MINIMIZING OR ELIMINATING NEW YORK INCOME TAXES ON NONGRANTOR TRUSTS

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I. INTRODUCTION

New York fiduciaries pay a lot of New York income taxes. Thus, for 2014 (the latest year for which figures have been released), 59,685 resident estates and trusts paid approximately $342 million of New York income tax.[1] This is remarkable because clear rules for avoiding the taxation of trusts have existed for many years. This paper will survey the pertinent authorities and offer planning ideas.

II. CLIFFS NOTES VERSION

New York long has defined "Resident Trust" as a trust established by a New York domiciliary testator or trustor. Following the Mercantile-Safe Deposit and Trust Company v. Murphy (1964)[2] and Taylor v. State Tax Commissioner (1981)[3] decisions, the New York State Department of Taxation and Finance adopted a regulation in 1992 confirming their holdings (i.e., that the trustee of a trust created by a New York testator or trustor is not taxable if the trust has no New York trustee, asset, or source income),[4] thereby creating an exemption for an "Exempt Resident Trust." Subsequently, the State of New York Division of Tax Appeals rendered two decisions and the Technical Services Division of the State of New York Department of Taxation and Finance issued several advisory opinions indicating that Exempt Resident Trusts were not taxable[5] and the

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[1] N.Y. State Dep't of Taxation and Finance, Office of Tax Policy Analysis, Analysis of 2014 Personal Income Tax Returns, Tbl. 57 (Feb. 2017), www.tax.ny.gov/research/stats/stat_pit/personal_income_tax_returns/analysis_of_2014_personal_income_tax_returns.htm (last visited Sept. 7, 2022).

[2] Mercantile-Safe Deposit & Trust Co. v. Murphy, 203 N.E.2d 490 (N.Y. 1964), aff'g, 242 N.Y.S.2d 26 (N.Y. App. Div. 1963). See Timothy P. Noonan, The Nuts and Bolts of New York's Resident Credit, 82 State Tax Notes 901 (Dec. 19, 2016); Timothy P. Noonan & Catherine B. Eberl, Trust Us: New York's Residency Rules for Trusts Are Complicated, 81 State Tax Notes 631 (Aug. 22, 2016); Richard W. Nenno, Planning for New York Trusts to Escape State Income Tax, 42 Est. Plan. 12 (Oct. 2015).

[3] Taylor v. State Tax Comm'r, 445 N.Y.S.2d 648 (N.Y. App. Div. 1981).

[4] N.Y. Comp. Codes R. & Regs. tit. 20, § 105.23(c).

[5] In the Matter of Joseph Lee Rice III Family 1992 Trust, DTA No. 822892, 2010 N.Y. Tax Lexis 268 (N.Y. Div. Tax App. 2010); In the Matter of the Petition of the John Heffer Trust, DTA No. 820351, 2006 WL 1806492 (N.Y. Div. Tax App. June 22, 2006); N.Y. TSB-A-11(4)I, 2011 WL 7113861 (N.Y. Dep't Tax'n Fin. July 27, 2011), www.tax.ny.gov; N.Y. TSB-A-10(4)I, 2010 WL 2557532 (N.Y. Dep't Tax'n Fin. June 8, 2010), www.tax.ny.gov; N.Y. TSB-A-04(7)I, 2004 N.Y. Tax Lexis 259, at *1 (N.Y. Dep't Tax'n Fin. Nov. 12, 2004), www.tax.ny.gov; N.Y. TSB-A-00(2)I, 2000 WL 567678 (N.Y. Dep't Tax'n Fin. Mar. 29, 2000), www.tax.ny.gov; N.Y. TSB-A-96(4)I, 1996 WL 667910 (N.Y. Dep't Tax'n Fin. Oct. 25, 1996), www.tax.ny.gov; N.Y. TSB-A-94(7)I, 1994 WL 275392

Department of Taxation and Finance announced that trustees of such trusts did not have to file tax returns.[6] The Exempt Resident Trust exemption was codified in 2003, effective January 1, 1996.[7]

In 2010, Governor Paterson unsuccessfully attempted to repeal the exemption for Exempt Resident Trusts.[8] Later, though, the New York State Department of Taxation and Finance announced that, effective January 1, 2010, new and existing Exempt Resident Trusts must file informational returns.[9] That reporting requirement was made statutory in 2014.[10]

The 2014–2015 New York budget bill[11] made two substantive changes to how New York taxes trust income. First, the bill requires New York State and New York City residents to pay tax on accumulation distributions (which, as noted below, do not include capital gains) from Exempt Resident Trusts[12] and imposes reporting requirements on the trustees of such trusts.[13] Second, the bill classifies incomplete gift nongrantor trusts as grantor trusts for New York State and New York City income-tax purposes.[14]

III. EARLY CASES

A. Mercantile-Safe Deposit and Trust Company v. Murphy (1964)—No Income Taxation of Inter Vivos Trust Funded During Life and by Pourover Solely Based on Domicile of Trustor and Income Beneficiary

In Mercantile-Safe Deposit and Trust Company v. Murphy,[15] the New York Court of Appeals (the highest court in the state), affirming an intermediate appellate court decision, held that the Due Process Clause of the U.S. Constitution prohibited New York from taxing the accumulated income of an inter vivos trust, funded in part during life and in part by a pourover of assets under the decedent's Will, that had no New York trustee, New York assets, or New York source

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(N.Y. Dep't Tax'n Fin. Apr. 8, 1994), www.tax.ny.gov.

[6] N.Y. TSB-M-96(1)I (N.Y. Dep't Tax'n Fin. July 29, 1996), www.tax.ny.gov.

[7] N.Y. Tax Law § 605(b)(3)(D)(i).

[8] 2009 N.Y. S.B. 6610, Pt. G.

[9] N.Y. TSB-A-11(4)I, 2011 WL 7113861 (N.Y. Dep't. Tax'n Fin. July 27, 2011), www.tax.ny.gov; N.Y. TSB-M-10(5)I (N.Y. Dep't Tax'n Fin. July 23, 2010), www.tax.ny.gov.

[10] N.Y. Tax Law § 658(f)(2).

[11] 2014 N.Y. Laws 59, Pt. I (March 31, 2014). See N.Y. TSB-M-15(1)I (N.Y. Dep't Tax Fin. Feb. 12, 2015), www.tax.ny.gov.

[12] 2014 N.Y. Laws 59, Pt. I, §§ 1, 6 (Mar. 31, 2014).

[13] 2014 N.Y. Laws 59, Pt. I, § 4 (Mar. 31, 2014).

[14] 2014 N.Y. Laws 59, Pt. I, §§ 2, 7 (Mar. 31, 2014)

[15] Mercantile-Safe Deposit & Tr. Co. v. Murphy, 203 N.E.2d 490 (N.Y. 1964), aff'g, 242 N.Y.S.2d 26 (N.Y. App. Div. 1963).

income, even though the current discretionary beneficiary was a New York resident. Relying on the U.S. Supreme Court's 1929 Safe Deposit and Trust Company v. Virginia decision,[16] the court stated that:[17]

> The lack of power of New York State to tax in this instance stems not from the possibility of double taxation but from the inability of a State to levy taxes beyond its border. . . . [T]he imposition of a tax in the State in which the beneficiaries of a trust reside, on securities in the possession of the trustee in another State, to the control or possession of which the beneficiaries have no present right, is in violation of the Fourteenth Amendment.

Mercantile is significant because it confirmed that the presence of a New York trustor and current discretionary beneficiary did not justify the income taxation of a nondomiciliary trustee.

B. Taylor v. State Tax Commissioner (1981)—No Income Taxation of Nonresident Testamentary Trust Solely Based on Domicile of Testator

In Taylor v. State Tax Commissioner,[18] a New York intermediate appellate court considered whether New York income tax was payable on gain incurred upon the sale of Florida real property held in a trust created by the Will of a New York decedent. Although the Will appointed two nondomiciliary individual trustees and a New York corporate trustee, Florida law prohibited the corporate trustee from serving so that only the nondomiciliary trustees acted with respect to the Florida real estate. The sale proceeds of the Florida property were held by the New York corporate co-trustee in an agency account in New York. The court held on due-process grounds that New York could not tax the gain as follows:[19]

> New York's only substantive contact with the property was that New York was the domicile of the settlor of the trust, thus creating a resident trust.
>
> The fact that the former owner of the property in question died while being domiciled in New York, making the trust a resident trust under New York tax law, is insufficient to establish a basis for jurisdiction.

[16] Safe Deposit & Trust Co. v. Virginia, 280 U.S. 83 (1929).

[17] Mercantile, 203 N.E.2d at 491.

[18] Taylor v. State Tax Comm'n, 445 N.Y.S.2d 648 (N.Y. App. Div. 1981).

[19] Id. at 649 (citations omitted).

Note that depositing the sale proceeds of the Florida real estate in an agency account at a New York financial institution did not affect the outcome.

IV. CURRENT RULES

A. New York State

1. General

In New York State, a trustee of a "Resident Trust" must file a return if it must file a federal return, had New York taxable income, or was subject to a separate tax on a lump-sum distribution, whereas the trustee of a "Nonresident Trust" must file a return if it had New York-source income and New York adjusted gross income, was subject to a separate tax on a lump-sum distribution, or incurred a net operating loss in certain circumstances.[20]

New York State treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[21] and the Empire State permits trustees of nongrantor trusts to take a distribution deduction.[22] In 2021 and continuing through 2027, New York State taxes the New York taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts with such income between $1,077,550 and $5,000,000 at 9.65%, such income between $5,000,000 and $25,000,000 at 10.30%, and such income over $25,000,000 at 10.90%.[23]

New York State defines "Resident Trust" as a trust that is created by a New York State testator or trustor as follows:[24]

> (B) a trust, or a portion of a trust, consisting of property transferred by will of a decedent who at his death was domiciled in this state, or
>
> (C) a trust, or portion of a trust, consisting of the property of:
>
> (i) a person domiciled in this state at the time such property was transferred to

[20] Instructions to 2021 N.Y. Form IT-205 at 1. See N.Y. Tax Law § 651(a)(2)–(3), (e).

