2016

Let My Trustees Go! Planning to Minimize or Eliminate Virginia and Other State 12 Income Taxes on Trusts (Outline)

Richard W. Nenno

62ND ANNUAL

WILLIAM & MARY TAX CONFERENCE

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

Richard W. Nenno, Esquire
Senior Managing Director and Trust Counsel
Wilmington Trust Company
Rodney Square North
1100 North Market Street
Wilmington, Delaware 19890-0001
Tel: (302) 651-8113
Fax: (302) 427-4920
rnenno@wilmingtontrust.com

November 11, 2016

Table of Contents

LET MY TRUSTEES GO!
PLANNING TO MINIMIZE OR ELIMINATE VIRGINIA AND OTHER STATE INCOME TAXES ON TRUSTS [1]

By

Richard W. Nenno, Esquire
Wilmington Trust Company
Wilmington, Delaware

I. INTRODUCTION

A. Background

States[2] tax all income of a "Resident Trust" but just the "source income" of a "Nonresident Trust."[3] They define "Resident Trust" in several different ways, however, leading to inconsistent income-tax treatment of the same entity, often resulting in double (or more) state income taxes being imposed on the same income. Moreover, recognizing the constitutional limits on their ability to tax, some states do not tax Resident Trusts in certain circumstances. I will refer to such a trust as an "Exempt Resident Trust."

Practitioners must factor the state income-tax treatment of the trusts they create for their clients into their estate-planning recommendations. They must take steps to assure that the income of these trusts is not taxed by any state, or by no more than one state in any event. Trustees of trusts that do not already reflect this planning must consider whether there is any way to reduce the incidence of state income taxation on the trusts' income. Failure of the estate planner and the trustee to consider these issues may give rise to claims of malpractice or breach of the trustee's fiduciary duty of competence.

---

[1] For comprehensive coverage of this subject, see Richard W. Nenno, 869 T.M., State Income Taxation of Trusts. For valuable commentary, see Roger J. Traynor, State Taxation of Trust Income, 22 Iowa L. Rev. 268 (1937); Bradley E.S. Fogel, What Have You Done For Me Lately? Constitutional Limitations on State Taxation of Trusts, 32 U. Rich. L. Rev. 165 (Jan. 1998) (hereinafter "Fogel"); Bernard E. Jacob, An Extended Presence, Interstate Style: First Notes on a Theme From Saenz, 30 Hofstra L. Rev. 1133 (Summer 2002) (hereinafter "Jacob"); Joseph W. Blackburn, Constitutional Limits on State Taxation of a Nonresident Trustee: Gavin Misinterprets and Misapplies Both Quill and McCulloch, 76 Miss. L.J. 1 (Fall 2006) (hereinafter "Blackburn"); See also 2 Jerome R. Hellerstein, Walter Hellerstein & John A. Swain, State Taxation ¶ 20.09 (3d ed. 2016); Norman M. Abramson, Susan Gary, George G. Bogert & George T. Bogert, The Law of Trusts and Trustees § 300 at 96–102 (3d ed. 2014) (hereinafter "Bogert"). I would like to thank my Wilmington Trust Company colleague Peter M. Hyde for preparing the sample calculations in this paper.

[2] For convenience, "state" refers to the District of Columbia as well as to the fifty states.

[3] Many—but not all—states formally define "Resident Trust" and "Nonresident Trust." In this paper, "Resident Trust" refers to a trust that is treated as a resident for tax purposes and "Nonresident Trust" refers to a trust that is not so treated.

All income of a trust that is treated as a grantor trust for federal income-tax purposes normally is taxed to the trustor,[4] distributed ordinary income of a nongrantor trust generally is taxed to the recipient, and source income of a trust (e.g., income attributable to real property, tangible personal property, or business activity) usually is taxed by the state where the property is situated or the activity occurs.[5] Thus, the tax-savings opportunities typically are for the accumulated nonsource income of nongrantor trusts, particularly their capital gains.

B. The Opportunity

1. Introduction

In 2015, the state fiduciary income-tax rates ranged from a lowest top rate of 2.90% in North Dakota[6] and 3.07% in Pennsylvania[7] to a highest top rate of 9.90% in Oregon,[8] 12.696% in New York City,[9] and 13.30% in California.[10] With proper planning, this tax may be minimized or eliminated in many instances. Conversely, without proper planning, the income of a trust might be subject to tax by more than one state.

2. The Stakes Are High

Trustees pay a lot of state income taxes. For example, in 2011 (the latest year for which figures have been released), 43,310 resident estates and trusts paid approximately $218 million of New York income tax.[11] Given that the rules for exempting such trusts from taxation are straightforward, one wonders how much of that tax could have been saved.

3. The Opportunities Are Great

---

[4] In various states and among various practitioners, "trustor" may be replaced by "grantor," "settlor," or "trust creator" to identify the individual creating an inter vivos trust. I will use "trustor." In addition, I will use "testator" to describe an individual executing a Will.

[5] See VIII, F, below.

[6] N.D. Cent. Code § 57-38-30.3(1)(e).

[7] 72 P.S. § 7302.

[8] Or. Rev. Stat. § 316.037.

[9] N.Y. Tax Law §§ 601(c)(1)(A), 1304.

[10] Cal. Rev. & Tax. Code §§ 17041(a)(1), (e), (h), 17043(a); Cal. Const. Art. XIII, § 36(f)(2). See Tax Foundation, Facts and Figures, Tbl. 12 (Feb. 29, 2016), www.taxfoundation.org/article/facts-figures-2016-how-does-your-state-compare (last visited Sept. 26, 2016); Tax Foundation Fiscal Facts, at 1–8 (Feb. 8, 2016), www.taxfoundation.org/sites/taxfoundation.org/files/docs/TaxFoundation-FF500.pdf (last visited Sept. 26, 2016); Ralph B. Tower, Today's Personal Income Tax: Measuring Change and Discovering Innovation, 2015 State Tax Today 199-8 (Oct. 15, 2015).

[11] N.Y. State Dep't of Taxation and Finance, Office of Tax Policy Analysis, Analysis of 2011 Personal Income Tax Returns, at 89 (May 2015), www.tax.ny.gov/research/stats/stat_pit/analysis_of_personal_income_tax_returns.htm (last visited Sept. 26, 2016).

In many situations, the rules for eliminating state income tax by trustees are clear.

For example, if a nongrantor trust, which had a California trustee but no California beneficiaries, incurred a $1 million long-term capital gain in 2015, had no other income, and paid its California income tax by the end of the year, the trustee would have paid $109,422 of California income tax on December 31, 2015, and $232,852 of federal income tax on April 18, 2016. If the trust had a Washington trustee, however, the trustee would have owed $0 of state income tax and $236,539 of federal income tax.

Similarly, if a nongrantor trust, which was created by a New York City resident and was subject to New York State and City tax, incurred a $1 million long-term capital gain in 2015, 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 New York City tax on December 31, 2015, and $232,939 of federal income tax on April 18, 2016. 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 $236,539 of federal income tax.

Under the Internal Revenue Code of 1986 ("I.R.C."), state income tax is deductible for federal purposes,[12] but the deduction is essentially worthless in the above examples due to the alternative minimum tax ("AMT"). Even if the AMT did not apply, the state income-tax deduction would have been of limited value because it is a deduction—not a credit—and because, in 2015, the maximum tax rate on long-term capital gains was 23.8%, therefore providing only a 23.8% federal tax offset for the state income taxes paid.[13]

4. Federal vs. State Tax Savings

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 net investment income tax, trusts reach the top 43.4% bracket for short-term capital gains and ordinary income in 2016 at only $12,400 of taxable income whereas single and joint filers don't do so until $415,050 and $466,950 of such income, respectively.[14] Similarly, in 2016, trusts reach the top 23.8% bracket for long-term capital gains and qualified dividends (the sources of income on which many trusts largely will be taxed) at just $12,400 of taxable income but single and joint filers don't do so until the

[12] IRC §§ 164(a)(3), 641(b).

[13] IRC § 1(h)(1).

[14] Rev. Proc. 2015-53 § 3.01, 2015-44 I.R.B. 615, 617 (Oct. 21, 2015); IRC §§ 1, 1411.

levels described in the preceding sentence.[15]

In light of this increased 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) to take advantage of the beneficiaries' lower tax burden.[16] 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, the adviser should evaluate the trust's purposes, the loss of protection from creditor claims, and fairness among beneficiaries.[17] From a tax standpoint, he or she 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 tax as described in this paper often can offset much—if not all—of the added federal tax costs. For example, if a nongrantor trust, which was created by a California resident but was not subject to California income tax because it had no California fiduciary or noncontingent beneficiary, incurred a $1 million long-term capital gain in 2015 and had no other income, the trustee would have owed $0 of California income tax and $236,539 of federal income tax. However, if the trustee distributed $1 million to a California resident beneficiary (who had no other income) in 2015 and elected to include the $1 million of long-term capital gain in DNI, the beneficiary would have owed $108,924 of California income tax and $204,000 of federal income tax on April 18, 2016. Thus, $108,924 of California income tax was incurred to achieve a $32,539 federal tax reduction, a $76,385 added tax cost.

5. People Are Doing It

In 2008, Professor Sitkoff of Harvard Law School and Professor Schanzenbach of Northwestern University School of Law reported that:[18]

> In the timeframe of our data [1987–2003], seventeen states abolished the Rule [Against

---

[15] Rev. Proc. 2015-53 § 3.01, 2015-44 I.R.B. 615, 618 (Oct. 21, 2015); IRC §§ 1, 1411.

[16] See Christopher Floss, Does 3.8% Change Anything? The Intersection of the Net Investment Income Tax and Fiduciary Income Tax, 69 Tax Law. 401 (Winter 2016); William P. LaPiana & Marc S. Bekerman, Estate Tax Planning in an Income Tax World, 40 Tax Mgmt. Est., Gifts & Tr. J. 111 (Mar. 12, 2015).

[17] See Paul S. Lee, Anne K. Bucciarelli & Stephanie Shen Torosian, Managing Trusts in a Mad, Mad, Mad, Mad World, Tr. & Est., Feb. 2014, at 12, 18.

[18] Robert H. Sitkoff & Max Schanzenbach, Perpetuities, Taxes and Asset Protection: An Empirical Assessment of the Jurisdictional Competition for Trust Funds, 42 U. Miami Inst. on Est. Plan. ¶ 1400 at 14-3 (2008) (footnote omitted; emphasis added).

Perpetuities], implying that through 2003 roughly \$100 billion—10% of total reported trust assets—moved as a result of the Rule's abolition. <u>In addition, our findings highlight the importance of state fiduciary income taxes. Abolishing states only experienced an increase in trust business if the state also did not levy an income tax on trust funds attracted from out of state</u>.

6. <u>The Risks of Inaction Are Real</u>

Attorneys who do not discuss the state income taxation of trusts with individual clients and trustees face potential malpractice claims for subjecting trusts to needless expense.[19] In addition, as discussed more fully in VI, H, below, trustees in more than half the states have a statutory duty to ensure that trusts are placed in suitable jurisdictions. In the other states, that duty might exist under common law.

C. <u>How to Approach the Issue</u>

As I will explore more fully in III, below, the planner should approach the income taxation of trusts in three stages. First, the planner should identify all state statutes that potentially apply. Second, keeping in mind that a trust is a relationship—not an entity—so that the trustee—not the trust—pays tax, the planner should analyze whether each state in question has jurisdiction over the trustee or trust assets. Third, the planner should consider whether imposition of tax is consistent with the Due Process Clause and the Commerce Clause of the United States Constitution.

