in the state but spend more than 183 days (in the aggregate) in New York and maintain a “permanent place of abode.”<sup>[4]</sup>

### **Application to New York Trusts**

The Budget Act tax increases will also apply to certain trusts created by a New York resident if the trust is a “Resident Trust.”<sup>[5]</sup>

Generally, for income tax purposes, there are two types of trusts—“grantor” trusts and “non-grantor” trusts.

A grantor trust is a trust in which the trust’s creator (the “grantor”) (or some other person) retains control over, or an interest in, the trust to such an extent that the grantor (or such other person) is treated as the owner of all or part of the trust for federal income tax purposes. Certain powers in the trust instrument can trigger grantor trust status as determined pursuant to the provisions of Internal Revenue Code (IRC) §§ 671–679 and the corresponding regulations. For example, a trust will be treated as a grantor trust if someone related to the grantor (e.g., a related trustee) retains the right to sprinkle the trust’s income among the trust beneficiaries.

If a trust is a grantor trust, the grantor will be taxed directly on the income and other tax attributes of the trust on the grantor’s individual income tax return in the state of the grantor’s residence. Accordingly, a grantor trust for a New York resident will be subject to New York state income tax.

A trust that does not qualify as a grantor trust is a non-grantor trust. Generally, a non-grantor trust pays income tax at the trust level on the taxable income retained by the trust. New York treats a trust as a grantor trust or non-grantor trust based on such trust’s classification for federal income tax purposes.<sup>[6]</sup>

A non-grantor trust created by a New York resident will be considered a “Resident Trust,” and subject to New York state income tax on all its income if it has any of the following characteristics:<sup>[7]</sup>

1. A fiduciary domiciled in New York;
2. Trust property, real or tangible, located in New York; or
3. Any income or gains derived from or connected with sources in New York.<sup>[8]</sup>

A non-grantor trust created by a New York resident that does not have any of the foregoing characteristics is a “Resident Exempt Trust,” and will not be subject to New York state income tax on its trust income.<sup>[9]</sup> In other words, a non-grantor trust created by a New York resident with only non-New York fiduciaries, assets, and source income will qualify as a “Resident Exempt Trust” and avoid New York state income tax.

### **Considerations for New York Resident Trusts**

New Yorkers with trusts that are considered Resident Trusts should consider moving those trusts to a state that does not tax trust income, generally, by changing the trustees of those trusts to residents of that other state.

Additionally, for trusts with New York situs assets or source income, steps can be taken to change the character of the New York situs assets and/or to divide the trust such that the New York situs assets or source income are

segregated into a separate subtrust. The separate subtrust would continue to be a Resident Trust while the main trust that would no longer have New York situs assets or source income would be moved to another state.

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<sup>[1]</sup> The Budget Act enacts a temporary increase to the corporate franchise tax rate from 6.5% to 7.25% through 2023 for corporations with business income in excess of \$5 million.

<sup>[2]</sup> The top marginal rate was California's 13.3%.

<sup>[3]</sup> The 8.82% had been New York's highest marginal income tax rate since it was enacted in 2009 as a temporary increase to the previous top rate of 6.85%. The 8.82% tax bracket has been extended through 2025 for individual taxpayers making less than \$1 million or joint filers making less than \$2 million. The rate is also increased from 8.82% to 9.65% for heads of households reporting over approximately \$1.6 million of taxable income.

<sup>[4]</sup> N.Y. Tax Law § 605(b)(1)(B). Permanent place of abode is defined as a "dwelling place of a permanent nature maintained by the taxpayer, whether or not owned by him, and will generally include a dwelling place owned or leased by his or her spouse." 20 NYCRR § 105.20(e).

<sup>[5]</sup> Budget Act, S. 2509-C, Part A, § 3; N.Y. Tax Law § 601(c)(1)(B)(iv).

<sup>[6]</sup> N.Y. Tax Law § 611(a) and § 612(a).

<sup>[7]</sup> Instructions to 2020 N.Y. Form IT-205 at 2.

<sup>[8]</sup> N.Y. Tax Law § 605(b)(3)(D)(i); 20 NYCRR § 105.23(c).

<sup>[9]</sup> **5 Min. Read** N.Y. Tax Law § 605(b)(3)(D)(i); Instructions to 2020 N.Y. Form IT-205 at 2.

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