[21] See N.Y. Tax Law §§ 611(a), 612(a); Instructions to 2021 N.Y. Form IT-205 at 5.

[22] See N.Y. Tax Law § 618; N.Y. Comp. Codes R. & Regs. tit. 20, § 118.1; Instructions to 2021 N.Y. Form IT-205 at 6.

[23] N.Y. Tax Law § 601(c)(1)(B)(iv)–(ix); Instructions to 2021 N.Y. Form IT-205 at 9.

[24] N.Y. Tax Law § 605(b)(3)(B)–(C). See N.Y. Comp. Codes R. & Regs. tit. 20, § 105.23(a)–(b).

> the trust, if such trust or portion of a trust was then irrevocable, or if it was then revocable and has not subsequently become irrevocable; or
>
> (ii) a person domiciled in this state at the time such trust, or portion of a trust, became irrevocable, if it was revocable when such property was transferred to the trust but has subsequently become irrevocable.

Given that taxation is based on the testator's or trustor's domicile, the statutory-resident test does not come into play.[25]

The statute describes when a trust is deemed to be "revocable" or "irrevocable":[26]

> For the purposes of the foregoing, a trust or portion of a trust is revocable if it is subject to a power, exercisable immediately or at any future time, to revest title in the person whose property constitutes such trust or portion of a trust, and a trust or portion of a trust becomes irrevocable when the possibility that such power may be exercised has been terminated.

A "Nonresident Trust" is a trust that is not a "Resident Trust."[27]

New York State taxes all New York taxable income of Resident Trusts[28]

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[25] See N.Y. Tax Law § 605(b)(1)(B). See also In the Matter of Thomas A. and Jean Boniface, DTA No. 829018, 2022 WL 271958, at *13 (N.Y Div. Tax App. June 30, 2022), dta.ny.gov ("[P]etitioners failed to bear their burden of proof to show by clear and convincing evidence that they had changed their domicile before the period at issue"); In the Matter of the Petition of Jonathan Adams, DTA No. 828793, 2021 WL 4202486, at *14 (N.Y. Div. Tax App. Sept. 3, 2021) (taxpayer was domiciled in New York City in 2012). But see In the Matter of Joseph Pilaro and Joseph Gorrie, DTA No. 829204, 2022 WL 3903339, at *8 (N.Y. Div. Tax App. Aug. 18, 2022), dta.ny.gov ("[P]etitioner was not a statutory resident of New York for the 2014 tax year"); Obus v. New York State Tax Appeals Tribunal, 2022 WL 2346956, at *3 (N.Y. App. Div. June 30, 2022) ("[P]etitioners have not utilized the dwelling in a manner which demonstrates that they had a residential interest in the property"). For commentary, see Andrea Muse, New York Appeals Court: Vacation Home Not Enough for Statutory Residency, 105 Tax Notes State 224 (July 11, 2022); Timothy P. Noonan & Joseph F. Tantillo, New Guidelines and a New Rule for New York Residency Audits, 103 Tax Notes State 951 (Feb. 28, 2022); Robert Kantowitz, A Tale of Two States, 98 Tax Notes State 161 (Oct. 12, 2020).

[26] N.Y. Tax Law § 605(b)(3) (flush language). See N.Y. Comp. Codes R. & Regs. tit. 20, § 105.23(a); Instructions to 2021 N.Y. Form IT-205 at 2.

[27] N.Y. Tax Law § 605(b)(4). See Instructions to 2021 N.Y. Form IT-205 at 2.

[28] N.Y. Tax Law § 618. See N.Y. Comp. Codes R. & Regs. tit. 20, § 118.1.

but only New York-source income of Nonresident Trusts.[29] In New York State, trustees must make estimated tax payments for trusts.[30]

2. Exempt Resident Trust Exemption

Importantly, as mentioned above, the New York Tax Law was amended in 2003, effective for tax years beginning in 1996, to codify an exemption for an Exempt Resident Trust. Hence, a Resident Trust is not subject to tax if it has no New York State trustee, asset, or source income as follows:[31]

> (D)(i) Provided, however, a resident trust is not subject to tax under this article if all of the following conditions are satisfied:
>
> (I) all the trustees are domiciled in a state other than New York;
> (II) the entire corpus of the trusts, including real and tangible property, is located outside the state of New York; and
> (III) all income and gains of the trust are derived from or connected with sources outside of the state of New York, determined as if the trust were a non-resident trust.

Regarding (I) above, note the use of "domicile." In this connection, the Technical Services Division of the State of New York Department of Taxation and Finance has issued guidance on how to determine the domicile of a corporate trustee and the circumstances in which advisors, protectors, and committee members will be treated as domiciliary trustees.[32]

Regarding (II) above, the New York tax law provides: [33]

> (ii) For purposes of item (II) of clause (i) of this subparagraph, intangible property shall be located in this state if one or more of the trustees

[29] N.Y. Tax Law §§ 631, 633; Instructions to 2021 N.Y. Form IT-205 at 1. See N.Y. Tax Bull. TB-IT-615 (Dec. 15, 2011), www.tax.ny.gov.

[30] N.Y. Tax Law § 685(c)(6); Instructions to 2021 N.Y. Form IT-205 at 3.

[31] N.Y. Tax Law § 605(b)(3)(D)(i). See N.Y. Comp. Codes R. & Regs. tit. 20, § 105.23(c); Instructions to 2021 N.Y. Form IT-205 at 2.

[32] N.Y. TSB-A-04(7)I, 2004 N.Y. Tax Lexis 259 (N.Y. Dep't Tax'n Fin. Nov. 12, 2004), www.tax.ny.gov. See V, D, below.

[33] N.Y. Tax Law § 605(b)(3)(D)(ii).

are domiciled in the state of New York.

Thus, if a trust only has non-New York trustees and intangible assets (e.g., stocks and bonds), the trust will meet the exemption. If a trust holds New York tangible personal property and/or real property, the trustee might consider placing it in a family-limited partnership ("FLP") or a limited-liability company (" LLC") to convert it into intangible personal property. Guidance on the circumstances in which this approach will succeed is discussed below regarding source income.[34]

Regarding (III) above, the New York State Department of Taxation and Finance takes the position that a single dollar of source income prevents a trust from satisfying the Exempt Resident Trust exemption.[35] Hence, to minimize tax, the trustee of a trust that holds assets that produce source income should consider dividing it into separate trusts, one of which holds the source-income assets and one of which does not. New York source income is described below.[36]

One might read the Exempt Resident Trust provision to say that a trust that has New York source income but no New York trustee or assets is taxable just on the source income (not on the entire income of the trust), and this appears to be what the Appellate Division of the New Jersey Superior Court concluded in a 2015 case interpreting that state's similar rule.[37] But, the prudent course is to treat the provision as a safe harbor and to assume that a trust that does not satisfy all three tests will be taxed on all income.

In 2010, the New York State Department of Taxation and Finance announced a change in the filing responsibilities of trustees of Exempt Resident Trusts as follows:[38]

> [U]nder the policy described in TSB-M-96(1)I, Resident Trusts, a resident trust that was not subject to tax because it met the conditions described in section 605(b)(3)(D) of the Tax Law was not required to file a return . . .

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[34] See VI, below.

[35] See N.Y. TSB-A-20(2)I, 2020 WL 2615558 (N.Y. Dep't Tax'n Fin. Feb. 4, 2020), www.tax.ny.gov. See also Andrea Muse, Irrevocable Trust Taxed as Resident Trust, Advisory Says, 96 Tax Notes State 962 (May 18, 2020).

[36] See VI, below.

[37] See Residuary Tr. A U/W/O Kassner v. Dir., Div. of Tax'n, 28 N.J. Tax 541, 548 (N.J. Super. Ct. App. Div. 2015), aff'g, 27 N.J. Tax 68 (N.J. Tax Ct. 2013). Accord Hill v. Dir., State Div. of Tax'n, 29 N.J. Tax 318 (N.J. Super. Ct. App. Div. 2016).

[38] N.Y. TSB-M-10(5)I (N.Y. Dep't Tax'n. Fin. July 23, 2010), www.tax.ny.gov. See Instructions to 2021 N.Y. Form IT-205 at 2.

> Effective for tax years beginning on or after January 1, 2010, the policy in TSB-M-96(1)I is revoked, and a resident trust that meets the conditions of section 605(b)(3)(D) of the Tax Law will be required to file a New York State fiduciary income tax return if it meets the filing requirements for resident trusts.

In 2011, that department clarified that the new filing requirement applies to trustees of Exempt Resident Trusts that satisfied § 605(b)(3)(D)(i)'s requirements before 2010.[39]

> As of tax year 2010, even though the Trusts meet the conditions set forth in Tax Law § 605(b)(3)(D), they are required to file Form IT-205 Fiduciary Income Tax Return and attach Form IT-205-C New York Resident Trust Nontaxable Certification to Form IT-205.

Thanks to the 2014–2015 budget bill, this filing requirement now is imposed by statute. Hence, § 658(f)(2) of the N.Y. Tax Law provides:[40]

> Every resident trust that does not file the return required by section six hundred fifty-one of this part on the ground that it is not subject to tax pursuant to subparagraph (D) of paragraph three of subsection (b) of section six hundred five of this article for the taxable year shall make a return for such taxable year substantiating its entitlement to that exemption and providing such other information as the commissioner may require.

3. Throwback Tax

As noted above, the 2014–2015 New York budget bill imposes a throwback tax on distributions of accumulated income to New York resident beneficiaries from Exempt Resident Trusts. The provision in question provides that the income on which such a beneficiary is taxed includes:[41]

> In the case of a beneficiary of a trust that, in any tax year after its creation including its first tax year,

[39] N.Y. TSB-A-11(4)I, 2011 WL 7113861, at *2 (N.Y. Dep't Tax'n. Fin. July 27, 2011), www.tax.ny.gov.