D. <u>Scope</u>

This paper will examine briefly the general pattern of state income taxation of trusts and then will consider the significant constitutional limitations on such taxation, which states sometimes ignore in their reach for more revenue. Next, it will focus on the taxation schemes of several states. Then, it will discuss how the practical estate planner should establish the situs of a trust in order to minimize state income taxes on trusts and what options may exist for the trustee of an existing trust to reduce or eliminate state income tax liabilities. Finally, the paper will consider some related issues. The Appendix summarizes the rules for all the states.

In this paper, I attempt to alert practitioners to general principles. Attorneys and trustees must consult local counsel in specific cases.

---

[19] For a case in which executors and attorneys were surcharged for overpaying federal estate tax and Pennsylvania inheritance tax, see <u>Lohm Estate</u>, 269 A.2d 451, 454 (Pa. 1970) ("It is well-settled in this Commonwealth that a fiduciary who has negligently caused a loss to an estate may properly be surcharged for the amount of such loss.").

II. STATE APPROACHES TO TAXATION OF TRUST INCOME

A. Introduction

Currently, eight states—Alaska, Florida, Nevada, New Hampshire, South Dakota, Texas, Washington, and Wyoming—do not tax the income of trusts. The planner should not assume that this always will be the case, however. For example, the "temporary" income tax on trustees that Ohio adopted for 2002–2004 became permanent in 2005, Florida levied an intangible personal property tax on trustees until 2007, and Washington voters considered—but defeated—a ballot initiative to impose an income tax in 2010. Tennessee[20] taxes interest and dividends only.

As noted above, if a trust is treated as a grantor trust for federal and for state income-tax purposes, all income (including accumulated ordinary income and capital gains) is taxed to the trustor, making planning difficult if not impossible while that status continues. Nevertheless, where the federal and state grantor-trust rules are not identical, it might be possible to structure a trust to be a grantor trust for federal purposes but to be a nongrantor trust for state purposes and to arrange matters so that the trust is not subject to that state's tax. For instance, Pennsylvania doesn't have any grantor-trust rules for irrevocable trusts; statutes in Arkansas, the District of Columbia, Louisiana, and Montana tax the grantor only in limited circumstances;[21] and Massachusetts and Michigan classify a trust as a grantor trust based on IRC §§ 671–678 only, so that a trust that falls under IRC § 679 will be a grantor trust for federal but not for state purposes. Unfortunately, a number of those same states tax individuals based on federal taxable income,[22] which captures all federal grantor-trust income,[23] making the foregoing planning option unavailable.

Some states explicitly allow trustees to take a distribution deduction. Others make the distribution deduction available by taxing trustees on federal taxable income,[24] which is calculated after the trustee has taken a distribution deduction, if available.[25]

B. Bases of Taxation

---

[20] Tenn. Code Ann. §§ 67-2-101–67-2-122. See Notice 16-05, 2015 State Tax Today 130-27 (July 2016), www.tn.gov/assets/entities/revenue/attachments/16-05Hall.pdf.

[21] Ark. Inc. Tax Reg. § 4.26-51-102; D.C. Code §§ 47-1809.08–47-1809.09; La. Rev. Stat. Ann. § 47:187; Mont. Code Ann. § 15-30-2151(5).

[22] IRC § 63. See Annette Nellen, Lessons From State Personal Income Tax Forms, 81 State Tax Notes 205 (July 18, 2016).

[23] IRC § 671.

[24] IRC § 641(b).

[25] IRC §§ 651, 661.

All of the 43 taxing states, including Tennessee, classify a nongrantor trust as a Resident Trust based on one or more of the following five criteria:

(1) If the trust was created by the Will of a testator who lived in the state at death;

(2) If the trustor of an inter vivos trust lived in the state;

(3) If the trust is administered in the state;

(4) If one or more trustees live or do business in the state; or

(5) If one or more beneficiaries live in the state.

Louisiana taxes a trust if the trust specifically provides that Louisiana law governs, but it does not tax such a trust if the trust specifies that the law of another state applies. Idaho and North Dakota consider the designation of their laws as a factor in determining whether a trust is a Resident Trust. Otherwise, the designation of a state's law to govern a trust has no bearing on its tax classification.

In some states, a trust might be a Resident Trust under more than one category (e.g., because the trust was created by the Will of a resident and because the trust is administered in the state). In some other states, one or more of the above criteria will lead to the classification of a trust as a Resident Trust only in combination with other factors.

Because statutes that tax trusts on the same basis are not identical, one must always analyze the statute in question. A trust might be treated as a Resident Trust by more than one state based on the residence of the testator or trustor, the place of administration, the residence of the trustees, and the residence of the beneficiaries. When creating a new trust in or moving an existing trust to an unfamiliar jurisdiction, the attorney must consider the income-tax system of the intended situs.

The Appendix summarizes the criteria that the 43 taxing states employ in taxing trust income.

C. Trust Created by Will of Resident

Sixteen states—Connecticut, the District of Columbia, Illinois, Louisiana, Maine, Maryland, Michigan, Minnesota (trusts created or first administered in state after 1995), Nebraska, Ohio, Oklahoma, Pennsylvania, Vermont, Virginia, West Virginia, and Wisconsin—tax a trustee solely because the testator lived in the state at death. Recognizing the constitutional vulnerability of that approach, several states require more contact. Accordingly, New Jersey and New York tax a trust created by the Will of a resident decedent only if the trust has resident trustees, assets, and/or source income, and Idaho and Iowa tax if this is one of several factors. Although Delaware, Massachusetts, Missouri, and Rhode Island tax if the trust has at least one resident beneficiary, Arkansas taxes if the trust has at least one resident trustee. Alabama taxes on this basis if a trust has a resident fiduciary or a current beneficiary. Utah taxes on this basis, but, after 2003, a Utah trust that has a Utah corporate trustee may deduct all nonsource income.[26]

This criterion must be considered if a decedent's Will creates a trust or pours assets into an inter vivos trust. Also, many states consider an individual to be a resident if he or she owns a residence and spends a certain amount of time in the state as well as if he or she is domiciled there.[27] This must be kept in mind in determining whether a trust is a resident trust in this category.

D. Inter Vivos Trust Created by Resident

Twelve states—the District of Columbia, Illinois, Maine, Maryland, Minnesota (trusts created or first administered in state after 1995), Nebraska, Oklahoma, Pennsylvania, Vermont, Virginia, West Virginia, and Wisconsin (trusts created or first administered in state after October 28, 1999)—tax an inter vivos trust solely because the trustor resided in the state. For constitutional reasons, several states have departed from the approach, however. New Jersey and New York tax on this basis if a trust has resident trustees, assets, and/or source income, and Connecticut, Delaware, Michigan, Missouri, Ohio, and Rhode Island tax if the trust has at least one resident beneficiary. Massachusetts taxes if the trust has at least one resident trustee and at least one resident beneficiary. The Commonwealth does not specify when an institution is a resident, but, in a controversial 2016 decision, the Supreme Judicial Court of Massachusetts held:[28]

> [W]e interpret the three interrelated statutes that apply in this case, §§ 1(f)(2), 10, and 14, to mean that a corporate trustee will qualify as an "inhabitant" of the Commonwealth within the meaning and for the purposes of these statutes if it: (1) maintains an established place of business in the Commonwealth at which it abides, i.e., where it conducts its business in the aggregate for more than 183 days of a taxable year; and (2) conducts trust administration activities within the Commonwealth that include, in particular, material trust activities relating specifically to the trust or trusts whose tax liability is at issue.

[26] See App. See also Charles A. Redd, State Tax Stew, Tr. & Est., July 2016, at 10.

[27] See, e.g., N.Y. Tax Law § 605(b)(1).

[28] Bank of America, N.A. v. Commission of Revenue 54 N.E.3d 13, 21 (Mass. 2016).

Arkansas taxes if the trust has at least one resident trustee. Idaho and Iowa tax if this is one of several factors. Alabama taxes on this basis if a trust has a resident fiduciary or a current beneficiary.[29]

The planner must consider this criterion if a client creates a revocable trust or an irrevocable inter vivos trust or if the client contributes assets to a trust created by someone else. As with the prior category, a state might classify an individual as a "resident" if he or she owns a residence and spends a significant amount of time in the state or if he or she is domiciled there.[30]

E. Trust Administered in State

Fourteen states—Colorado, Indiana, Kansas, Louisiana (unless trust instrument designates law of another state), Maryland, Minnesota (trusts created or first administered in state before 1996), Mississippi, Montana, New Mexico, North Dakota, Oregon, South Carolina, Virginia, and Wisconsin (inter vivos trusts created or first administered in state before October 29, 1999)—tax the trustee if a trust is administered in the state. Idaho and Iowa tax on this basis if it is combined with other factors. Hawaii taxes if the trust has at least one resident beneficiary. Utah taxes inter vivos trusts on this basis, except that, after 2003, a Utah inter vivos trust that has a Utah corporate trustee may deduct all nonsource income. Oregon provides guidance on whether a corporate trustee is administering a trust in the state.[31]

F. Resident Trustee

Seven states—Arizona, California, Kentucky, New Mexico, North Dakota, Oregon, and Virginia—tax if one or more trustees reside in the state. Idaho and Iowa tax on this basis when combined with other factors. Delaware and Hawaii tax on this basis only if the trust has one or more resident beneficiaries. Arizona, California, and Oregon provide guidance on whether a corporate trustee is a resident. If some, but not all, of the trustees of a trust are California residents, California taxes only a portion of the income.[32]

In some states, an individual trustee will be treated as a resident if he or she owns a residence and spends a substantial amount of time in the state or if he or she is domiciled there.[33]

---

[29] See App.

[30] See, e.g., Md. Code Ann., Tax-Gen. § 10-101(k)(1)(iii)(2).

[31] See App.

[32] See App.

[33] See, e.g., Cal. Rev. & Tax. Code § 17742(a); 30 Del. C. § 1601(8)(c); 23 Va. Regs. § 10-115-10.

G. Resident Beneficiary

Five states—California, Georgia, North Carolina, North Dakota, and Tennessee—tax a trust if it has one or more resident beneficiaries. An individual might be treated as a "resident" if he or she owns a residence and spends a substantial amount of time in the state or if he or she is domiciled there.[34] If a trust is taxed on this basis, California and Tennessee tax only income attributable to resident beneficiaries.[35]

III. DETERMINING WHETHER IMPOSITION OF TAX IS CONSTITUTIONAL

A. Introduction

As mentioned in I, C, above, the planner should approach the income taxation of trusts in the following three steps:

(1) Determine which, if any, state tax statutes apply;

(2) Determine whether each state in question has personal jurisdiction over the trustee or in rem jurisdiction over trust assets;[36] and

(3) Determine whether imposition of tax violates the state's or the United States's Constitution.

Regarding (1) above, it will be plain in some situations whether a particular state's statute applies. For example, if a state taxes trusts administered within the state or trusts that have resident trustees, the statute won't apply if the trust has nonresident trustees or establishes administration elsewhere. Similarly, a statute that taxes trusts created by resident testators and trustors won't extend to trusts created by nonresidents. In this regard, a trust created by a New York or New Jersey testator or trustor will not be taxable if there is no trustee, asset, or source income in the state and if the trustee files a tax return reporting that it is taking that position.

Regarding (2) above, keeping in mind that a trust is a relationship not an entity,[37] the planner and the trustee should not assume that a state has jurisdiction to tax a nonresident trustee. I am not aware of a reported case in which the tax department of a state sued a trustee in another state to collect the first state's tax. Nor have I found pertinent law review articles or other authorities that analyze the

---

[34] See, e.g., Cal. Rev. & Tax Code § 17742(a); N.C. Gen. Stat. § 105-160.2.

