

2016

# Let My Trustees Go! Planning to Minimize or Eliminate Virginia and Other State Income Taxes on Trusts (PowerPoint)

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## Repository Citation

Nenno, Richard W., "Let My Trustees Go! Planning to Minimize or Eliminate Virginia and Other State Income Taxes on Trusts (PowerPoint)" (2016). *William & Mary Annual Tax Conference*. 744.  
<https://scholarship.law.wm.edu/tax/744>



# **62<sup>ND</sup> ANNUAL WILLIAM & MARY TAX CONFERENCE**

## **LET MY TRUSTEES GO! PLANNING TO MINIMIZE OR ELIMINATE VIRGINIA AND OTHER STATE INCOME TAXES ON TRUSTS**

**November 11, 2016**

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# SCOPE

- Introduction
- How Do States Tax Trust Income?
- Is Imposition of Tax Constitutional?
- How Do Specific States Tax Trust Income?
- What Are the Planning Considerations for New Trusts?
- What Are the Planning Considerations for Existing Trusts?
- Why is Reliance on Availability of Home State Courts  
Misplaced?
- What Are Some Other Relevant Issues?

# INTRODUCTION

- Background
- The Opportunity
  - Introduction
  - The Stakes Are High
  - The Opportunities Are Great
  - Federal vs. State Tax Savings
  - People Are Doing It
  - The Risks of Inaction Are Real

## INTRODUCTION (Cont'd)

### ➤ How to Approach the Issue

- Determine Which State Statutes Apply
- Determine If State Courts Have Jurisdiction
- Determine Whether Imposition of Tax Violates US Constitution
  - Due Process Clause
  - Commerce Clause

# HOW DO STATES TAX TRUST INCOME?

- Introduction
- Bases of Taxation
- Trust Created by Will of Resident
- Inter Vivos Trust Created by Resident
- Trust Administered in State
- Resident Trustee
- Resident Beneficiary

# IS IMPOSITION OF TAX CONSTITUTIONAL?

- Introduction
- Early United States Supreme Court Cases
  - Safe Deposit and Trust Co. v. Virginia (1929)
  - Guaranty Trust Co. v. Virginia (1938)
  - Greenough v. Tax Assessors of Newport (1947)
- State Court Cases Before Quill
  - Mercantile-Safe Deposit & Trust Co. v. Murphy (NY 1964)
  - McCulloch v. Franchise Tax Board (CA 1964)
  - Taylor v. State Tax Commissioner (NY 1981)
  - Pennoyer v. Taxation Div. Dir. (NJ 1983)
  - Potter v. Taxation Div. Dir. (NJ 1983)

# IS IMPOSITION OF TAX CONSTITUTIONAL? (Cont'd)

- State Court Cases Before Quill (Cont'd)
  - In re Swift (MO 1987)
  - Blue v. Dep't of Treasury (MI 1990)
  - Westfall v. Dir. of Revenue (MO 1991)
- Quill Corporation v. North Dakota (US 1992)
- Post-Quill State Court Cases
  - District of Columbia v. Chase Manhattan Bank (DC 1997)
  - Chase Manhattan Bank v. Gavin (CT 1999)



# IS IMPOSITION OF TAX CONSTITUTIONAL? (Cont'd)

## ➤ Recent State Court Cases

- Residuary Trust A v. Director (NJ 2015)
- McNeil v. Commonwealth (PA 2013)
- Linn v. Dep't of Revenue (IL 2013)

## ➤ Constitutional Analysis

## ➤ Limitations on Personal Jurisdiction

- Walden v. Fiore (US 2014)
- Bernstein v. Stiller (E.D. PA 2013)

# IS IMPOSITION OF TAX CONSTITUTIONAL? (Cont'd)

## ➤ Taxation of Trust Administered in State

- Wisconsin Dep't of Taxation v. Pabst (WI 1961)
- Pabst v. Wisconsin Dep't of Taxation (WI 1963)

## ➤ Taxation of Resident Trustee

## ➤ Taxation of Trustee of Trust Having Resident Beneficiary

- McCulloch v. Franchise Tax Board (CA 1964)
- In the Matter of the Appeal of the First National Bank of Chicago (CA 1964)
- In the Matter of the Appeal of C. Pardee Erdman (CA 1970)
- Kimberly Rice Kaestner 1992 Family Trust v. N.C. Dep't of Revenue (NC 2016)

# HOW DO SPECIFIC STATES TAX TRUST INCOME?— VIRGINIA

## ➤ Filing Requirement

- Resident Trust
- Nonresident Trust

## ➤ Grantor-Trust Rules

## ➤ Distribution Deduction

## ➤ Tax Rates

## ➤ Resident Trust

- Created by Will of Virginia Testator
- Created or Funded by Virginia Trustor
- Administered in Virginia

## ➤ Nonresident Trust – Trust Not Resident Trust

# HOW DO SPECIFIC STATES TAX TRUST INCOME?— VIRGINIA (Cont'd)

## ➤ Taxation of Trust

- Resident Trust
  - Taxed on all Virginia taxable income
- Nonresident Trust
  - Taxed on Virginia source income
- Estimated Payments
  - Required

# HOW DO SPECIFIC STATES TAX TRUST INCOME?— VIRGINIA (Cont'd)

## ➤ Taxation of Trust (Cont'd)

- CRT

## ➤ DING Trust Option

- Incomplete Gift
- Nongrantor Trust

## ➤ Planning

## ➤ Trustee Duty to Minimize Tax

# HOW DO SPECIFIC STATES TAX TRUST INCOME? (Cont'd)

- New York
- Northeast (Other Than New York)
  - Delaware
  - Maryland
- South
  - Florida
  - North Carolina
  - Virginia
- California

# WHAT ARE THE PLANNING CONSIDERATIONS FOR NEW TRUSTS?

- Introduction
- Trust Created by Will of Resident
- Inter Vivos Trust Created by Resident
- Trust Administered in State
- Resident Trustee
- Resident Beneficiary

# WHAT ARE THE PLANNING CONSIDERATIONS FOR EXISTING TRUSTS?

- Introduction
- Trust Created by Will of Resident
- Inter Vivos Trust Created by Resident
- Trust Administered in State
- Resident Trustee
- Resident Beneficiary
- Effecting the Move
- Trustee Duty to Minimize Tax
- Federal Transfer-Tax Consequences



# WHY IS RELIANCE ON AVAILABILITY OF HOME STATE COURTS MISPLACED?

- Exercise of Jurisdiction
- Full Faith and Credit

## WHAT ARE SOME OTHER RELEVANT ISSUES?

- Simply Paying Tax is Risky
- Filing Position
- Establishing Residence of Future Beneficiaries
- Establishing Place of Administration
- Choosing a Jurisdiction for a Long-Term Trust
- Source Income
- Combining Nonresident Trust With Resident Adviser, Protector, or Committee

## WHAT ARE SOME OTHER RELEVANT ISSUES? (Cont'd)

- Changing Testator or Trustor by Exercise of Trustee Power
- State Income Taxation of CRTs
- Self-Settled Trust Option—The “DING Trust”
- Ethical Concerns
- Practical Concerns
- What Can States Do?



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