[40] N.Y. Tax Law § 658(f)(2).

[41] N.Y. Tax Law § 612(b)(40).

> was not subject to tax pursuant to subparagraph (D) of paragraph three of subsection (b) of section six hundred five of this article (except for an incomplete gift non-grantor trust, as defined by paragraph forty-one of this subsection), the amount described in the first sentence of section six hundred sixty-seven of the internal revenue code for the tax year to the extent not already included in federal gross income for the tax year, except that, in computing the amount to be added under this paragraph, such beneficiary shall disregard (i) subsection (c) of section six hundred sixty-five of the internal revenue code; (ii) the income earned by such trust in any tax year in which the trust was subject to tax under this article; and (iii) the income earned by such trust in a taxable year prior to when the beneficiary first became a resident of the state or in any taxable year starting before January first, two thousand fourteen. Except as otherwise provided in this paragraph, all of the provisions of the internal revenue code that are relevant to computing the amount described in the first sentence of subsection (a) of section six hundred sixty-seven of the internal revenue code shall apply to the provisions of this paragraph with the same force and effect as if the language of those internal revenue code provisions had been incorporated in full into this paragraph, except to the extent that any such provision is either inconsistent with or not relevant to this paragraph.

The provision does not apply to distributions made before June 1, 2014.[42] The law also imposes reporting requirements on trustees making accumulation distributions.[43]

Although the result might not have been intended, accumulation distributions do not include capital gains because the taxable amount is based on undistributed net income under the first sentence of § 667(a) of the Internal Revenue Code ("I.R.C.").[44] Hence, the accumulation tax will

[42] 2014 N.Y. Laws 59, Pt. I, § 9 (Mar. 31, 2014).

[43] N.Y. Tax Law § 658(f)(1).

[44] See N.Y. TSB-M-14(3)(I), (N.Y. Dep't Tax'n Fin. May 16, 2014), www.tax.ny.gov. See also Richard B. Covey & Dan T. Hastings, Tax Changes in New York and Minnesota, Prac. Drafting 11569, 11594–11602 (Apr. 2014); Bruce D. Steiner, Coping With the New York Tax Changes Affecting Estates and Trusts, LISI Est. Plan. Newsl. #2225 (May 19, 2014), www.leimbergservices.com; Hannah W. Mensch & George D. Karibjanian, New York Tax Changes for Estates and Trusts, LISI Est. Plan. Newsl. #2222 (May 8, 2014), www.leimbergservices.com.

not be burdensome in many instances given that the largest tax savings usually involve capital gains. Also, the throwback tax does not reach income accumulated before 2014 or income accumulated before a beneficiary is born, reaches age 21, or moves to New York. In addition, there is no interest charge for the deferred payment of tax. It should be noted that the United States Supreme Court did not endorse the throwback-tax structure in its 2019 North Carolina Department of Revenue v. The Kimberley Rice Kaestner 1992 Family Trust decision.[45]

4. Incomplete Gift Nongrantor Trust

As also mentioned above, the 2014–2015 budget bill treats incomplete gift nongrantor trusts as grantor trusts for New York income-tax purposes. The statutory language is:[46]

> In the case of a taxpayer who transferred property to an incomplete gift non-grantor trust, the income of the trust, less any deductions of the trust, to the extent such income and deductions of such trust would be taken into account in computing the taxpayer's federal taxable income if such trust in its entirety were treated as a grantor trust for federal tax purposes. For purposes of this paragraph, an "incomplete gift non-grantor trust" means a resident trust that meets the following conditions: (i) the trust does not qualify as a grantor trust under section six hundred seventy-one through six hundred seventy-nine of the internal revenue code, and (ii) the grantor's transfer of assets to the trust is treated as an incomplete gift under section twenty-five hundred eleven of the internal revenue code, and the regulations thereunder.

The provision does not apply to income of such trusts that were liquidated before June 1, 2014.[47] The validity of this provision is questionable unless or until Mercantile-Safe Deposit and Trust Company v. Murphy[48] is overruled.

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[45] See N.C. Dep't of Revenue v. The Kimberley Rice Kaestner 1992 Fam. Tr., 139 S. Ct. 2213, 2225 n.13 (2019) ("The Trust also raises no challenge to the practice known as throwback taxation, by which a State taxes accumulated income at the time it is actually distributed. See, e.g., Cal. Rev. & Tax Code § 17745(b)").

[46] N.Y. Tax Law § 612(b)(41). See Instructions to 2021 N.Y. Form IT-205 at 16. See also New York State Bar Association, Report No. 1455–Report on New York State Tax Law Section 612(b)(41) (Jan. 12, 2022), nysba.org.

[47] 2014 N.Y. Laws 59, Pt. I, § 9 (Mar. 31, 2014).

[48] Mercantile-Safe Deposit & Tr. Co. v. Murphy, 203 N.E.2d 490 (N.Y. 1964), aff'g, 242 N.Y.S.2d 26 (N.Y. App. Div. 1963). See III, A, above.

B. New York City

In New York City, a trustee of a Resident Trust for New York City tax purposes must file a return if it must file a New York State return.[49]

New York City treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[50] and the City permits trustees of nongrantor trusts to take a distribution deduction.[51] In 2021, the City taxed the City taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 3.876% (the 3.876% rate applied starting with such income over $50,000),[52] and the current rate schedule is not scheduled to change until 2024.[53]

Like New York State, New York City defines "Resident Trust" as a trust that is created by a testator or trustor domiciled in New York City as follows:[54]

> (c) City resident . . . trust. A city resident . . . trust means: . . .
> (2) a trust, or a portion of a trust, consisting of property transferred by will of a decedent who at his death was domiciled in such city, or
> (3) a trust, or a portion of a trust, consisting of the property of:
>
> (A) a person domiciled in such city at the time such property was transferred to the trust, if such trust or portion of a trust was then irrevocable, or if it was then revocable and has not subsequently become irrevocable; or
>
> (B) a person domiciled in such city at the time such trust or portion of a trust became irrevocable, if it was revocable when such property was transferred to the trust but has subsequently become irrevocable.

[49] N.Y. Tax Law § 1306(a), (e); Instructions to 2021 N.Y. Form IT-205 at 16.

[50] N.Y. Tax Law § 1303; N.Y.C. Admin. Code §§ 11-1711, 11-1712.

[51] See N.Y. Tax Law § 1303.

[52] N.Y. Tax Law §§ 1304(a)(3)(A), 1304-B(a)(1)(ii); N.Y.C. Admin. Code City. §§ 11-1701(a)(3)(A), 11-1704.1; Instructions to 2021 N.Y. Form IT-205 at 1.18. See N.Y. TSB-M-10(7)I (N.Y. Dep't Tax'n Fin. Aug. 17, 2010), www.tax.ny.gov.

[53] N.Y. Tax Law § 1304(b)(3); N.Y.C. Admin. Code § 11-701(b)(3). See N.Y. TSB-M-15(2)I (N.Y. Dep't Tax'n Fin. Feb. 13, 2015), www.tax.ny.gov.

[54] N.Y. Tax Law § 1305(c). See N.Y.C. Admin. Code § 11-1705(b)(3).

> For the purposes of the foregoing, a trust or portion of a trust is revocable if it is subject to a power, exercisable immediately or at any future time, to revest title in the person whose property constitutes such trust or portion of a trust and a trust or portion of a trust becomes irrevocable when the possibility that such power may be exercised has been terminated.

A "Nonresident Trust" is a trust that is not a "Resident Trust."[55]

New York City taxes all city taxable income of Resident Trusts; it does not tax Nonresident Trusts.[56] In New York City, trustees must make estimated tax payments for trusts.[57]

Also like New York State, New York City does not tax trustees of Exempt Resident Trusts but requires them to file informational returns:[58]

> (D) (i) Provided, however, a resident trust is not subject to tax under this article if all of the following conditions are satisfied:
> (I) all the trustees are domiciled outside the city of New York;
> (II) the entire corpus of the trusts, including real and tangible property, is located outside the city of New York; and
> (III) all income and gains of the trust are derived from or connected with sources outside of the city of New York, determined as if the trust were a non-resident trust.
> (ii) For purposes of item (II) of clause (i) of this subparagraph, intangible property shall be located in this city if one or more of the trustees are domiciled in the city of New York.
> (iii) Provided further, that for the purposes of item (I) of clause (i) of this subparagraph, a trustee which is a banking corporation as defined in subdivision (a) of section 11-640 of this title and which is domiciled outside the city of New York at the time it becomes a trustee of the trust shall be deemed to continue to be a trustee domiciled outside the city of

[55] N.Y. Tax Law § 1305(d); N.Y.C. Admin. Code § 11-1705(b)(4).

[56] N.Y. Tax Law § 1303; N.Y.C. Admin. Code § 11-1718.

[57] See N.Y. Tax Law § 1301(b).

[58] N.Y.C. Admin. Code § 11-1705(b)(3)(D).

> New York notwithstanding that it thereafter otherwise becomes a trustee domiciled in the city of New York by virtue of being acquired by, or becoming an office or branch of, a corporate trustee domiciled within the city of New York.

The 2014–2015 New York budget bill also added the throwback-tax requirements[59] and the incomplete gift-nongrantor-trust rules[60] described above to the taxation of New York City trusts and their beneficiaries.

C. New York State and City

In 2021, the trustee of a trust that was a Resident Trust for New York State and New York City purposes was taxed on taxable income between $1,077,550 and $5,000,000 at 13.526%, on such income between $5,000,000 and $25,000,000 at 14.176%, and on such income over $25,000,000 at 14.776%.[61]

D. CRTs

A charitable-remainder trust ("CRT") is exempt from federal income tax.[62] It therefore is exempt from New York State and City income tax under the following statute:[63]

> (h) Exempt trusts and organizations. A trust or other unincorporated organization which by reason of its purposes or activities is exempt from federal income tax shall be exempt from tax under this article (regardless of whether subject to federal and state income tax on unrelated business taxable income).