[35] See App.

[36] See Bernegger v. Thompson, 2016 WL 3919232, at *4 (Wis. Ct. App. July 21, 2016) ("[I]t would not comport with due process requirements to subject the out-of-state defendants to the jurisdiction of Wisconsin courts").

[37] See Lauren J. Wolven & Carrie A. Harrington, Beneficiary Loans: Obvious Problems and Subtle Solutions, Est. Plan., June 2015, at 18, 19 ("a trust is not a separate legal entity, but rather, a contractural arrangement between the grantor and trustee").

subject, but it appears that such a tax department would encounter significant obstacles.

First, the tax department of the first state might have to litigate in the courts of the second state for the following reasons:[38]

> A state itself . . . is not considered a "citizen" of any state, and therefore diversity jurisdiction will not apply to a suit brought by or against a state. Moreover, where a state agency or officer, rather than the state itself, is a party, the same result will obtain if the state is regarded as the real party in interest in the suit. In general, the state is regarded as the real party in interest in suits for monetary relief involving state taxing agencies or their officers; hence, diversity jurisdiction will not be available for such cases.

Second, if the tax department of the first state requests information from nonresident parties and compliance is not forthcoming, "the state finds itself at the mercy of the laws of the destination state regarding enforcement of its information request."[39]

Challenging the existence of jurisdiction might seem daunting, but, if the amount of tax involved is substantial and if the trustee's contacts with the taxing state are minimal, it might be worth the effort. In III, H, below, I cover recent U.S. Supreme Court and other precedents regarding personal jurisdiction.

Regarding (3) above, a state cannot tax a trustee on income of a trust simply by saying so. A state that taxes trustees of trusts created by resident testators and trustors may not collect tax in all circumstances even if it has jurisdiction over the trustee. Hence, the Michigan Court of Appeals observed in 1990:[40]

> We are unpersuaded by defendant's arguments that the fact that the trust is defined as a resident trust

---

[38] Peter D. Enrich, Federal Courts and State Taxes: Some Jurisdictional Issues, With Special Attention to the Tax Injunction Act, 65 Tax Law. 731, 735 (Summer 2012) (footnotes omitted). See 28 U.S.C. § 1341 ("The district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State"). See also Kelly v. Ala. Dep't of Revenue, 2016 WL 181338, at *7 (11th Cir. Jan. 15, 2016) ("[G]iven that Kelly's action seeks to enjoin, suspend or restrain the assessment of taxes and that Alabama provides Kelly with sufficient state court remedies, the district court lacked subject matter jurisdiction under the TIA and principles of comity").

[39] Jennifer Carr, State Sovereign Immunity and Franchise Tax Board v. Hyatt, 2015 State Tax Today 222-9 (Nov. 4, 2015). See Franchise Tax Bd. of California v. Hyatt, 136 S. Ct. 1277 (2016). See also Kathleen K. Wright, U.S. Supreme Court to Nevada: Play Nice!, 80 State Tax Notes 779 (June 6, 2016).

[40] Blue v. Dep't of Treasury, 462 N.W.2d 762, 764–65 (Mich. Ct. App. 1990).

> imparts legal protections and jurisdiction. We find that these protections are illusory considering that the trust is registered and administered in Florida. The state cannot create hypothetical legal protections through a classification scheme whose validity is constitutionally suspect and attempt to support the constitutionality of the statute by these hypothetical legal protections. We analogize the present case to a hypothetical statute authorizing that any person born in Michigan to resident parents is deemed a resident and taxable as such, no matter where they reside or earn their income. We believe this would be clearly outside of the state's power to impose taxes.

A state may tax a trustee on income of a trust only if doing so will not violate limits set by that state's and the United States's Constitution. The constitutionality of various state approaches to the income taxation of trusts has not been directly addressed by the United States's Supreme Court, but the Court's rulings on other forms of state taxation and the decisions of various state and federal courts on the state income taxation of trusts have focused on two constitutional restraints on the right of a state to tax the income of a trust—the Due Process Clause of the Fifth or Fourteenth Amendment[41] and the Negative or Dormant Commerce Clause.[42]

The Due Process Clause of the Fourteenth Amendment provides that:

> No State shall make or enforce any law which shall . . . deprive any person of life, liberty, or property, without due process of law . . . .

The Commerce Clause provides that:

> The Congress shall have Power . . . [t]o regulate Commerce . . . among the several States . . . .

B. Early United States Supreme Court Cases

1. Introduction

From 1929 to 1947, the United States Supreme Court rendered three decisions that still are pertinent to the state income taxation of trusts.

2. Safe Deposit and Trust Company v. Virginia (1929)—Setting

[41] U.S. Const. amend. V, amend. XIV, § 1. See Fogel, supra note 1, at 185.

[42] U.S. Const. art. I, § 8, cl. 3. See Fogel, supra note 1, at 184–85, 203–06.

Constitutional Standards for Nexus to Impose Tax on Trustee

In Safe Deposit and Trust Company v. Virginia,[43] the United States Supreme Court held that Virginia's assessment of a tax on the value of an inter vivos trust created by a Virginia domiciliary and having Virginia beneficiaries but a Maryland trustee, violated the Due Process Clause. The Court stated:[44]

> Here we must decide whether intangibles—stocks, bonds—in the hands of the holder of the legal title with definite taxable situs at its residence, not subject to change by the equitable owner, may be taxed at the latter's domicile in another State. We think not.

3. Guaranty Trust Company v. Virginia (1938)—Taxing Resident Beneficiaries Not Nonresident Trustee

In Guaranty Trust Company v. Virginia,[45] the Court considered the legality of Virginia's right to tax income received by a resident beneficiary where the trustee already had paid tax on the same income to New York. Pursuant to discretion granted in the Will, the trustees distributed about $300,000 of income to the beneficiary during the years in question.[46] The Court sustained Virginia's right to tax the beneficiary as follows:[47]

> Here, the thing taxed was receipt of income within Virginia by a citizen residing there. The mere fact that another state lawfully taxed funds from which the payments were made did not necessarily destroy Virginia's right to tax something done within her borders . . .. The challenged judgment must be Affirmed.

4. Greenough v. Tax Assessors of Newport (1947)—Taxing Resident Trustee

In Greenough v. Tax Assessors of Newport,[48] the United States Supreme Court held that an ad valorem tax could be imposed upon a trustee with

---

[43] Safe Deposit & Trust Co. v. Virginia, 280 U.S. 83 (1929). See Fogel, supra note 1, at 179–84.

[44] Safe Deposit, 280 U.S. at 93.

[45] Guaranty Trust Co. v. Virginia, 305 U.S. 19 (1938).

[46] Guaranty Trust Co., 305 U.S. at 21.

[47] Guaranty Trust Co., 305 U.S. at 23 (citations omitted).

[48] Greenough v. Tax Assessors of Newport, 331 U.S. 486 (1947).

respect to its interest in the trust. The Court explained:[49]

> A resident trustee of a foreign trust would be entitled to the same advantages from Rhode Island laws as would any natural person there resident.

C. State Court Cases Before Quill

1. Introduction

Between 1963 and 1991, state courts decided eight cases involving the state income taxation of trusts. In six of them, the court denied its state's power to tax.

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

In Mercantile-Safe Deposit & Trust Company v. Murphy,[50] the New York Court of Appeals (the highest court in the state), affirming an intermediate appellate court decision, held that the Due Process Clause 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 income, even though the current discretionary beneficiary was a New York resident. Relying on Safe Deposit & Trust Company v. Virginia, the court stated that:[51]

> 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.

3. McCulloch v. Franchise Tax Board (1964)—Taxation in State of Residence of Co-Trustee/Beneficiary

[49] Greenough, 331 U.S. at 495.

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

[51] Mercantile-Safe Deposit & Trust Co., 203 N.E.2d at 491.

In McCulloch v. Franchise Tax Board,[52] the Supreme Court of California held that California could tax the co-trustee/beneficiary on accumulated income distributed to him from a Missouri trust because the co-trustee/beneficiary was a California resident. The court said:[53]

> We conclude that California could constitutionally tax plaintiff as the resident beneficiary upon the accumulated income when it was distributed to him. But plaintiff in the instant case was simultaneously beneficiary and a trustee. No possible doubt attaches to California's constitutional power to tax plaintiff as a trustee. His secondary role as a trustee reinforces the independent basis of taxing plaintiff as beneficiary.

4. 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,[54] 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 nonresident individual trustees and a New York corporate trustee, Florida law prohibited the corporate trustee from serving so that only the nonresident trustees served 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:[55]

> 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.

5. Pennoyer v. Taxation Division Director (1983)—No Income Taxation of Nonresident Testamentary Trust Based Solely on Residence of Testator

---

[52] McCulloch v. Franchise Tax Board, 390 P.2d 412 (Cal. 1964).

[53] McCulloch, 390 P.2d at 421.

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

[55] Taylor, 445 N.Y.S.2d at 649 (citations omitted).

In Pennoyer v. Taxation Division Director[56] the New Jersey Tax Court held that the state could not tax undistributed income of a testamentary trust based primarily on the residence of the testator—there were no New Jersey trustees, beneficiaries, or assets.[57] The court held:[58]

> I conclude that the creation of the subject trust in New Jersey in 1970, the probate proceeding in a New Jersey court and the jurisdiction and availability of the New Jersey courts are not sufficient contacts with the State of New Jersey to support taxation of the 1979–1980 undistributed income of the trust, and therefore, N.J.S.A. 54A:1-2(o)(2) may not constitutionally be applied in the subject case.

6. Potter v. Taxation Division Director (1983)—No Income Taxation of Nonresident Inter Vivos Trust Funded During Life and By Pourover Based Solely on Residence of Trustor

In Potter v. Taxation Division Director[59] the same court held that the state could not tax undistributed income of an inter vivos trust, which was funded in part during life and in part by a pourover under the decedent's Will, based primarily on the residence of the trustor. Again, the trust had no New Jersey trustees, beneficiaries, or assets.[60] The court held:[61]

> Any benefit to the trust from the laws of the State of New Jersey relative to the distribution of assets from the estate to the trust can be accounted for in terms of the inheritance tax paid to the State of New Jersey on the assets distributed and transferred to the trust. The facts of this case indicate that the irrevocable inter vivos trust has a situs in New York, not New Jersey. The fact that contingent beneficiaries reside in New Jersey does not alter this conclusion. These beneficiaries are taxable on trust income distributed to them or on undistributed income over which they have control. The state in

---

[56] Pennoyer v. Taxation Div. Dir., 5 N.J. Tax 386 (Tax Ct. 1983).

[57] Pennoyer, 5 N.J. Tax at 388.

[58] Pennoyer, 5 N.J. Tax at 399.

[59] Potter v. Taxation Div. Dir., 5 N.J. Tax 399 (Tax Ct. 1983).

[60] Potter, 5 N.J. Tax at 401.

[61] Potter, 5 N.J. Tax at 405 (citation omitted).

> which a beneficiary is domiciled may tax trust income distributed to the beneficiary. The fact that contingent beneficiaries are domiciled in New Jersey does not constitute a contact sufficient to empower New Jersey to tax undistributed trust income where the contingent beneficiaries have no right to the undistributed trust income.