V. CASES AND RULINGS

A. Introduction

In addition to Mercantile and Taylor, New York courts and administrative agencies have issued numerous cases and rulings that involve the income taxation of trustees by New York State and New York City. Here is a sampling.

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[59] N.Y.C. Admin. Code § 11-1712(b)(36).

[60] N.Y.C. Admin. Code § 11-1712(b)(37).

[61] N.Y. Tax Law §§ 601(c)(1)(B)(iv)–(ix), 1304(a)(3)(A), 1304-B(a)(1)(ii).

[62] I.R.C. § 664(c)(1).

[63] N.Y. Tax Law § 601(h).

B. In the Matter of Joseph Lee Rice III Family 1992 Trust (2010)—Trustee Denied Refund for Closed Years Based on Change of Domicile of Trustee

This 2010 decision of the New York State Division of Tax Appeals illustrates the importance of paying attention to detail.[64] In 1992, the trustor, who resided in New York City, created an irrevocable nongrantor trust in which he named his attorney, also a New York City domiciliary, as trustee. The trust initially was subject to New York State and City income tax because of the trustor's and the trustee's New York City domiciles. In 1995, the trustee moved to Florida but continued to file tax returns using his law firm's Manhattan address and to pay State and City tax. Subsequently, it was discovered that the trustee should have ceased paying tax upon his move to Florida. The New York State Division of Taxation granted refunds for the open years—2001–2003, but the administrative law judge upheld the Division of Taxation's refusal to pay refunds for the closed years—1996–2000.[65] The amount of tax was not disclosed. Although the trustee and the accountant might have faced liability for the tax erroneously paid for the closed years, we have been informed that the beneficiaries were notified of the issue but that they opted not to pursue their claim.

C. In the Matter of the Petition of the Amauris Trust (2008)—Trusts Created at End of GRIT Term Not Resident Trusts

This 2008 decision of the New York State Division of Tax Appeals considered the taxation of two trusts that were funded at the expiration of the initial 10-year term of a grantor-retained income trust ("GRIT").[66] The trustor was a New York domiciliary in 1990 when he created the GRIT, but he lived in Connecticut at the end of the initial term in 2000. Because the trusts had source income, the establishment of the trustor's domicile determined whether the trusts were taxed on all income or on source income only. Several million dollars was involved. The administrative law judge concluded:[67]

> [S]ince the transfers were not effectuated until July 30, 2000, the ten-year anniversary of the Peterffy Trust, the Amauris and Niavius Trusts could not properly be taxed as resident trusts by the State of New York because, pursuant to Tax Law § 605(b)(3), Thomas Peterffy was a Connecticut and

[64] In the Matter of Joseph Lee Rice III Family 1992 Tr., DTA No. 822892, 2010 N.Y. Tax Lexis 268 (N.Y. Div. Tax App. Nov. 4, 2010). See N.C. Dep't of Revenue v. The Kimberley Rice Kaestner 1992 Fam. Tr., 139 S. Ct. 2213 (2019) (imposition of North Carolina income tax on accumulated income of portion of same trust having nonresident trustor and trustee based on resident discretionary beneficiaries violated Due Process Clause).

[65] See N.Y. Tax Law § 697(d).

[66] In the Matter of the Petition of the Amauris Tr., DTA No. 821369, 2008 WL 2954180 (N.Y. Div. Tax App. July 24, 2008).

[67] Amauris Trust, 2008 WL 2954180, at *13.

> not a New York domiciliary at the time the stock was transferred to these trusts. As such, since the Timber Hill, Inc., stock was not transferred to the Amauris Trust and the Niavius Trust until July 30, 2000, at a time that the grantor of the Peterffy Trust was a Connecticut domiciliary, it is hereby determined that the Amauris Trust and the Niavius Trust were not resident trusts as defined by Tax Law § 605(b)(3)(C).

D. N.Y. TSB-A-04(7)I (2004)—Rules Set for Determining Domicile of Corporate Trustee and for Evaluating Role of Advisor, Committee, Etc.

In 2004, the New York Technical Services Division considered whether proposed actions by a committee acting under five irrevocable trusts entered into by John D. Rockefeller, Jr., and Chase National Bank in 1934 would enable the trustees to eliminate New York State and City income tax as follows:[68]

> The issue raised by Petitioner, JPMorgan Chase Bank, as Trustee of the 1934 Trusts, is whether the trusts, described below, will be subject to New York State or New York City income tax if (a) the Committee, described below, replaces the trustee with a trustee not domiciled in New York State, and (b) the two Committee members who are currently domiciled in New York State are replaced by individuals who are not domiciled in New York State.

First, the five-member committee, which directed the trustee on investment and distribution matters, proposed to replace the New York corporate trustee with its Delaware affiliate. The ruling said that the domicile of the proposed successor trustee should be determined as follows:[69]

> [F]or purposes of section 605(b)(3)(D) of the Tax Law and section 105.23(c) of the Regulations, the domicile of the Proposed Successor Trustee will be the state where its principal place of business is located, as set forth in the above guidelines for determining the domicile of a corporation.

However, the ruling declined to decide this issue for the following reason:[70]

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[68] N.Y. TSB-A-04(7)I, 2004 N.Y. Tax Lexis 259, at *1 (N.Y. Dep't Tax'n Fin. Nov. 12, 2004), www.tax.ny.gov.

[69] Id. at *20.

[70] Id.

> The determination of domicile is a factual matter that is not susceptible of determination in this Advisory Opinion. An Advisory Opinion merely sets forth the applicability of pertinent statutory and regulatory provisions to a specified set of facts.

Next, the two members of the committee who lived in New York proposed to resign. The ruling observed:[71]

> An advisor to a trustee has been interpreted by the courts to include not only a person who has been designated by particular terminology in the trust instrument but also any other individual who, by the terms of the trust instrument, has been given power to direct or control a trustee in the performance of some part or all of that trustee's functions and duties, or who has been invested with a form of veto power over particular actions of a trustee through the medium or device of requiring that those actions be taken only with the consent and approval of such advisor.
>
> It is well settled under New York law that a grantor of a trust may limit a trustee's powers. In Matter of Rubin, the court addressed the status of advisors. The court held that the designation of an advisor is a valid limitation on a trustee's powers, and noted that the courts have generally considered an advisor to be a fiduciary, somewhat in the nature of a co-trustee. Another term that may be employed, said the court, is quasi-trustee or special trustee. The court's statement "since the relationship between the fiduciary and the advisor is that of a co-trustee, with the advisor having the controlling power, the fiduciary is justified in complying with the directives and will not generally be held liable for any losses," indicates a tacit acceptance of the characterization of the advisor as a trustee. However, an advisor that does not have any powers under the terms of the trust instrument to direct or control a trustee in the performance of some part or all of that trustee's functions and duties, and has not been invested with a form of veto power over

[71] Id. at *21–23 (citations omitted).

> particular actions of a trustee through the medium or device of requiring that those actions be taken only with the consent and approval of the advisor, will not be considered a co-trustee.
>
> Under the facts in this case, the Committee has been granted broad powers over the assets of the Trusts. For example, the Committee may direct the Trustee to take or refrain from taking any action which the Committee deems it advisable for the Trustee to take or refrain from taking. All of the powers of the Trustee under the Trust Agreements are subject to the directions of the Committee. Since the Committee is an advisor having the controlling power over the Trustee, following Rubin, supra, the members of the Committee are considered to be co-trustees of the Trusts. Therefore, for purposes of the first condition under section 605(b)(3)(D)(i) of the Tax Law and section 105.23(c) of the Regulations, the individuals comprising the Committee are considered to be trustees of the Trusts.
>
> However, the determination of whether Petitioner or any other investment management firms or former Committee members that may be retained by the Proposed Committee to provide investment advice or management services would also be treated as co-trustees of the Trusts for purposes of section 605(b)(3)(D)(i) of the Tax Law and section 105.23(c) of the Regulations is a factual matter that is not susceptible of determination in this Advisory Opinion.

Regarding New York State income tax, the ruling concluded:[72]

> In conclusion, Petitioner states that all real and tangible property included in the corpus of the Trusts, is located outside New York and all the income and gains of the Trusts are derived or connected from sources outside of New York State, determined as if the Trusts were a nonresident. Pursuant to section 605(b)(3)(D)(ii) of the Tax Law, any intangible property included in the corpus of the Trusts is located in New York State if any of the

[72] Id. at *23–25.

> trustees are domiciled in New York State. Therefore, the determination of whether the Trusts will be exempt from New York State personal income tax for purposes of section 605(b)(3)(D) of the Tax Law and section 105.23(c) of the Regulations will depend on whether the Proposed Successor Trustee, any member of the Proposed Committee or any other investment advisor or manager that is considered to be a co-trustee is domiciled in New York State. The Trusts will meet the three conditions of section 605(b)(3)(D)(i) of the Tax Law and section 105.23(c) of the Regulations only if all of the trustees are domiciled outside of New York State. In the case of the Proposed Successor Trustee, pursuant to the concept of domicile with respect to an individual, the domicile of the corporation is the principal place from which the trade or business of the corporation is directed or managed. In the case of any member of the Proposed Committee or any other investment advisor or manager that is considered to be a co-trustee, pursuant to section 105.20(d)(1) of the Regulations, the domicile of an individual is the place which such individual intends to be such individual's permanent home.

Regarding New York City income tax, the ruling concluded:[73]

> The New York City personal income tax is similar to the New York State personal income tax and is administered by New York State the same as Article 22 of the Tax Law. Accordingly, for the taxable years that the Trusts have not met the three conditions contained in section 605(b)(3)(D)(i) of the Tax Law and section 105.23(c) of the Regulations, New York State personal income tax is imposed on the Trusts, and if any of the trustees are domiciled in New York City, New York City personal income tax authorized under Article 30 of the Tax Law is imposed on the Trusts for those taxable years that a trustee is domiciled in New York City.