7. In re Swift (1987)—No Income Taxation of Nonresident Trust Created By Deceased Domiciliary Permitted

In In re Swift,[62] the Missouri Supreme Court held that a Missouri decedent's testamentary trusts, which had nonresident trustees, nonresident beneficiaries, and out-of-state property, received no benefit or protection of Missouri law, and, thus, the state could not tax the trust's income under the state and federal due process clauses. The court observed:[63]

> An income tax is justified only when contemporary benefits and protections are provided the subject property or entity during the relevant taxing period. In determining whether this state has a sufficient nexus to support the imposition of an income tax on trust income, we consider six points of contact: (1) the domicile of the settlor, (2) the state in which the trust is created, (3) the location of trust property, (4) the domicile of the beneficiaries, (5) the domicile of the trustees, and (6) the location of the administration of the trust. For purposes of supporting an income tax, the first two of these factors require the ongoing protection or benefit of state law only to the extent that one or more of the other four factors is present.

In this case, the court added, Missouri provided "no present benefit or protection to the subject trusts, their beneficiaries, trustees, or property." [64]

8. Blue v. Department of Treasury (1990)—No Income Taxation of Nonresident Trust Based Solely on Domicile of Trustor

In Blue v. Department of Treasury,[65] the Michigan Court of Appeals held

[62] In re Swift, 727 S.W.2d 880 (Mo. 1987).

[63] In re Swift, 727 S.W.2d at 882.

[64] In re Swift,727 S.W.2d at 882.

[65] Blue v. Dep't of Treasury, 462 N.W.2d 762 (Mich. Ct. App. 1990).

that the Due Process Clause of the Fourteenth Amendment prohibited imposition of tax on income of a Resident Trust with no income producing property in the state and with the trustee and income beneficiary domiciled in Florida. The court said:[66]

> We hold that there are insufficient connections between the trust and the State of Michigan to justify the imposition of an income tax. We choose to follow the cases in Missouri and New York restricting the state's power to impose tax on resident trusts where neither the trustee nor the trust property are within the state. We conclude that there is no ongoing protection or benefit to the trust. All of the income-producing trust property is located in Florida while the only trust property in Michigan is nonincome-producing. Both the income beneficiary of the trust and the trustee are domiciled in Florida. Most importantly, the trust is administered and registered in Florida. . . .
>
> We conclude that MCL 206.18; MSA 7.577(118), in defining the present trust as a resident trust subject to Michigan income tax, violates the due process clause of the Fourteenth Amendment.

9. Westfall v. Director of Revenue (1991)—Swift Permits Income Taxation of Trust Based on Residence of Testator and In-State Source of Trust Income

In Westfall v. Director of Revenue, [67] the Missouri Supreme Court took a second look at the state rules for income taxation of Nonresident Trusts and reaffirmed its earlier holding in Swift that the state could not tax a portion of a trust's income that was derived from sources outside of the state. The court reviewed the six points of contact enumerated in Swift: (1) the domicile of the testator, (2) the state in which the trust is created, (3) the location of trust property, (4) the domicile of the beneficiaries, (5) the domicile of the trustees, and (6) the location of the administration of the trust. In Swift, the court had rejected state income taxation because the trust met only the first two requirements—the testator's domicile and the situs of the trust's creation. The situation in this case, however, was different. The court stated:[68]

---

[66] Blue, 462 N.W.2d at 764–65.

[67] Westfall v. Dir. of Revenue, 812 S.W.2d 513 (Mo. 1991).

[68] Westfall, 812 S.W.2d at 514 (citations and internal quotation marks omitted).

> The Rollins trust differs, however, from the trusts in Swift because the Rollins trust also satisfies point (3) of the test by its ownership of real estate in Columbia, Missouri. In addition, the trust instrument shows that under certain contingencies charities in Columbia will receive distributions; it specifies the Board of Trustees of the Columbia [Missouri] Public Library as a contingent beneficiary and the Boone County National Bank as a possible successor trustee. These considerations taken together with points (1), (2) and (3) provide a sufficient nexus to support the imposition of an income tax on trust income.

D. Quill Corporation v. North Dakota (1992)—Reducing Level of Contacts Required by Due Process Clause—But Leaving Commerce Clause Requirements Intact

1. The Case

In Quill Corporation v. North Dakota,[69] the United States Supreme Court considered the constitutionality of North Dakota's imposition of a use tax on an out-of-state mail-order business that had no outlets or sales representatives in the state under the Due Process Clause and the Commerce Clause.

Writing for the Court, Justice Stevens first looked at the application of the Due Process Clause and concluded that it did not bar enforcement of the state's use tax against Quill. He stated:[70]

> The Due Process Clause requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax, and that the income attributed to the State for tax purposes must be rationally related to values connected with the taxing State. . . . Building on the seminal case of International Shoe Co. v. Washington, we have framed the relevant inquiry as whether a defendant had minimum contacts with the jurisdiction such that the maintenance of the suit does not offend traditional notions of fair play and substantial justice.

Concluding that imposing the use tax on Quill would not violate the Due

[69] Quill Corp. v. North Dakota, 504 U.S. 298 (1992). See Fogel, supra note 1, at 186–89.

[70] Quill Corp, 504 U.S. at 306–07 (citations and internal quotation marks omitted).

Process Clause, Justice Stevens stated:[71]

> In this case, there is no question that Quill has purposefully directed its activities at North Dakota residents, that the magnitude of those contacts is more than sufficient for due process purposes, and that the use tax is related to the benefits Quill receives from access to the State.

He reached a different conclusion regarding the Commerce Clause, however, stating:[72]

> Article I, § 8, cl. 3, of the Constitution expressly authorizes Congress to regulate Commerce with foreign Nations, and among the several States. It says nothing about the protection of interstate commerce in the absence of any action by Congress. Nevertheless, as Justice Johnson suggested in his concurring opinion in Gibbons v. Ogden, the Commerce Clause is more than an affirmative grant of power; it has a negative sweep as well. The Clause, in Justice Stone's phrasing, by its own force prohibits certain state actions that interfere with interstate commerce.

Justice Stevens then focused on the four-part test for satisfying the Commerce Clause explained in Complete Auto Transit, Inc. v. Brady,[73] which requires that a valid tax must be (1) applied to an activity with a substantial nexus with the taxing state, (2) be fairly apportioned, (3) not discriminate against interstate commerce, and (4) be fairly related to the services provided by the state.[74]

He explained the difference between Due-Process-Clause and Commerce-Clause analysis as follows:[75]

> Despite the similarity in phrasing, the nexus requirements of the Due Process and Commerce Clauses are not identical. The two standards are animated by different constitutional concerns and

---

[71] Quill Corp, 504 U.S. at 308.

[72] Quill Corp, 504 U.S. at 309 (citation and internal quotation marks omitted).

[73] Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977).

[74] Quill Corp., 504 U.S. at 311.

[75] Quill Corp., 504 U.S. at 312–13 (footnotes, citations, and internal quotation marks omitted).

> policies.
>
> Due process centrally concerns the fundamental fairness of governmental activity. Thus, at the most general level, the due process nexus analysis requires that we ask whether an individual's connections with a State are substantial enough to legitimate the State's exercise of power over him. We have, therefore, often identified "notice" or "fair warning" as the analytic touchstone of due process nexus analysis. In contrast, the Commerce Clause and its nexus requirement are informed not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy. . . . It is in this light that we have interpreted the negative implication of the Commerce Clause. Accordingly, we have ruled that that Clause prohibits discrimination against interstate commerce. . . . [T]he "substantial nexus" requirement is not, like due process' "minimum contacts" requirement, a proxy for notice, but rather a means for limiting state burdens on interstate commerce. Accordingly, contrary to the State's suggestion, a corporation may have the "minimum contacts" with a taxing State as required by the Due Process Clause, and yet lack the "substantial nexus" with that State as required by the Commerce Clause.

The Court concluded by reaffirming prior decisions that a business must have a physical presence in a state to justify imposition of a use tax.[76]

2. Implications of the Case

With respect to the income taxation of trusts, Quill makes three important points. First, the Due Process Clause's "minimum contacts" test no longer requires physical presence in a state in order to permit state taxation. Second, multistate taxation is not a serious impediment to state imposition of a tax, as long as the state apportions the tax to the income with which it has contacts. Third, the Commerce Clause's "substantial nexus" test continues to require "physical presence" in a state in order for a state to tax a business engaging in interstate commerce. The significance of these points has not always been appreciated by courts after Quill.

[76] Quill Corp., 504 U.S. at 318–19.

E. Post-Quill State Court Cases

1. Introduction

In Quill's immediate aftermath, two courts upheld their state's power to tax trustees in questionable circumstances.

2. District of Columbia v. Chase Manhattan Bank (1997)—Taxation of Nonresident Trustee Based on Residence of Testator Passes Due-Process Test

a. The Case

In District of Columbia v. Chase Manhattan Bank,[77] the first relevant case decided after Quill, the District of Columbia Court of Appeals denied a $324,315 District of Columbia income-tax refund claimed by the trustee under the Will of a resident of the District. The court, citing the Due Process Clause of the Fifth Amendment, held that the District of Columbia could base its income taxation of a trust on the domicile of the testator. The court indicated that the only relevant contact was that the testator lived in the District at death, but, in fact, the trust had had frequent recourse to the courts of the District.[78]

The court summarized the facts and its conclusion as follows:[79]

> This case presents an issue of first impression in this court: can the District of Columbia, consistent with the Due Process Clause, tax the annual net income of a testamentary trust created by the will of an individual who died while domiciled in the District, when the trustee, trust assets, and trust beneficiaries are all presently located outside the District. We hold that the Due Process Clause does not prevent the District from imposing such a tax, given the continuing supervisory relationship which

---

[77] District of Columbia v. Chase Manhattan Bank, 689 A.2d 539 (D.C. 1997). The court noted that the considerations were the same under the Due Process Clauses of the Fifth and Fourteenth Amendments (689 A.2d at 541 n.6) and that the Commerce Clause did not apply because the District of Columbia is part of the federal government and therefore not subject to that limitation (689 A.2d at 542 n.7). See Fogel, supra note 1, at 191.

[78] See Chase Manhattan Bank, 689 A.2d at 540–41.

[79] Chase Manhattan Bank, 689 A.2d at 540.

> the District's courts have with respect to administration of such a trust, and in so doing we reject several decisions in other states holding that due process requires a greater connection between the trust and the taxing jurisdiction than the residence of the settlor.

The court noted that the Commerce Clause did not apply because the District of Columbia is part of the federal government and therefore not subject to that limitation.[80] This is significant because Quill retained a stricter standard for the Commerce Clause—actual physical presence in the state—than for the Due Process Clause and because that stricter standard applies to taxation by each of the 50 states.

The case dealt exclusively with the income taxation of a trust created by the Will of a District of Columbia decedent that had no trustees, beneficiaries, or assets in the District. Nevertheless, it sometimes is cited erroneously to support the taxation of an inter vivos trust in the same circumstances. But, the court was careful to note that it might not have upheld the District's right to tax an inter vivos trust as follows:[81]

> We express no opinion as to the constitutionality of taxing the entire net income of inter vivos trusts based solely on the fact that the settlor was domiciled in the District when she died and the trust therefore became irrevocable. In such cases, the nexus between the trust and the District is arguably more attenuated, since the trust was not created by probate of the decedent's will in the District's courts. An irrevocable inter vivos trust does not owe its existence to the laws and courts of the District in the same way that the testamentary trust at issue in the present case does, and thus it does not have the same permanent tie to the District. In some cases the District courts may not even have principal supervisory authority over such an inter vivos trust. The idea of fundamental fairness, which undergirds our

[80] Chase Manhattan Bank, 689 A.2d at 542 n.7.

[81] Chase Manhattan Bank, 689 A.2d at 547 n.11.

> due process analysis, therefore may or may not compel a different result in an inter vivos trust context.

It should be noted that, whereas, in Quill, North Dakota sought to tax only income attributable to North Dakota activity, in District of Columbia v. Chase Manhattan Bank, the District sought to tax all of the income of the trust.

b. Implications of the Case

District of Columbia v. Chase Manhattan Bank was decided in 1997. In January of the following year, Professor Fogel, of the University of Richmond Law School, wrote an article roundly criticizing the holding. He first acknowledged the difficulty of applying Quill, which dealt with a use tax, to state fiduciary income tax, stating:[82]

> The ramifications of the Quill commerce clause holding for state income taxation of a trust with little connection to the potentially taxing state are unclear. Quill was an attempt to retain a straight-forward "bright-line" test regarding the commerce clause limitations on a state's power to tax; however, the Quill Court expressly limited its holding to sales and use taxes. Moreover, even if a court were to apply the physical presence requirement of Quill to a state's income taxation of a trust with minimal connections to that state, it is difficult to see how such a physical presence requirement would be applied. As will be discussed infra, a trust is something of a hybrid between an entity and a mere relationship. Thus, it is difficult to determine where, if anywhere, a trust can be said to have a physical presence, although, clearly, the residence of the trustees, the beneficiaries, the settlor/testator or the location of trust assets are all possibilities.

Professor Fogel explained that two types of contacts might justify taxation under the Due Process Clause—(1) jurisdiction of the

[82] Fogel, supra note 1, at 190 (footnotes omitted).

state courts and periodic accountings, and (2) residence of the trustor/testator.[83] He dismissed the first category, stating:[84]

> The availability of the state courts and the periodic accountings that may be required are possible "minimum connections" between a trust and a state that may justify the imposition of the income tax. These possible connections, however, arise out of the initial event that is, by state statute, the basis for the imposition of the income tax; that is, the creation of the trust by a resident of the state. The residence of the settlor/testator at the time of the creation of the trust engenders three events, namely: (i) the classification of the trust as a Resident Trust (and the concomitant state income tax liabilities); (ii) the continuing jurisdiction of the state courts; and (iii) the periodic accountings that may be required. Evaluating the constitutionality of the tax based on the latter two events allows the state to constitutionally justify an income tax by the same "constitutionally suspect" classification that is the basis of the tax; namely, the residence of the settlor/testator at the time of the creation of the trust. Such analysis would allow the constitutionality of a tax imposed based on the residence of the settlor/testator at the time of creation of the trust to turn on connections that are imposed, by statute, based on the residence of the settlor/testator at the time of the creation of the trust. This analysis is circular in its reasoning.

He acknowledged the initial relevance of the second category but pointed out that it would "wear out" over time.[85] He concluded:[86]

> If one must draw a conclusion from the various conflicting decisions and factors, it

[83] Fogel, supra note 1, at 192–98.

[84] Fogel, supra note 1, at 195–96 (footnote omitted).

[85] Fogel, supra note 1, at 196–98.

[86] Fogel, supra note 1, at 225.

> seems that the more reasonable conclusion is that a state is constitutionally prohibited from imposing an income tax on the entire income of a trust based solely on the fact that the trust was created by a resident settlor/testator.

3. Chase Manhattan Bank v. Gavin (1999)—Taxation of Testamentary Trusts and Inter Vivos Trust Based on Residence of Testator/Trustor Passes Both Due-Process and Commerce-Clause Tests

a. The Case

In Chase Manhattan Bank v. Gavin,[87] the Supreme Court of Connecticut denied the trustees' request under both the Due Process Clause and the Commerce Clause for Connecticut income-tax refunds with respect to four testamentary trusts. The court summarized its analysis and conclusions as follows:[88]

> [T]he taxability of the income of the resident testamentary trusts in this case is based on the fact that the testators were Connecticut domiciliaries at the time of their deaths. . . . The plaintiff claims that this taxation scheme, as applied to it, violates the due process clause and the commerce clause of the federal constitution. We consider the plaintiff's contentions in turn. We conclude that none of them is persuasive.

The court also denied the trustees' request on constitutional grounds for Connecticut income-tax refunds in an inter vivos trust that had a current resident noncontigent beneficiary. The court held as follows:[89]

> The taxability of the income of the inter vivos trust in this case is based on the fact that the settlor of the trust was a Connecticut domiciliary when the trust was established and the beneficiary is a Connecticut domiciliary. The plaintiff claims that this taxation scheme, as applies to it, violates the

[87] Chase Manhattan Bank v. Gavin, 733 A.2d 782 (Conn. 1999).

[88] Gavin, 733 A.2d at 790.

[89] Gavin, 733 A.2d at 790.

> due process clause and the commerce clause of the federal constitution. We consider the plaintiff's contentions in turn. We conclude that none of them is persuasive.

b. Implications of the Case

In a 2006 article, Professor Blackburn of Cumberland School of Law, Samford University, described Gavin as a "misguided holding"[90] and opined that:[91]

> Gavin is a badly flawed ruling which, in most respects, has no precedent whatsoever. It was founded on state desperation for revenues and local politics, reflecting the tax adage "Don't tax you, don't tax me, tax the fella behind the tree." In Gavin, the "you" and the "me" are Connecticut resident settlors and beneficiaries, and the "fella behind the tree" is a nonresident trustee.

In 2002, Professor Jacob of Hofstra University School of Law observed of Gavin that:[92]

> There is really no justification to the Founder-State Trust model of taxation: the asserted contact of a potentially available forum in the local probate court is too tenuous to justify the significant result of full tax liability (subject to rules relating to trust distribution of income to beneficiaries). Invocation of this concept in the case of an inter vivos trust seems totally indefensible. And the claim that jurisdiction based on the settlor's death as a resident is a perpetual and unchanging commitment to that state is insupportable.

Professor Jacob concluded that:[93]

> Probate courts long functioned as sporadic

[90] Blackburn, supra note 1, at 4.

[91] Blackburn, supra note 1, at 53–54.

[92] Jacob, supra note 1, at 1239 (footnote omitted).

[93] Jacob, supra note 1, at 1240 (footnote omitted).

> traps for the unwary in the long, evasion marked history of the property taxation of intangible property. In any event, this relic deserves to be put at rest; and taxable events that are more attuned to the current status of trusts, from time to time should be selected and employed. The Founder-State Trust is inconsistent with the relations of states of the American Union and with the reality, and realistic expectations, of the citizens of each state.

Even though Gavin's constitutional analysis is wanting, however, it remains the law in Connecticut.

F. Recent State Court Cases

1. Introduction

There have been three recent taxpayer victories in the state income taxation of trusts. They might signal a pendulum swing away from judicial approval of states' power to tax.

2. Residuary Trust A U/W/O Kassner v. Director, Division of Taxation (2015)—Without Addressing Constitutional Issues, New Jersey Appellate Court Confirms Testamentary Trust with Trustee and Administration Outside New Jersey Not Taxable on all Income

a. The Case

New Jersey classifies a trust created by a resident testator or trustor as a Resident Trust.[94] In the 2015 case of Residuary Trust A U/W/O Kassner v. Director, Division of Taxation,[95] a New Jersey intermediate appellate court held that a trust that qualified as an Exempt Resident Trust was not taxable on interest income or income from business activity not attributable to New Jersey. About $200,000 of taxes, interest, and penalties was involved.

The trust was created by the Will of a New Jersey resident who died in 1998 and therefore was a Resident Trust for New Jersey tax

---

[94] NJSA § 54A:1-2(o)(2)–(3).

[95] Residuary Trust A U/W/O Kassner v. Dir. Div. of Taxation, 28 N.J. Tax 541 (Super. Ct. App. Div. 2015), aff'g, 27 N.J. Tax 68 (N.J. Tax Ct. 2013). See Open Weaver Banks, Amy Nogid & Leah Robinston, It's Hip to Be Square in New Jersey, 2015 State Tax Today 178-8 (Aug. 24, 2015); Richard W. Nenno, Taxpayer Victory in the New Jersey Kassner Case: More Than One Way to Skin A Cat and Save State Income Taxes on Trusts, LISI Est. Plan. Newsl. # 2331 (Aug. 11, 2015), www.leimbergservices.com.

purposes. But, for all of 2006—the tax year in question—the sole trustee resided in New York and administered the trust outside New Jersey. The trustee filed a return and paid New Jersey tax on S corporation income attributable to activity in New Jersey but not on interest income or on S corporation income allocated outside New Jersey. After an audit, the Director of the Division of Taxation contended that the trustee was taxable on all undistributed income because the trust held assets in New Jersey.

Unlike the Tax Court, the appellate court did not find it necessary to apply constitutional principles. Instead, it based its decision on New Jersey's square corners doctrine:[96]

> The square corners doctrine is particularly important in the field of taxation, because trusts, businesses, individuals and others must be able to reliably engage in tax planning and, to do so, they must know what the rules are. It is fundamentally unfair for the Division to announce in its official publication that, under a certain set of facts a trust's income will not be taxed, and then retroactively apply a different standard years later.

b. Implications of the Case

Residuary Trust A U/W/O Kassner shows that, in an appropriate case, a taxpayer may achieve victory without having to resort to constitutional arguments.

3. McNeil v. Commonwealth (2013)—Pennsylvania Commonwealth Court Holds that Nonresident Trustees of Trusts Created by Resident Trustor Not Taxable Under Commerce Clause Notwithstanding Resident Discretionary Beneficiaries

a. The Case

Like New Jersey, Pennsylvania classifies a trust created by a resident testator or trustor as a Resident Trust.[97] Nevertheless, in McNeil v. Commonwealth,[98] the Pennsylvania Commonwealth

[96] Kassner, 28 N.J. Tax at 548 (citations omitted).

[97] 72 P.S. § 7301(s).

[98] McNeil v. Commonw., 67 A.3d 185 (Pa. Commw. Ct. 2013). See Mark E. Wilensky, Trusts Prevail on Commerce Clause Challenge to Pennsylvania's Taxation of Trust Income, 54 Tax Mgmt. Memo. 491 (Dec. 30, 2013).

Court held that Pennsylvania's imposition of personal income tax on nonresident trustees of two trusts violated the Commerce Clause of the United States Constitution even though the trusts had a Pennsylvania trustor and Pennsylvania discretionary beneficiaries. The amounts at stake were $232,164 for one trust and $276,263 for the other trust.[99]

Concerning the United States Commerce Clause, the court summarized the governing principles from Complete Auto Transit, Inc. v. Brady[100] as follows:[101]

> Commerce Clause cases are governed by Complete Auto Transit, Inc. v. Brady, in which the U.S. Supreme Court established a four prong test to determine whether a state tax withstands constitutional scrutiny. Those four prongs are: (1) the taxpayer must have a substantial nexus to the taxing jurisdiction; (2) the tax must be fairly apportioned; (3) the tax being imposed upon the taxpayer must be fairly related to the benefits being conferred by the taxing jurisdiction; and (4) the tax may not discriminate against interstate commerce. To pass constitutional muster, all four prongs must be satisfied and the failure to meet any one of these requirements renders the tax unconstitutional. The Trusts contend that the imposition of the PIT here does not satisfy prongs (1), (2), and (3).

Regarding the first prong, the court observed that:[102]

> In Quill Corporation v. North Dakota, the U.S. Supreme Court articulated the standard for establishing the substantial nexus prong of the Complete Auto test—physical presence within the taxing state.

After considerable analysis, the court concluded:[103]

---

[99] McNeil, 67 A.3d at 190.

[100] Complete Auto Transit, Inc., 430 U.S. 274.

[101] McNeil, 67 A.3d at 192 (citations omitted).

[102] McNeil, 67 A.3d at 192 (citation omitted). For a summary of Quill, see III, D, above.

[103] McNeil, 67 A.3d at 195 (citations omitted).