We often are asked about the circumstances, if any, in which a New York

[73] Id. at *25.

domiciliary advisor, protector, or committee member may participate in the administration of a New York Resident Trust having a nondomiciliary corporate trustee without subjecting the trust to tax. Based on this ruling, the safest course clearly is to have absolutely no participation by New Yorkers. According to the Technical Services Division, serving in a fiduciary or nonfiduciary capacity might have no bearing on this analysis.

E. N.Y. TSB-A-03(6)I (2003)—Rules Set for Powers of Appointment

The New York State Department of Taxation provided guidance in 2003 on whether or not the donee of a power of appointment is the "transferor" to the appointive trust for New York income-tax purposes in six situations.[74] The ruling concluded that:[75]

> [T]he residency of an appointive trust created by the exercise of a power of appointment is determined based on the domicile of the donor of the property who transferred the property to the trust. A person who transfers property held in trust to an appointive trust by the exercise of a general power of appointment over the trust property is considered the donor of the trust property for purposes of determining the residency of the appointive trust. Conversely, a person who transfers property held in trust to an appointive trust by the exercise of a special power of appointment over the trust property is not considered the donor of the trust property for purposes of determining the residency of the appointive trust. The donor of the special power of appointment is considered the donor of the trust property for purposes of determining the residency of the appointive trust.

A trustee considering exercising a decanting power with the hope of escaping tax by changing the creator of the trust should keep this Advisory Opinion in mind because:[76]

> An exercise of the power to invade trust principal . . . shall be considered the exercise of a special power of appointment . . ..

F. Cases and Rulings Recognizing Exempt Resident Trust Exemption

[74] N.Y. TSB-A-03(6)I, 2003 WL 22970581 (N.Y. Dep't Tax'n Fin. Nov. 21, 2003), www.tax.ny.gov.

[75] Id. at *5 (citation omitted).

[76] N.Y. Est. Powers & Trusts Law § 10-6.6(d).

1. N.Y. TSB-A-94(7)I (1994)—Resident Trust Not Taxable Once Trustee Became Nonresident

In this 1994 ruling,[77] a New York City domiciliary established an irrevocable complex inter vivos trust in 1976. Although the sole individual trustee initially lived in New York City, he moved to Connecticut in 1985. During the years in question, the corpus consisted solely of intangible personal property (some of which was held by a New York financial institution), and the trust earned no source income.

Regarding New York State tax, the ruling said:[78]

> [T]he Charles B. Moss Trust is a New York resident trust. However, since the three conditions contained in section 105.23(c) of the Personal Income Tax Regulations have been met, for the taxable years at issue, 1990, 1991 and 1992, no New York State personal income tax is imposed on such trust for said years.

Regarding New York City tax, the ruling concluded:[79]

> The New York City personal income tax is similar to the New York State personal income tax and is administered by New York State the same as Article 22 of the Tax Law. Accordingly, since the Charles B. Moss Trust has met the three conditions contained in section 105.23(c) of the New York State Personal Income Tax Regulations and no New York State personal income tax is imposed on such trust for taxable years 1990, 1991 and 1992, no New York City personal income tax authorized under Article 30 of the Tax Law is imposed on such trust for such taxable years.

The tax preparer might have been at risk for the tax erroneously paid for the closed years—1985–1989.

2. N.Y. TSB-A-96(4)I (1996)—Resident Trust Not Taxed on Capital Gain

The issue in this 1996 Technical Services Bulletin was whether the trustees of a trust created by a New York City domiciliary in 1961 had to

[77] N.Y. TSB-A-94(7)I, 1994 WL 275392 (N.Y. Dep't Tax'n Fin. Apr. 8, 1994), www.tax.ny.gov.

[78] Id. at *3.

[79] Id.

pay New York State and City income tax on a large capital gain.[80] Initially, the two individual trustees were New York residents, but, by 1988, both trustees were nonresidents. Regarding New York State income tax, the ruling said:[81]

> In this case, after 1988 the three conditions contained in section 105.23(c) of the Personal Income Tax Regulations have been met. First, after 1988 all of the trustees have been domiciled outside of New York State. Second, the corpus of the Trust consists of intangible assets some of which are held by Lazard Freres & Co. located in New York City. Third, none of the assets of the Trust were employed in a business carried on in New York State and all income and gains of the Trust were derived from sources outside of New York State, determined as if the Trust were a nonresident. With respect to the second condition, the situs of the intangible assets of a trust is deemed to be at the domicile of the trustee. Therefore, the situs of the corpus of the Trust is deemed to be outside of New York State.
>
> Accordingly, the Trust is a New York resident trust. However, for the taxable years that the three conditions contained in section 105.23(c) of the Personal Income Tax Regulations have been met, no New York State personal income tax is imposed on such trust for those years.

Regarding New York City income tax, it concluded:[82]

> The New York City personal income tax is similar to the New York State Personal income tax and is administered by New York State the same as Article 22 of the Tax Law. Accordingly, for the taxable years that the Trust has met the three conditions contained in section 105.23(c) of the New York State Personal Income Tax Regulations, no New York State personal income tax is imposed on the Trust, and no New York City personal income tax authorized under Article 30 of the Tax Law is

[80] N.Y. TSB-A-96(4)I, 1996 WL 667910 (N.Y. Dep't Tax'n Fin. Oct. 25, 1996), www.tax.ny.gov.

[81] Id. at *3.

[82] Id.

imposed on the Trust for those taxable years.

3. N.Y. TSB-A-00(2)I (2000)—Resident Trust Not Taxable Even Though It Held Interest in LLC Managed By New York City Domiciliary

In this 2000 ruling,[83] a New York City domiciliary created a Delaware LLC of which she was the managing member. She kept a 1% interest and contributed a 99% interest to a trust for the benefit of New York beneficiaries but appointed a nonresident individual as trustee.

The ruling identified the pertinent issues as follows:[84]

> 3. Whether the Trust . . . or Trustee(s) . . . is subject to any New York State or New York City tax law or filing requirements or fees (i.e., Fiduciary Income Tax Return).
>
> 4. Whether the domicile of the Trustee(s) or Beneficiary affects the tax status of the Trust.

It found that the trustee was not taxable for the following reasons:[85]

> Issue 3 . . . In this case, the three conditions contained in section 105.23(c) of the Personal Income Tax Regulations have been met. First, the trustee is domiciled outside of New York State. Second, the corpus of the Trust consists of intangible assets. The situs of the intangible assets of a trust are deemed to be at the domicile of the trustee. Therefore, the situs of the corpus of the Trust is deemed to be outside of New York State. Third, none of the assets of the Trust are employed in a business carried on in New York State and all income and gains of the Trust were derived from sources outside of New York State, determined as if the Trust were a nonresident.
>
> Accordingly, the Trust is a New York resident trust. However, for the taxable year that the three conditions contained in section 105.23(c) of the Personal Income Tax Regulations are met, no New York State personal income tax is imposed on such

[83] N.Y. TSB-A-00(2)I, 2000 WL 567678 (N.Y. Dep't Tax'n Fin. Mar. 29, 2000), www.tax.ny.gov.

[84] Id. at *1.

[85] Id. at *5–6.

> Trust for those years. Further, no New York City personal income tax authorized under Article 30 of the Tax Law is imposed on the Trust for those taxable years.
>
> Issue 4
> The domicile of the Trustee of the Trust does affect the taxable status of the Trust. If the Trustee is domiciled in New York State, the Trust would not meet the three conditions contained in section 105.23(c) of the Personal Income Tax Regulations, and the Trust would be subject to New York State personal income tax. In addition, if the Trustee is a resident of the City of New York, the Trust would be subject to the New York City personal income tax authorized under Article 30 of the Tax Law. The domicile of the beneficiary does not affect the taxable status of the trust.

The significance of this technical services bulletin is that a New York City domiciliary could manage trust investments indirectly as the managing member of an LLC in which the trustee held an interest that she could not have managed directly as trustee without subjecting the trust to tax.

4. N.Y. TSB-A-04(7)I (2004)—Resident Trust Not Taxable if Corporate Trustee and Committee Members Are Not Domiciliaries

   This 2004 ruling, summarized above,[86] recognized that the trusts under consideration would qualify as Exempt Resident Trusts if the corporate trustee and the committee members were nondomiciliaries.

5. In the Matter of the Petition of the John Heffer Trust (2006)—Resident Trust Not Taxable Once Domiciliary Trustee Resigned in Accordance with Governing Instrument

   This 2006 decision[87] involved a trust that a New York City domiciliary created in 1973 naming individual trustees. In 1981, the last New York domiciliary trustee resigned and was replaced by a nondomiciliary trustee as provided in the trust instrument but without a court proceeding. Nevertheless, the trustees continued to file returns and to pay tax. In 2004, the trustees filed amended returns seeking refunds for 2000 (about $100,000), 2001 (about $6,000), and 2002 (about $100,000), which were

[86] N.Y. TSB-A-04(7)I, 2004 N.Y. Tax Lexis 259 (N.Y. Dep't Tax'n Fin. Nov. 12, 2004), www.tax.ny.gov. See D, above.

[87] In the Matter of the Petition of the John Heffer Trust, DTA No. 820351, 2006 WL 1806492 (N.Y. Div. Tax App. June 22, 2006).

denied by the Division of Taxation.

On appeal, the Division of Tax Appeals identified the issue as follows:[88]

> Whether the resignation of a New York domiciled trustee of a New York resident trust, without court approval, was sufficient to satisfy the requirements of 20 NYCRR former 105.23(c), such that petitioner trust was no longer subject to New York personal income tax and was entitled to a refund of taxes paid for the years 2000, 2001 and 2002.

The Division of Tax Appeals reversed the determination of the Division of Taxation and granted the refunds for the following reasons:[89]

> The John Heffer Trust clearly prescribed procedures for the resignation of a trustee and the appointment of successor trustees which were carefully followed in accordance with the intent of the grantor, thereby giving legal effect to the resignation of Sidney J. Silberman on November 20, 1981.
>
> Therefore, for the years 2000, 2001 and 2002, petitioner has established that it met the requirements of 20 NYCRR 105.23(c) and was not subject to income tax.