> [W]e hold that neither Settlor's residency nor the residency of the beneficiaries provides the Trusts with the requisite presence in Pennsylvania to establish a substantial nexus and, therefore, the first prong of Complete Auto is not met and the imposition of the PIT here violates the Commerce Clause of the U.S. Constitution.

Regarding the second prong of the Complete Auto test, the court set out the following guiding principles:[104]

> To satisfy the fair apportionment prong of the Complete Auto test, a tax must be both internally and externally consistent. To be internally consistent, the tax must be structured so that, if every taxing jurisdiction were to apply the identical tax, the taxpayer would not be subject to double taxation. The external consistency test asks whether a state taxed only that portion of the revenues from the interstate activity which reasonably reflects the intrastate component of the activity being taxed. External consistency examines the economic justification for the taxing authority's claim upon the value being taxed to determine whether the jurisdiction is taxing economic activity that occurs in other jurisdictions and there must be a rational relationship between the income attributed to the state and the intrastate values of the business being taxed. Our Supreme Court has held that a taxpayer will successfully challenge a tax where the income attributed to the state is either: (1) out of all appropriate proportion to the business transacted by the taxpayer in the state; or (2) inherently arbitrary or produces an unreasonable result.

The court then reasoned:[105]

---

[104] McNeil, 67 A.3d at 195 (citations and internal quotation marks omitted).

[105] McNeil, 67 A.3d at 196–97 (citations and internal quotation marks omitted) (emphasis in original).

> [T]he imposition of the PIT on the Trusts' income, when all of that income was derived from sources outside of Pennsylvania, is inherently arbitrary and has no rational relationship to the Trusts' business activity that occurred in Pennsylvania. Accordingly, the imposition of the PIT here does not satisfy the fair apportionment prong of Complete Auto.

Regarding the third prong of the Complete Auto test, the court summarized the governing rules as follows:[106]

> Taxes are fairly related to the services a state provides where the taxpayer benefits directly or indirectly from the state's protections, opportunities, and services. These services include: access to the state's economic markets; the benefits and protections of the state's courts, laws and law enforcement; use of the state's roadways and bridges; and police and fire protection, the benefit of a trained work force, and the advantages of a civilized society.

The court concluded:[107]

> In 2007, the Trusts had no physical presence in Pennsylvania, none of their income was derived from Pennsylvania sources, none of their assets or interests were located in Pennsylvania, and they were established under and were governed by Delaware law. Hence, . . . the Trusts do not benefit from Pennsylvania's roadways, bridges, police, fire protection, economic markets, access to its trained workforce, courts, and laws. We recognize that the Trusts' discretionary beneficiaries almost certainly benefit from Pennsylvania's societal and legal framework because they reside in Pennsylvania; however, they are not the taxpayer in this

[106] McNeil, 67 A.3d at 197 (citations and internal quotation marks omitted). See Clark R. Calhoun, Alexandra Sampson & Kendall Houghton, No Taxation Without Nondiscrimination, 81 State Tax Notes 113 (July 11, 2016).

[107] McNeil, 67 A.3d at 197–98 (citations omitted).

> matter and, importantly, as discretionary beneficiaries, they have no present or future right to distributions from the Trusts. Moreover, pursuant to Sections 302 and 305 of the Tax Code the beneficiaries will pay PIT on any distributions they do receive from the Trusts, which are fairly related to the benefits they receive from residing in Pennsylvania. Similarly, Settlor, who was deceased in TY 2007, is not the taxpayer in this matter.
>
> Thus, the Department's imposition of the PIT on the Trusts' entire income is not reasonably related to the benefits Pennsylvania provides the Trusts. Therefore, the Commonwealth's imposition of the PIT here does not satisfy the fairly related prong of Complete Auto.

Having concluded that imposition of tax would violate the Commerce Clause,[108] the court did not have to decide whether it would violate the Due Process or the Equal Protection Clause of the United States Constitution or the Uniformity Clause of the Pennsylvania Constitution.[109]

b. Implications of the Case

McNeil v. Commonwealth is a very important decision. The Pennsylvania Department of Revenue takes a hard-nosed approach regarding situations in which a trust is not subject to personal income tax. Given that the tax rate is only 3.07%, few trusts have found it to be worthwhile to challenge the tax. This case should encourage more trusts to make the attempt. The Commonwealth did not appeal.

4. Linn v. Department of Revenue (2013)—Illinois Intermediate Appellate Court Holds that Nonresident Trustee of Trust Created by Resident Trustor Not Taxable Under Due Process Clause.

a. The Case

Like New Jersey and Pennsylvania, Illinois classifies a trust

---

[108] McNeil, 67 A.3d at 198.

[109] McNeil, 67 A.3d at 198 n.17.

created by a resident testator or trustor as a Resident Trust.[110] In Linn v. Department of Revenue,[111] however, the Appellate Court of Illinois held that Illinois's imposition of income tax on the nonresident trustee of a trust would violate the Due Process Clause of the United States Constitution even though the trust had an Illinois trustor.

In Linn, trustor A. N. Pritzker, an Illinois resident, created an irrevocable trust (the "Linda Trust") for his granddaughter, Linda Pritzker, in 1961 and named an Illinois resident individual as trustee.[112] The trust designated Illinois law to govern.[113] In 2002, the trustees of the Linda Trust exercised a decanting power given them in the trust instrument to transfer assets of the Linda Trust to a new trust (the Autonomy Trust 3) for Linda's exclusive benefit.[114] In 2006—the tax year in question—none of the beneficiaries of the Autonomy Trust 3 were Illinois residents, the trustee was a Texas resident and administration took place there, no trust assets were in Illinois, and the protector was a Connecticut resident.[115] In May of 2007, the trustee filed for a refund of the $2,729 of Illinois income tax that he had paid under protest after the Department of Revenue took the position that the Autonomy Trust 3 was an Illinois Resident Trust and therefore taxable on all its income.[116]

In considering the parties' opposing motions for summary judgment on whether imposition of tax would violate the United States Due Process Clause, the Appellate Court of Illinois summarized Quill,[117] distinguished Gavin,[118] and commented favorably on Blue and Mercantile.[119] As the result of its analysis, the court opined:[120]

> [W]e find the fact the Autonomy Trust 3's

---

[110] 35 Ill. Comp. Stat. 5/1501(a)(20)(C)–(D).

[111] Linn v. Dep't of Revenue, 2 N.E.3d 1203 (Ill. App. Ct. 2013).

[112] Linn, 2 N.E 3d at 1205.

[113] Linn, 2 N.E.3d at 1205.

[114] Linn, 2 N.E.3d at 1205.

[115] Linn, 2 N.E.3d at 1205.

[116] Linn, 2 N.E.3d at 1206.

[117] Linn, 2 N.E 3d at 1208.

[118] Linn, 2 N.E.3d at 1208–10.

[119] Linn, 2 N.E.3d at 1210.

[120] Linn, 2 N.E.3d at 1210.

> grantor was an Illinois resident is not a sufficient connection to satisfy due process.

After rejecting the Department of Revenue's contentions regarding the trust's continuing contacts with Illinois, the court concluded:[121]

> [W]e find insufficient contacts exist between Illinois and the Autonomy Trust 3 to satisfy the due process clause, and thus the income tax imposed on the Autonomy Trust 3 for the tax year 2006 was unconstitutional. Thus, summary judgment should have been granted in plaintiff's favor.

Having disposed of the case under the Due Process Clause, the court found it unnecessary to address Commerce Clause arguments.[122]

b. Implications of the Case

Linn is another taxpayer victory—this time under the Due Process Clause. The decision was not appealed.

G. Constitutional Analysis of Taxation Based on Residence of Testator/Trustor

A careful analysis of the constitutional limitations on the income taxation of trusts based solely on the domicile of the testator or trustor necessarily is impaired by the fact that the United States Supreme Court never has actually addressed the issue. Safe Deposit and Trust involved a personal property ad valorem tax and Quill considered state income taxation of corporate business income, yet these cases do appear to create a set of rules that must be followed in evaluating such state income-tax rules.

Under Quill, the Due Process Clause requires only minimum contacts between the taxing state and the trustee. Notwithstanding the views of the District of Columbia Court of Appeals and the Supreme Court of Connecticut, it seems questionable whether a relationship with the creator of the trust should ever suffice as a nexus with the trustee itself. A trust may be viewed as either an independent entity or a mere relationship, but even if the latter approach is used, it is a relationship between the trustee and the beneficiaries. The trustee owes no fiduciary duty to the testator or trustor. The trust cannot sue or be sued; only the trustee can do that.

[121] Linn, 2 N.E.3d at 1211.

[122] Linn, 2 N.E.3d at 1211.

Nonetheless, notwithstanding a 2015 decision to the contrary, given that two courts have held that the due process requirements are met by the domicile of the testator of a testamentary trust, practitioners should assume that testamentary trusts are likely to be valid subjects for income taxation by the state in which the testator was domiciled at his or her death.[123]

On the other hand, an inter vivos trust does not take advantage of the probate system for its creation, and, in most states, no state action is involved in the creation of an inter vivos trust, even if that trust is revocable during the trustor's lifetime. The analysis of the Connecticut Supreme Court in Gavin, which concluded that the state provided adequate contacts by virtue of affording the protection of its laws to the noncontingent income beneficiary who resided in that state, would not appear to extend taxability to a trust where the only contact was the domicile of the trustor at the time the trust was created.[124]

More significantly, the Commerce Clause should preclude state income taxation of a trust based solely on the domicile of the testator or trustor. The Connecticut Supreme Court was correct on one point—the Commerce Clause does apply to the income taxation of trusts. However, this issue appears to have been oddly argued in Gavin, and the analysis of that court is highly questionable.

The United States Supreme Court stated in Complete Auto Transit, Inc. v. Brady[125] that a valid tax must be: (1) applied to an activity with a substantial nexus with the taxing state, (2) be fairly apportioned, (3) not discriminate against interstate commerce, and (4) be fairly related to the services provided by the state. The Connecticut Supreme Court in Gavin did not really evaluate whether the contacts between the state and the trust were a "substantial nexus." The courts that had looked at the due process issue before Quill had also sought substantial contacts, and had uniformly held that the mere domicile of the trustor was an insufficient basis for state income taxation of the trust income. This same standard still exists, though, under the Commerce Clause. Even if a state attempts to apportion its tax fairly, it seems that it cannot meet the first of the four requirements of Complete Auto Transit, Inc., and that its tax effort must fail under the Commerce Clause. In my view, the Pennsylvania Commonwealth Court correctly applied the Commerce Clause in McNeil v. Commonwealth.

Two 2015 decisions of the United States Supreme Court have a bearing on Commerce-Clause analysis.

First, in his concurring opinion in Direct Marketing Association v. Brohl,[126]

---

[123] See Roxanne Bland, Taxing Trust Income and Due Process, 79 State Tax Notes 871 (Mar. 21, 2016).

[124] Accord Stanley R. Kaminski, Due Process Tax Nexus and the Expatriate Inter Vivos Trust, Est. Plan., Mar. 2012, at 34.

[125] Complete Auto Transit, Inc., 430 U.S. at 279.

[126] Direct Mktg. Ass'n v. Brohl, 135 S. Ct. 1124 (2015).

Justice Kennedy called for a reevaluation of Quill.[127] It should be noted, though, that no other justice joined in the opinion.

Second, in Comptroller of the Treasury v. Wynne,[128] the Court clarified Quill's reach. Previously, some commentators had contended that Quill was limited to the situation that it addressed—a gross receipts tax imposed on a corporation—and that it did not extend to other taxes. Writing for himself and four other justices, Justice Alito put many of these concerns to rest. He first wrote that:[129]

> The principal dissent distinguishes these cases on the sole ground that they involved a tax on gross receipts rather than net income. We see no reason why the distinction between gross receipts and net income should matter . . . .