Although the trustees obtained refunds for the open years—2000, 2001, and 2002, we wonder whether they, the tax return preparer, or their advisors were at risk for tax erroneously paid for the closed years, going all the way back to 1981.

6. In the Matter of Joseph Lee Rice III Family 1992 Trust (2010)—Resident Trust Not Taxable Once Trustee Became Nondomiciliary

This 2010 decision of the Division of Tax Appeals, summarized above,[90] recognized that a Resident Trust ceased to be taxable as soon as the sole domiciliary individual trustee became a Florida domiciliary.

7. N.Y. TSB-A-10(4)I (2010)—Resident Trust No Longer Taxable Upon Death of Domiciliary Trustee

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[88] Id. at *1.

[89] Id. at *5.

[90] In the Matter of the Joseph Lee Rice III Fam. 1992 Tr., DTA No. 822892, 2010 N.Y. Tax Lexis 268 (N.Y. Div. Tax App. 2010). See B, above.

This 2010 Technical Services Bulletin addressed the tax-payment requirements of the surviving nondomiciliary trustee of a New York Resident Trust due to the death of the New York domiciliary individual co-trustee on August 1, 2008.[91] The ruling concluded:[92]

> Once a resident trust satisfies the conditions in Tax Law section 605(b)(3)(D)(i), it is no longer subject to further taxation by New York State so long as the trustee remains a non-domiciliary and the trust continues to meet the other conditions in section 605(b)(3)(D)(i). The Trusts must, however, accrue to the period of their taxable residence any income, gain, loss, deduction, items of tax preference or any ordinary income portion of a lump sum distribution accruing prior to the Trusts' change of tax status, regardless of the Trusts' method of accounting.

8. N.Y. TSB-A-11(4)I (2011)—Resident Trust No Longer Taxable When Domiciliary Trustee Resigns

This 2011 Technical Services Bulletin considered the New York income-tax consequences for Resident Trusts caused by changes of domiciles of the grantors and trustees.[93] It concluded:[94]

> Based on the information submitted, the Trusts never owned and do not currently own any real or tangible property in New York and they have no New York source income. Therefore, the Trusts met the second and third requirements of Tax Law § 605(b)(3)(D). However, because Trustee 1 was a New York resident, the Trusts did not meet the first requirement of Tax Law § 605(b)(3)(D) and initially were subject to New York State income tax only on the New York resident portions of the Trusts. When Trustee 1 resigned as trustee, leaving only Trustee [sic] 2, a Connecticut resident, as the sole trustee, the Trusts met all the requirements of Tax Law § 605(b)(3)(D). Accordingly, when Trustee 1 resigned as trustee, the Trusts were no longer subject to New York income tax.

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[91] N.Y. TSB-A-10(4)I, 2010 WL 2557532 (N.Y. Dep't Tax'n Fin. June 8, 2010), www.tax.ny.gov.

[92] Id. at *2.

[93] N.Y. TSB-A-11(4)I, 2011 WL 7113861 (N.Y. Dep't Tax'n Fin. July 27, 2011), www.tax.ny.gov.

[94] Id. at *2.

9. N.Y. TSB-A-20(2)I (2020)—Nongrantor Trust With Any New York Source Income Will Be Taxed as Resident Trust

TSB-A-20(2)I, issued in 2020, recited these facts:[95]

> The Trust is an irrevocable, non-grantor trust that was established by ("Grantor") for the benefit of the Grantor's descendants, some of whom are currently domiciliaries of New York. The Grantor was a New York State domiciliary at the time the Trust was created and funded on December 7, 2016. Petitioner is the sole trustee and is a domiciliary of the State of New Jersey. As an irrevocable non-grantor trust, the Trust is treated as a separate taxpayer for federal income purposes.

It noted that "[a]ll the income of the trust has been retained, and no distributions have been made to the trust beneficiaries."[96]

According to the advisory, the trust held the following investments:[97]

> The corpus of the Trust includes two types of intangible investments. Approximately fifteen percent (15%) is invested in a Vanguard tax exempt municipal bond fund ("Bond Fund"). Approximately fifteen percent (15%) of the total income generated by the Bond Fund is from New York tax exempt bonds. The approximately eighty-five percent (85%) remaining corpus consists of a limited partnership interest in a publicly traded partnership ("Partnership"). Less than one percent of the Partnership's income is New York source income. Thus, in the aggregate, New York source income accounts for less than five percent (5%) of the Trust's total income.

The advisory noted:[98]

> In order for a resident trust to qualify for the exemption in Tax Law § 605(b)(3)(D, three conditions must be met: (1) all trustees must be

[95] N.Y. TSB-A-20(2)I, 2020 WL 2615558, at *1 (N.Y. Dep't Tax'n Fin. Feb. 4, 2020), www.tax.ny.gov.

[96] Id.

[97] Id.

[98] Id. at *2.

> domiciled outside of New York State; (2) the entire corpus of the trust must be located outside of New York State; and (3) all of the trust's income or gain must be sourced outside New York State. For the purpose of sourcing the trust corpus, intangible property shall be deemed "located in New York if one or more of the trustees are domiciled in the state.

The determination concluded:[99]

> Based on the facts herein, the Trust is subject to New York taxation as a resident trust. While the trust meets the first two conditions for exemption, the Trust does not meet the third condition in § 605(b)(3)(D)(i)(III). The Trust's income includes New York source income. Therefore, all the income, regardless of source, earned by the Trust is subject to New York income tax as a resident trust.

It should be noted that New York's approach is different from that of states such as New Jersey[100] and Minnesota,[101] where there is authority to tax such a trust on source income only. Given that the Department of Taxation and Finance could not consider constitutional issues, it is possible that federal district court might be available to adjudicate similar controversies.

G. Michael A. Goldstein No. 1 Trust v. Tax Appeals Tribunal of the State of New York (2012)—New York Intermediate Appellate Court Holds that Interest on New York Income-Tax Refund Runs from Date of Filing of Amended Return Not from Date of Filing of Original Return

This 2012 case illustrates the importance of thinking about the state income taxation of trusts at the outset rather than relying on a refund request. In Michael A. Goldstein No. 1 Trust v. Tax Appeals Tribunal of the State of New York,[102] the trustees filed New York income tax returns for 1995, 1996, and 1997. As the result of an Internal Revenue Service ("I.R.S.") audit, the trustees' taxable income was decreased. The trustees filed amended returns requesting New York income-tax refunds in July 2006 that were issued in December of that year.

The Department of Taxation and Finance paid interest from July 2006 rather than

[99] N.Y. TSB-A-20 (2) I, 2020 WL 2615558, at *1 (N.Y. Dep't Tax'n Fin. Feb. 4, 2020), www.tax.ny.gov.

[100] See Residuary Tr. A U/W/O Kassner, 28 N.J. Tax 541 (N.J. Super. Ct. App. Div. 2015).

[101] See Fielding for MacDonald v. Comm'r of Revenue, 916 N.W.2d 323 (Minn. 2018).

[102] Michael A. Goldstein No. 1 Tr. v. Tax Appeals Trib. of N.Y., 957 N.Y.S.2d 433 (N.Y. App. Div. 2012).

from the dates of the filing of the original returns based on then N.Y. Tax Law § 688.[103] A New York intermediate appellate court confirmed that determination.[104]

Although the New York statute in question was amended as of tax year 1999, the same issue might arise in another state. In addition, even though advance planning might not have prevented the problem in this case because it resulted from an I.R.S. audit, trustees and their attorneys should consider potential state income taxation while a trust is being created. Even though a trustee might later be able to pry refunds out of a state tax department for open years, they might be forestalled for closed years and, as demonstrated by this case, unable to make the trust whole.

VI. SOURCE INCOME

A. Introduction

In New York, trustees of Nonresident Trusts are taxed on source income[105] and a single dollar of source income apparently will prevent a Resident Trust from meeting the Exempt Resident Trust exemption.[106] The New York State Department of Taxation and Finance has announced that source income includes:[107]

> - real or tangible personal property located in New York State, (including certain gains or losses from the sale or exchange of an interest in an entity that owns real property in New York State, see TSB-M-09(5)I) Amendment to the Definition of New York Source Income of a Nonresident Individual; . . .
>
> - a business, trade, profession, or occupation carried on in New York State;
>
> - your distributive share of New York State partnership income or gain;
>
> - your share of New York State estate or trust income or gain; . . .

[103] N.Y. Tax Law § 688.

[104] Goldstein, 957 N.Y.S.2d at 436.

[105] N.Y. Tax Law §§ 633, 631. See N.Y. TSB-M-18(2)I (N.Y. Dep't Tax'n Fin. Apr. 6, 2018), www.tax.ny.gov.

[106] N.Y. Tax Law § 605(b)(3)(D)(i)(III).

[107] N.Y. Tax Bull. TB-IT-615 at 1 (N.Y. Dep't Tax'n Fin. Dec. 15, 2011; updated Sept. 10, 2019), www.tax.ny.gov.

- any gain from the sale, transfer, or other disposition of shares of stock in a cooperative housing corporation in connection with the grant or transfer of a proprietary leasehold, when the real property comprising the units of the cooperative housing corporation is located in New York State;

- any income you received related to a business, trade, profession, or occupation previously carried on in New York State, including but not limited to covenants not to compete and termination agreements (see TSB-M-10(9)I) Income Received by a Nonresident Related to a Business, Trade, Profession, or Occupation Carried on Within New York State; and

- a New York S corporation in which you are a shareholder . . .

That agency has said that the following items do not constitute source income:[108]

- your income from annuities and pensions that meet the New York State definition of an annuity, unless the annuity is employed or used as an asset of a business, trade, profession, or occupation carried on in New York State;

- your interest, dividends, or gains from the sale or exchange of intangible personal property, unless they are part of the income you received from carrying on a business, trade, profession, or occupation in New York State . . .