He later opined that:[130]

> [I]t is hard to see why the dormant Commerce Clause should treat individuals less favorably than corporations.

A 2015 article summarizes Justice Alito's analysis succinctly:[131]

> Wynne also discards any distinction between taxes on gross receipts and taxes on net income for purposes of meeting the dormant Commerce Clause as well as any contention that the dormant Commerce Clause provides less protection to individuals than corporations.

In light of the above, it appears, therefore, that a state tax on the income of a trust the only contact with which is the domicile of the trustor, should fail under the Commerce Clause of the United States Constitution and possibly under the Due Process Clause of the Fourteenth Amendment, though the Due Process Clause may not preclude such taxation with respect to testamentary trusts.

H. Limitations on Personal Jurisdiction

[127] Direct Mktg. Ass'n., 135 S. Ct. at 1135.

[128] Comptroller of the Treasury v. Wynne, 135 S. Ct. 1787 (2015). See Note: Dormant Commerce Clause—Personal Income Taxation—Comptroller of the Treasury of Maryland v. Wynne, 129 Harv. L. Rev. 181 (Nov. 2015); Walter Hellerstein, Deciphering the Supreme Court's Opinion in Wynne, 123 J. Tax'n 4 (July 2015).

[129] Wynne, 135 S. Ct. at 1795.

[130] Wynne, 135 S. Ct. at 1797.

[131] Donald Williamson & Michelle Hobbs, The Constitution's Dormant Commerce Clause Limits the Power of States to Tax Their Residents, 56 Tax Mgmt. Memo. 513, 522 (Dec. 28, 2015).

1. Introduction

Recent United States Supreme Court precedent emphasizes the continuing limitations on personal jurisdiction. A 2013 federal district court opinion describes the limited nature of personal jurisdiction in the state-income-taxation-of-trusts context.

2. Walden v. Fiore (2014)—United States Supreme Court Confirms Limits of Personal Jurisdiction

a. The Case

In 2014, the United States Supreme Court revisited personal-jurisdiction issues in Walden v. Fiore.[132] Writing for a unanimous Court, Justice Thomas laid out the issue and the Court's conclusion at the beginning of his opinion:[133]

> This case asks us to decide whether a court in Nevada may exercise personal jurisdiction over a defendant on the basis that he knew his allegedly tortious conduct in Georgia would delay the return of funds to plaintiffs with connections to Nevada. Because the defendant had no other contacts with Nevada, and because a plaintiff's contacts with the forum State cannot be decisive in determining whether the defendant's due process rights are violated, we hold that the court in Nevada may not exercise personal jurisdiction under these circumstances.

At the end of the opinion, Justice Thomas stressed that the focus of due process analysis is the defendant's—not the plaintiff's—conduct. He wrote:[134]

> Well-established principles of personal jurisdiction are sufficient to decide this case.

[132] Walden v. Fiore, 134 S. Ct. 1115 (2014). See Clark R. Calhoun & Andrew W. Yates, More Adventures in Due Process, 2014 State Tax Today 101-9 (May 27, 2014); Jennifer Carr, News Analysis: U.S. Supreme Court Continues Trend in Cases With Nexus Implications, 2014 State Tax Today 41-2 (Mar. 3, 2014). Three other recent cases in which the United States Supreme Court recognized restrictions on the exercise of personal jurisdiction are: J. McIntyre Mach., Ltd. v. Nicastro, 564 U.S. 873 (2011); Goodyear Dunlop Tire Operations, S.A. v. Brown, 564 U.S. 915 (2011); Daimler AG v. Bauman, 134 S. Ct. 746 (2014).

[133] Walden, 134 S. Ct. at 1119 (citation and internal quotation marks omitted).

[134] Walden, 134 S. Ct. at 1126 (citation and internal quotation marks omitted).

> The proper focus of the minimum contacts inquiry in intentional-tort cases is the relationship among the defendant, the forum, and the litigation. And it is the defendant, not the plaintiff or third parties, who must create contacts with the forum State. In this case, the application of those principles is clear: Petitioner's relevant conduct occurred entirely in Georgia, and the mere fact that his conduct affected plaintiffs with connections to the forum State does not suffice to authorize jurisdiction.

b. Implications of the Case

Walden reminds us that personal jurisdiction is a function of the defendant's activities. A May 2014 article summarizes the status of personal jurisdiction:[135]

> The U.S. Supreme Court has made clear in recent years that the procedural protections of the due process clause are alive and well. . . . [D]ue process continues to limit a state's ability to obtain jurisdiction over out-of-state taxpayers, indicating that taxpayers must purposefully establish contacts with a state before it can claim taxing jurisdiction.

3. Bernstein v. Stiller (2013)—Federal District Court Holds Filing of Tax Return For Resident Trust Alone Does Not Give Court Personal Jurisdiction Over Nonresident Trustee

a. The Case

Bernstein v. Stiller[136] was not a tax case. Rather, in it, trust beneficiaries sought accountings and removal of the trustees in a Pennsylvania court.[137]

Judge Surrick held:[138]

---

[135] Clark R. Calhoun & Andrew W. Yates, More Adventures in Due Process, 2014 State Tax Today 101-9 (May 27, 2014). For a recent analysis of personal jurisdiction in Delaware, see Herman v. BRP, Inc., 2015 WL 1399239 (Del. Super. Ct. Apr. 13, 2015).

[136] Bernstein v. Stiller, 2013 WL 3305219 (E.D. Pa. June 27, 2013).

[137] Bernstein, 2013 WL 3305219, at *1.

[138] Bernstein, 2013 WL 3305219 at *7.

The declared residency of the trust assets is insufficient to give the Court personal jurisdiction over Respondent Trustees.

b. Implications of the Case

A court will have personal jurisdiction over a foreign trustee in certain situations, such as when it appointed the trustee.[139] But, Walden and Bernstein demonstrate that nonresident trustees should not automatically concede that personal jurisdiction exists. A state and its taxing authorities simply might not have the power to compel a foreign trustee to file returns and/or to pay tax through its own court system.

I. Taxation of Trust Administered in State

1. Introduction

The United States Supreme Court never has addressed whether a state can tax a trustee on income of a trust administered in the state, but there is no doubt that a state can do so. Practitioners should be on the lookout for guidelines that states use in assessing "administration" for purposes of their tax system.

The following Wisconsin cases considered this issue.

2. In Wisconsin Department of Taxation v. Pabst,[140] the Supreme Court of Wisconsin held that Wisconsin could not tax a trust because the administration did not occur in the state. The court justified its conclusion as follows:[141]

> To administer the trusts involved would be to manage, direct, or superintend the affairs of these trusts. Weber [a Wisconsin resident] did not perform these functions. The policy decisions were made by the nonresident trustees. Weber implemented those policy determinations. The trustees decided whether to distribute the income, whether to seek investment advice, and whether ministerial duties should be delegated to someone other than themselves. Ministerial acts performed

[139] See Ohlheiser v. Shepherd, 228 N.E.2d 210, 215 (Ill. App. Ct. 1967).

[140] Wis. Dep't of Taxation v. Pabst, 112 N.W.2d 161 (Wis. 1961).

[141] Wis. Dep't of Taxation, 112 N.W.2d at 165.

> in Wisconsin included an annual audit made by a Milwaukee certified public accountant and the filing of federal tax returns in the Milwaukee office of the internal revenue department. The activities carried on in Wisconsin were only incidental to the duties of the trustees.

3. In Pabst v. Wisconsin Department of Taxation,[142] the same court held that Wisconsin could tax a different Pabst family trust because administration did occur in the state. At the outset, the court announced a change of approach regarding income taxation in Wisconsin:[143]

> The key word of the statute, insofar as this appeal is concerned, is 'administered.' In Wisconsin Department of Taxation v. Pabst, we had before us the application of this same statute to two other trusts created by the settlor Ida C. Pabst. The decision cited the definition of 'administer' in Webster's Third New International Dictionary which stressed the element of managing, directing, or superintending affairs.
>
> Nevertheless, upon further consideration we now conclude that the statutory word 'administered' as applied to an inter vivos trust of intangibles means simply conducting the business of the trust. The problem of determining whether such a trust is administered in Wisconsin may be made more difficult when the business of the trust is partly conducted in other states as well as in Wisconsin. In such a situation, a proper application of the statute would appear to require the conclusion that the trust is being administered in Wisconsin within the meaning of the statute if the major portion of the trust business is conducted in Wisconsin.

The court concluded:[144]

> In the instant case Wisconsin has extended the protection of its laws to the activities of Weber in carrying on the business of the trust at the office of Pabst Farms, Inc. Although no rent was paid by the

[142] Pabst v. Wis. Dep't of Taxation, 120 N.W.2d 77 (Wis. 1963).

[143] Pabst, 120 N.W.2d at 80 (citation omitted).

[144] Pabst, 120 N.W.2d at 85.

> trust for the use of such office, we deem this an entirely fortuitous circumstance. The only office that the trust had was maintained in Wisconsin and the major portion of the trust's business was transacted here during the period in question. We are satisfied there was a sufficient nexus with Wisconsin to permit it to impose the income taxes which it did, and we so hold.

J. Taxation of Resident Trustee

In Greenough v. Tax Assessor of Newport,[145] the United States Supreme Court held that Rhode Island could impose an ad valorem tax on a resident trustee of an otherwise Nonresident Trust without violating the Due Process Clause.

In McCulloch v. Franchise Tax Board,[146] the Supreme Court of California held that California could tax a beneficiary on accumulated income distributed to him from a Missouri trust because a cotrustee was a California resident. The court said:[147]

> We conclude that California could constitutionally tax plaintiff as the resident beneficiary upon the accumulated income when it was distributed to him. But plaintiff in the instant case was simultaneously beneficiary and a trustee. No possible doubt attaches to California's constitutional power to tax plaintiff as a trustee. His secondary role as a trustee reinforces the independent basis of taxing plaintiff as beneficiary.

K. Taxation of Trustee of Trust Having Resident Beneficiary

1. United States Supreme Court Cases

In Safe Deposit and Trust Company v. Virginia,[148] the United States Supreme Court held that a state cannot tax a nonresident trustee of a trust that had resident beneficiaries. But, in Guaranty Trust Company v. Virginia,[149] the Court confirmed that a state can tax resident beneficiaries on income that they received from a Nonresident Trust.

---

[145] Greenough, 331 U.S. 486. See III, B, 4, above.

[146] McCulloch, 390 P.2d 412. See III, C, 3, above.

[147] McCulloch, 390 P.2d at 421.

[148] Safe Deposit & Trust Co., 280 U.S. 83. See III, B, 2, above.

[149] Guaranty Trust Co., 305 U.S. 19. See III, B, 3, above.

2. State Court Cases

a. The following California and North Carolina cases considered this issue:

b. In McCulloch v. Franchise Tax Board,[150] the Supreme Court of California held that California could tax a California resident beneficiary on accumulated income distributed to him from a Missouri trust for the reason just quoted.[151]

c. In In the Matter of the Appeal of The First National Bank of Chicago,[152] the California State Board of Equalization ruled that California could tax six trusts being administered in Illinois because all beneficiaries were California residents. It said:[153]

> Appellant also urges that section 17742 (formerly 18102) is unconstitutional if it purports to tax the non-California income of a foreign trust which is administered by a nonresident trustee. This argument has been fully answered by the California Supreme Court in McCulloch v. Franchise Tax Board, wherein the court held that California could constitutionally tax a Missouri trust on income which was payable in the future to a beneficiary residing in this state, although such income was actually retained by the trust. The fact that the resident beneficiary was also one of the trust's three trustees was not relied upon by the court in holding that the residence of the beneficiary afforded a constitutionally sufficient connection to bring the trust's income within California's tax jurisdiction.

d. In In the Matter of the Appeal of C. Pardee Erdman,[154] the California State Board of Equalization, following McCulloch and

---

[150] McCulloch, 390 P.2d 412.