- your income as a shareholder of a corporation that is a New York C corporation; . . .

B. Contributing Tangible Personal Property or Real Property to an Entity to Escape Source-Income Classification

The trustee of a New York Nonresident Trust or of a Resident Trust that holds tangible personal property, real property, or shares of stock in a cooperative housing corporation might consider transferring the property into an FLP or LLC

[108] Id. at 1–2.

with the hope of converting it into intangible personal property that will not produce source income. In this regard, New York State treats the gain incurred upon the sale of interests in certain entities that hold New York real property as source income.[109] Specifically, real property located in New York includes an interest in an entity (i.e., a partnership, limited liability corporation, S corporation, or non-publicly traded C corporation with 100 or fewer shareholders) that owns real property or shares of stock in a cooperative housing corporation in New York having a fair market value that equals or exceeds 50% of all the assets of the entity on the date of sale or exchange of the taxpayer's interest in the entity.[110] Only the assets that the entity owned for at least two years before the date of the sale or exchange of the taxpayer's interest in the entity are to be used in determining the fair market value of all the assets of the entity on the date of sale or exchange.[111] The gain or loss derived from New York sources from the taxpayer's sale or exchange of an interest in an entity is the total gain or loss for federal income-tax purposes from that sale or exchange multiplied by a fraction, the numerator of which is the fair market value of the real property or shares of stock in a cooperative housing corporation located in New York on the date of sale or exchange and the denominator of which is the fair market value of all the assets of the entity on the date of sale or exchange.[112] The New York State Department of Taxation and Finance has issued Technical Services Bulletins that illustrate the operation of the provision and that describe its application to trusts.[113]

C. In the Matter of the Petition of Henry A. and Marianne Ittleson (2005)—An Example of Source Income

This 2005 case,[114] which did not involve a trust, illustrates source income. In

[109] N.Y. Tax Law § 631(b)(1)(A)(1). See N.Y. TSB-A-20(3)I (N.Y. Dep't Tax'n Fin. Feb. 10, 2020, www.tax.ny.gov (loss realized by nonresident individual limited partners upon liquidation and dissolution of limited partnership is not derived from or connected with New York sources). See also Robert Willens, New York Nonresident Limited Partners Unfairly Denied Loss Deductions, 97 Tax Notes State 21 (July 6, 2020).

[110] N.Y. Tax Law § 631(b)(1)(A)(1).

[111] Id.

[112] Id.

[113] N.Y. TSB-M-18(1)I (N.Y. Dep't Tax'n Fin. Apr. 6, 2018), www.tax.ny.gov; N.Y. TSB-M-09(5)I (N.Y. Dep't Tax'n Fin. May 5, 2009), www.tax.ny.gov.

[114] In the Matter of the Petition of Henry A. and Marianne Ittleson, N.Y. DTA 819283, 2005 WL 2108132 (N.Y. Div. Tax App. Aug. 25, 2005). See Burton v. N.Y.S. Dep't of Tax'n & Fin., 37 N.E.3d 718 (N.Y. 2015) (proceeds of nondomiciliary's deemed sale of S Corporation stock was New York source income); In the Matter of the Petition of Yacov Harel, N.Y. DTA 829515, 2022 WL 1559589, at *6 (N.Y. Div. Tax App. May 5, 2022) ("It is the portion of the distributive share attributable to New York sources which is subject to taxation"); In the Matter of the Petition of Franklin C. Lewis, N.Y. DTA 827791, 2019 WL 2610775, at *1 (N.Y. Div. Tax App. June 20, 2019 ("[A] nonresident individual's gain received on the sale of the stock he owned in an electing subchapter S New York domestic corporation was required to be included in that individual's New York source income, to the extent recognized for federal income tax purposes and in accordance with the S corporation's business allocation percentage"); In the Matter of the Petition of Lawrence Gleason, N.Y. DTA 823829, 2014 WL 1273575 (N.Y. Div. Tax App. Mar. 18, 2014) (Connecticut resident's income from exercise of nonstatutory stock options was New York

1986, a New York City married couple bought a Modigliani painting for about $1.5 million and hung it in their Manhattan cooperative apartment. The owners moved to South Carolina in December of 1996, but the painting remained in the apartment, where it stayed until March of 1997 when it was turned over to Sotheby's for auction. Sotheby's sold the painting for about $8.5 million in May of 1997, producing roughly a $7 million gain. The Tax Appeals Tribunal stated the issue at the outset:[115]

> Whether the Division of Taxation properly determined that the nonresident petitioners' gain from the sale of a painting was New York source income pursuant to Tax Law § 631(b)(1)(A) and, therefore, subject to New York personal income tax under Tax Law § 601(e).

In holding the gain to be taxable, it concluded:[116]

> In the present case, the physical presence of the Painting in New York at the time of sale and for a substantial period of years before that clearly satisfies the requirement of a "minimal connection" with the state. In addition, the manifest benefits of the laws of New York attaching to petitioners' ownership and sale of the Painting clearly are rationally related to the gain on the sale of the Painting which the state seeks to tax. This is no less true because high-end art auctions attract bidders from all parts of the world. There may well be cases in which the presence of tangible personal property in the state would be too ephemeral to satisfy the requirements of due process but this is not such a case.

The surviving owner had to pay about $500,000 of New York State and New York City income tax that probably could have been saved if the Modigliani had left New York.

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source income); In the Matter of the Petition of Ronald K. and Maxine H. Linde, N.Y. DTA 823300, 2012 WL 1980651 (N.Y. Div. Tax App. Mar. 24, 2012) (all income realized from nonresident partnership's sale of New York real property allocated to New York); N.Y. TSB-A-15(5)I (N.Y. Dep't Tax'n Fin. June 19, 2015), www.tax.ny.gov (nondomiciliary taxable on portion of gain from redemption of S corporation stock attributable to New York real property); N.Y. TSB-A-07(1)I, 2007 WL 1610039 (N.Y. Dep't Tax'n Fin. Feb. 7, 2007), www.tax.ny.gov (sale of interest in Georgia partnership not New York source income). See Andrea Muse, ALJ Upholds Retroactive Tax on Deemed Asset Sale, 93 Tax Notes State 151 (July 8, 2019).

[115] Ittleson, 2005 WL 2108132, at *1.

[116] Id. at *6.

VII. MOVING" TRUST TO ESCAPE TAX

A. Introduction

As discussed at length above, a nongrantor trust created by a New York testator or trustor is not subject to New York income tax if the trust has no New York trustees, assets, or source income. For an existing trust to be able to stop paying tax, it sometimes is necessary to involve a New York court in changing a resident trustee to a nonresident trustee. The following cases are illustrative.

B. In re Bush (2003)—Tax Escaped Without Changing Situs

At the beginning of this case,[117] Surrogate Preminger summarized the issue as follows:[118]

> In these companion proceedings, JPMorgan Chase Bank, as trustee of a trust created under an agreement dated September 30, 1952 between Harriet F. Bush, as grantor, and Donald F. Bush, as trustee, and JPMorgan Chase Bank, as trustee of a trust under the will of Donald F. Bush, both trusts being for the benefit of Edith B. Crawford, have petitioned for leave to resign and the appointment of J.P. Morgan Trust Company of Delaware as successor trustee. The court granted such relief by orders dated December 30, 2002. Petitioners' further requests-transfer of the situs of the trusts to Delaware, to avoid imposition of New York State fiduciary income tax—remain the sole issue before the court. All interested parties have consented to the requested relief.

In the course of the opinion, she noted that the court already had replaced the New York trustee with its Delaware affiliate.[119] She then observed:[120]

> Petitioners' ultimate goal—elimination of the imposition of a New York fiduciary income tax—can be, and has been, satisfied without the requested transfer of situs.

The Surrogate therefore denied the trustee's request to transfer the trusts' situs

[117] In re Bush, 774 N.Y.S.2d 298 (Surr. Ct. N.Y. Cty. 2003).

[118] Id. at 298–99.

[119] Id. at 299.

[120] Id.

from New York to Delaware as follows:[121]

> There being no evidence of any benefit to be derived from the transfer of the situs of the trusts to Delaware, petitioners' requests are denied.

C. In re Estate of Rockefeller (2003)—Tax Again Escaped Without Changing Situs

Surrogate Roth was presented with a similar issue in this case.[122] She began:[123]

> The trustees of the trust established under the will of William Rockefeller ask the court to allow the corporate trustee, the Chase Manhattan Bank (now known as JP Morgan Chase Bank), to resign in favor of its affiliate, JP Morgan Trust Company of Delaware, and to change the situs of the trust to the State of Delaware. By order dated May 15, 2002, the request for the change of corporate trustee was granted. The sole issue remaining is whether under the circumstances presented changing the situs of the trust is also warranted.

After reciting the facts,[124] the surrogate noted that:[125]

> Petitioners' application for a change of situs was based on the trustees' desire to eliminate the high New York State fiduciary income tax payable by the trust. But that objective concededly is met by the resignation of the New York corporate trustee and the appointment of its Delaware affiliate, as a result of which the trust will no longer be taxable by this State. Petitioners nevertheless request a change of situs.

Next, she observed:[126]

> The income tax benefit obtainable by the substitution of the corporate trustee's Delaware

[121] Id. at 300.

[122] In re Estate of Rockefeller, 773 N.Y.S.2d 529 (Surr. Ct. N.Y. Cty. 2003).

[123] Id. at 529.

[124] Id. at 530.

[125] Id. (citation omitted).

[126] Id.

> affiliate is clearly in the interests of the beneficiaries. Indeed, the frequency with which such applications are made reflects an understandable eagerness on the part of persons interested in trusts to be rid of the high tax price payable where the fiduciary is a New Yorker. Although no formal tally has been made of the number of such applications, it is clear that their combined result—a loss of trust business by this state—is sufficiently serious to suggest that New York's high fiduciary income tax may be counterproductive to the state's overall economic interests. The New York Legislature is urged to evaluate the present fiduciary income tax scheme in light of its negative repercussions, including the trend embodied by applications such as the one presently before the court

Surrogate Roth denied the requested change of situs and put future petitioners on notice as follows:[127]

> Petitioners' application to change the situs of this trust is accordingly denied. This decision puts future applicants on notice that, where the desired tax savings can be achieved by a change of trustee, a change of situs will not be allowed unless it would result in some benefit to the trust apart from the tax considerations themselves.

VIII. PLANNING

A. Third-Party Trusts

1. Exempt Resident Trust Exemption

a. Introduction

New York testators and trustors should plan their third-party nongrantor trusts to qualify as Exempt Resident Trusts. This planning should not cease in light of the addition of the throwback tax for the reasons noted above[128] and because tax rates might go down in the future, beneficiaries might leave New York, and distributions might go to non-New York beneficiaries.

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[127] Id. at 531.

[128] See IV, A, 3, above. Subsequent budget bills made no substantive changes in these provisions. See N.Y. TSB-M-18(4)I (N.Y. Dep't Tax'n Fin. May 25, 2018), www.tax.ny.gov.

b. New York State

If a nongrantor trust, which was created by a New York State domiciliary, incurred a $1 million long-term capital gain in 2021, had no other income, and paid its New York State income tax by year-end, the trustee would have owed $68,493 of New York State income tax on December 31, 2021, and $236,433 of federal income tax on April 18, 2022. If the trust had been structured to eliminate New York State income tax, however, the trustee would have owed no state income tax and $236,433 of federal income tax, producing a net tax savings of $68,493.

c. New York City

If a nongrantor trust, which was created by a New York City domiciliary and was subject to New York State and City tax, incurred a $1 million long-term capital gain in 2021, had no other income, and paid its New York State and City income tax by year-end, the trustee would have owed $107,124 of New York State and City income tax on December 31, 2021, and $236,433 of federal income tax on April 18, 2022. If the trust had been structured so that New York tax was not payable, however, the trustee would have owed no state or city tax and $236,433 of federal income tax, producing a net tax savings of $107,124.

If a trust will hold property that will generate source income, the testator or trustor might minimize tax by creating two trusts, one to hold assets that produce source income and the other to hold assets that do not generate such income.

2. Federal vs. New York Tax Savings

a. Introduction

The federal income-tax brackets for trusts are more compressed than those for individuals. Hence, as a result of the regular income tax and the 3.8% net investment income tax,[129] trusts reach the 2022 top 40.8% bracket for short-term capital gains and ordinary income in 2022 at only $13,450 of taxable income whereas single and joint filers don't do so until $539,900 and $647,850 of such income, respectively.[130] Similarly, in 2022, trusts reach the top 23.8% bracket for long-term capital gains and qualified dividends (the sources of income on which

[129] I.R.C. §§ 1, 1411.67

[130] Rev. Proc. 2021-45 § 3.01 (Nov. 10, 2021).

many trusts largely will be taxed) at just $13,700 of taxable income whereas single and joint filers don't do so until $459,750 and $517,200 of such income, respectively.[131]

In light of this disparity between the federal income taxation of trusts and individuals, attorneys and trustees are considering increasing distributions to beneficiaries and including capital gains in distributable net income ("DNI") to take advantage of the beneficiaries' lower tax burden.[132] Federal income taxation is only part of the picture, however, so that practitioners must analyze nontax and other tax factors as well. From a nontax standpoint, advisers should evaluate the trusts' purposes, the loss of protection from creditor claims, and fairness among beneficiaries. From a tax standpoint, they should factor in potential federal transfer-tax and state death-tax costs as well as the state income-tax impact on the beneficiaries. And, the savings from structuring a trust to minimize state income taxes often can offset much—if not all—of the added federal tax costs.

b. New York State

If a nongrantor trust, which was created by a New York State domiciliary, but was not subject to New York state income tax because it qualified as an Exempt Resident Trust, incurred a $1 million long-term capital gain in 2021 and had no other income, the trustee would have owed $0 of New York State income tax on December 31, 2021, and $236,433 of federal income tax on April 18, 2022. However, if the trustee distributed $1 million to a New York State resident beneficiary (who had no other income) in 2021, the trustee caused the $1 million long-term capital gain to be included in DNI, and the beneficiary paid the New York State income tax on the distribution by year-end, the beneficiary would have owed $67,952 of New York State income tax on December 31, 2021, and $202,048 of federal income tax on April 18, 2022. Thus, $67,952 of New York State income tax would be paid to save $34,385 of federal income tax, an additional $33,567 tax cost.

c. New York City

Similarly, if a nongrantor trust which was created by a New York City domiciliary but was not subject to New York State and City income tax because it qualified as an Exempt Resident Trust, incurred a $1 million long-term capital gain in 2021 and had no other income, the trustee would have owed $0 of New York State and City income tax

[131] Rev. Proc. 2021-45 § 3.03 (Nov. 10, 2021).

[132] See Charles A. Redd, Making Trust Distributions to Reduce Overall Income Taxes, 158 Tr. & Est. 9 (Mar. 2019).

on December 31, 2021, and $236,433 of federal income tax on April 18, 2022. However, if the trustee distributed $1 million to a New York City resident beneficiary (who had no other income) in 2021, the trustee caused the $1 million long-term capital gain to be included in DNI, and the beneficiary paid the New York State and City income tax on the distribution by year-end, the beneficiary would have owed $106,277 of New York State and City income tax on December 31, 2021, and $202,048 of federal income tax on April 18, 2022. Thus, $106,277 of New York State and City income tax would be paid to save $34,385 of federal income tax, an additional $71,892 tax cost.

B. Self-Settled Trust Option—The "ING Trust"

Most domestic asset-protection trusts ("APTs") are grantor trusts for federal income-tax purposes under I.R.C. § 677(a) because the trustee may distribute income to—or accumulate it for—the trustor without the approval of an adverse party. However, a client might use a type of domestic APT known as the incomplete gift nongrantor trust ("ING Trust"), to eliminate income tax on undistributed ordinary income and capital gains imposed by Pennsylvania, which has not adopted the federal grantor-trust rules for irrevocable trusts, or, if the client is willing to subject distributions to themselves to the control of adverse parties, to eliminate income tax on such income imposed by one of the numerous states that have adopted the federal grantor-trust rules. In dozens of private letter rulings issued since 2013,[133] the I.R.S. ruled that domestic APTs that followed the ING-Trust approach qualified as incomplete gifts and as nongrantor trusts. Most—if not all—of the early rulings involved Nevada law in large part because, at the time, Nevada was the only domestic APT state that allowed a trustor to keep a nongeneral lifetime power of appointment. In the meantime, other domestic APT states have added that option.[134] The trustor of an ING Trust might be able to receive tax-free distributions of the untaxed income in later years.[135]

As covered in IV, A, 4, above, ING Trusts are no longer available for New York domiciliaries.[136] New Yorkers who are interested in reducing New York State and New York City income tax should consider establishing domestic APTs as completed gifts and as nongrantor trusts. In addition, because New York's anti-

[133] See, e.g., I.R.S. Priv. Ltr. Ruls. 202017018 (Nov. 29, 2019); 202014001–202014005 (Aug. 26, 2019); 202007010 (Sept. 18, 2019); 202006002–202006006 (Sept. 18, 2019).

[134] See, e.g., Alaska Stat. § 34.40.110(b)(2); Del. Code Ann. tit. 30, § 3570(11)(b)(2); Nev. Rev. Stat. § 166.040(2)(b); S.D. Codified Laws § 55-16-2(2)(b).

[135] See Charles A. Redd, "ING" Trusts Aren't For Everyone, 160 Tr. & Est. 13 (Mar. 2021); Eric R. Bardwell, California Admits Incomplete Gift Non-Grantor Trusts Work. . . For Now, 46 Tax Mgmt. Est., Gifts & Tr. J. 24, 26–28 (Jan. 7, 2021); Lindsay R. DeMoss D'Andrea, Incomplete Gift Non-Grantor Trusts: How Kaestner Highlights the Importance of Planning for State Income Tax, 34 Prob. & Prop. 42 (May/June 2020).

[136] See N.Y. Tax Law § 612(b)(41).

ING Trust provision applies to taxpayers who create "Resident Trusts"[137] and because resident trusts are trusts created by New York domiciliaries,[138] the ING Trust option should be available to "statutory residents" (i.e., individuals who maintain a permanent place of abode and spend more than 183 days in New York State and/or New York City during a tax year).[139]

The days of the ING Trust might be numbered elsewhere for three reasons. First, a proposal would eliminate the ING-Trust option for Californians beginning in 2022.[140] Second, Professor McCouch of the University of Florida Levin College of Law published an article early in 2020 in which he questioned several tax aspects of the vehicle.[141] Third, in January of 2021, the I.R.S. announced that it will not issue Private Letter Rulings on the income-, estate-, and gift-tax implications of ING Trusts until it issues pertinent guidance.[142] The I.R.S. reconfirmed this no-ruling position in January 2022.[143]

[137] N.Y. Tax Law § 612(b)(41).

[138] N.Y. Tax Law § 605(b)(3)(B)–(C).

[139] N.Y. Tax Law § 605(b)(1)(B).

[140] See Eric R. Bardwell, California Admits Incomplete Gift Non-Grantor Trusts Work. . .For Now, 46 Tax Mgmt. Est., Gifts & Tr. J. 24, 28–29 (Jan. 7, 2021).

[141] Grayson M.P. McCouch, Adversity, Inconsistency, and the Incomplete Nongrantor Trust, 39 Va. Tax Rev. 419 (Spring 2020).

[142] Rev. Proc. 2021-3 §§ 5.01(9), (10), (15), (17) (Jan. 4, 2021).

[143] Rev. Proc. 2022-2 §§ 5.01(9), (10), (15), (18) (Jan. 3, 2022).