[151] McCulloch, 390 P.2d at 421.

[152] In the Matter of the Appeal of The First Nat'l Bank of Chi., 1964 WL 1459 (Cal. State Bd. Eq. June 23, 1964), www.boe.ca.gov/legal/pdf/64-sbe-054.pdf.

[153] First Nat'l Bank of Chi., 1964 WL 1459, at *3 (citation omitted).

[154] In the Matter of the Appeal of C. Pardee Erdman, 1970 WL 2442 (Cal. State Bd. Eq. Feb. 18, 1970), www.boe.ca.gov/legal/pdf/70-sbe-0007.pdf.

First National Bank of Chicago, ruled that California could require California resident remainder beneficiaries to pay California tax on accumulated income and capital gains that had not previously been paid by the trustee of two trusts being administered in Illinois.

e. In Kimberley Rice Kaestner 1992 Family Trust v. North Carolina Department of Revenue (2016),[155] the North Carolina Court of Appeals, considered whether North Carolina could tax the accumulated income of a trust having a nonresident trustee but resident discretionary beneficiaries under the state's statute taxing trusts for the benefit of North Carolina residents.[156] The trust was created by a New Yorker, was governed by New York law, and had only New York trustees.[157] In the tax years in question, the discretionary beneficiaries were a child of the trustor and her children, all North Carolina residents.[158] Over $1.3 million was at stake.[159] The court held that imposition of the tax in the circumstances would violate the Due Process Clause of the federal constitution and a provision of the North Carolina constitution:[160]

> [W]e hold that based on the facts of the instant case, the connection between North Carolina and the Trust was insufficient to satisfy the requirements of due process. Therefore, the Department's assessment of an income tax levied pursuant to the authority set out in General Statutes, section 105-160.2 was in violation of the Due Process Clause of the United States Constitution, and the Law of the Land Clause of the North Carolina Constitution. Accordingly, we affirm Judge McGuire's order granting summary judgment for the Trust and directing that the Department refund any and all taxes and penalties paid

---

[155] Kimberley Rice Kaestner 1992 Family Trust v. N.C. Dep't of Revenue, 789 S.E.2d 645 (N.C. Ct. App. 2016), aff'g, 2015 WL 1880607 (Super. Ct. N.C. Apr. 23, 2015). See Michael M. Giovannini & Matthew P. Hedstrom, The Fairly Related Prong: Back From the Dead or a Flash in the Pan?, 2015 State Tax Today 197-10 at 4–6 (Sept. 15, 2015); Richard W. Nenno, Taxpayer Victory in the North Carolina Kaestner Case: Presence of Resident Discretionary Beneficiaries Does Not Justify Income Taxation of Nonresident Trust, LISI Est. Plan. Newsl. #2339 (Sept. 1, 2015), www.leimbergservices.com.

[156] N.C. Gen. Stat. § 105-160.2.

[157] Kaestner, 789 S.E.2d at 646.

[158] Kaestner, 789 S.E.2d at 646.

[159] Kaestner, 789 S.E.2d at 646.

[160] Kaestner, 789 S.E.2d at 651.

by the Trust pursuant to section 105-160.2 with interest.

The North Carolina Department of Revenue is appealing the decision.

IV. SPECIFIC STATE CONSIDERATIONS

A. New York

1. Introduction

My discussion of particular states necessarily begins with New York. The Empire State has generated and continues to generate most of the pertinent caselaw and rulings. Moreover, those authorities are relevant in as many as 26 other states, including Maryland and Virginia, because they all tax trust income in a comparable manner. For 2011 (the latest year for which numbers are available), 43,310 resident estates and trusts paid approximately $218 million of New York income tax and 3,800 nonresident and part-year resident estates and trusts paid approximately $64 million of such tax.[161]

2. History

New York long has defined "Resident Trust" as a trust established by a New York resident testator or trustor. Following the Mercantile-Safe Deposit & Trust Company v. Murphy[162] and Taylor v. State Tax Commissioner[163] 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 trustees, assets, or source income),[164] 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[165] and

---

[161] N.Y. State Department of Taxation and Finance, Office of Tax Policy Analysis, Analysis of 2011 Personal Income Tax Returns, at 89 (May 2015), www.tax.ny.gov/research/stats/stat_pit/analysis_of_personal_income_tax_returns.htm (last visited Sept. 26, 2016).

[162] Mercantile-Safe Deposit & Trust Co., 242 N.Y.S.2d 26. See III, C, 2, above. See also 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, Est. Plan., Oct. 2015, at 12.

[163] Taylor, 445 N.Y.S.2d 648. See III, C, 4, above.

[164] 20 NYCRR § 105.23(c).

[165] In the Matter of Joseph Lee Rice III Family 1992 Trust, DTA No. 822892, 2010 N.Y. Tax Lexis 268 (Div. Tax

the Department of Taxation and Finance announced that trustees of such trusts did not have to file tax returns.[166] The Exempt Resident Trust exemption was codified in 2003, effective January 1, 1996.[167]

In 2010, Governor Paterson proposed to repeal the exemption for Exempt Resident Trusts,[168] but his proposal was not enacted. 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.[169]

The 2014–2015 New York budget bill[170] 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[171] and imposes reporting requirements on the trustees of such trusts.[172] Second, the bill classifies incomplete gift nongrantor trusts as grantor trusts for New York State and New York City income-tax purposes.[173]

3. Current Rules

a. New York State

(1) General

App. Nov. 4, 2010), www.dta.ny.gov; 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), www.dta.ny.gov; N.Y. TSB-A-11(4)I, 2011 WL 7113861 (N.Y. Dep't Tax. Fin. July 27, 2011), www.tax.ny.gov/pdf/advisory_opinions/income/a11_4i.pdf; N.Y. TSB-A-10(4)I, 2010 WL 2557532 (N.Y. Dep't Tax. Fin. June 8, 2010), www.tax.ny.gov/pdf/advisory_opinions/income/a10_4i.pdf; N.Y. TSB-A-04(7)I, 2004 N.Y. Tax Lexis 259 at 1 (Dep't Tax. Fin. Nov. 12, 2004), www.tax.ny.gov/pdf/advisory_opinions/income/a04_7i.pdf; N.Y. TSB-A-00(2)I, 2000 WL 567678 (N.Y. Dep't Tax. Fin. Mar. 29, 2000), www.tax.ny.gov/pdf/advisory_opinions/income/a00_2i.pdf; N.Y. TSB-A-96(4)I, 1996 WL 667910 (N.Y. Dep't Tax. Fin. Oct. 25, 1996), www.tax.ny.gov/pdf/advisory_opinions/income/a96_4i.pdf; N.Y. TSB-A-94(7)I, 1994 WL 275392 (N.Y. Dep't Tax. Fin. Apr. 8, 1994), www.tax.ny.gov/pdf/advisory_opinions/income/a94_7i.pdf.

166 N.Y. TSB-M-96(1)I (N.Y. Dep't Tax. Fin. July 29, 1996), www.tax.ny.gov/pdf/memos/income/m96_1i.pdf.

167 N.Y. Tax Law § 605(b)(3)(D)(i).

168 2009 N.Y. S.B. 6610, Pt. G.

169 N.Y. TSB-A-11(4)I, 2011 WL 7113861 (N.Y. Dep't Tax. Fin. July 27, 2011), www.tax.ny.gov/pdf/advisory_opinions/income/a11_4i.pdf; N.Y. TSB-M-10(5)I, 2010 State Tax Today 145-10 (N.Y. Dep't Tax. Fin. July 23, 2010), www.tax.ny.gov/pdf/memos/income/m10_5i.pdf.

170 2014 N.Y. Laws 59, Pt. I (Mar. 31, 2014). See N.Y. TSB-M-15(1)I, 2015 State Tax Today 31-32 (N.Y. Dep't Tax. Fin. Feb. 12, 2015), www.tax.ny.gov/pdf/memos/income/m15_1i.pdf.

171 2014 N.Y. Laws 59, Pt I, §§ 1, 6 (Mar. 31, 2014).

172 2014 N.Y. Laws 59, Pt I, § 4 (Mar. 31, 2014).

173 2014 N.Y. Laws 59, Pt. I, §§ 2, 7 (Mar. 31, 2014). See VIII, J, below.

In New York State, a trustee must file a return if it must file a federal return, had New York taxable income, or was subject to a separate tax on lump-sum distributions.[174]

New York State treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[175] and the Empire State permits trustees of nongrantor trusts to take a distribution deduction.[176] In 2015, New York State taxed the New York taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 8.82% on such income over $1,062,650,[177] and the current rate schedule applies through 2017.[178]

New York State defines "Resident Trust" as a trust that is created by a New York State testator or trustor as follows:[179]

> (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 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

---

[174] Instructions to 2015 N.Y. Form IT-205 at 2. See N.Y. Tax Law § 651(a)(2), (e).

[175] See N.Y. Tax Law §§ 611(a), 612(a); instructions to 2015 N.Y. Form IT-205 at 6.

[176] See N.Y. Tax Law § 618; 20 NYCRR § 118.1; instructions to 2015 N.Y. Form IT-205 at 6.

[177] N.Y. Tax Law § 601(c)(1)(A); instructions to 2015 N.Y. Form IT-205 at 10.

[178] N.Y. Tax Law § 601(c)(1)(A).

[179] N.Y. Tax Law § 605(b)(3)(B)–(C). See 20 NYCRR § 105.23(a)–(b).

> 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.[180]

The statute describes when a trust is deemed to be "revocable" or "irrevocable":[181]

> 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."[182]

New York State taxes all New York taxable income of Resident Trusts[183] but only New York source income of Nonresident Trusts.[184] In New York State, trustees must make estimated tax payments for trusts.[185]

(2) Exempt Resident Trust Exemption

---

[180] See N.Y. Tax Law § 605(b)(1)(B).

[181] N.Y. Tax Law § 605(b)(3), flush language at end. See 20 NYCRR § 105.23(a); instructions to 2015 N.Y. Form IT-205 at 2.

[182] N.Y. Tax Law § 605(b)(4).

[183] N.Y. Tax Law § 618. See 20 NYCRR § 118.1.

[184] N.Y. Tax Law §§ 631, 633; instructions to 2015 N.Y. Form IT-205 at 2. See N.Y. Tax Bull. TB-IT-615, 2011 State Tax Today 244-15 (Dec. 15, 2011), www.tax.ny.gov/pdf/tg_bulletins/pit/b11_615i.pdf.

[185] N.Y. Tax Law § 685(c)(6); instructions to 2015 N.Y. Form IT-205 at 4.

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 there are no New York State trustees, assets, or source income as follows:[186]

> (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, the Technical Services Division of the State of New York Department of Taxation and Finance has issued guidance on how to determine the residence of a corporate trustee and the circumstances in which resident advisors, protectors, and committee members will be treated as resident trustees.[187]

Regarding (II) above, the New York tax law provides: [188]

> (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 are domiciled in the state of New York.

---

[186] N.Y. Tax Law § 605(b)(3)(D)(i). See 20 NYCRR § 105.23(c); instructions to 2015 N.Y. Form IT-205 at 2.

[187] N.Y. TSB-A-04(7)I, 2004 N.Y. Tax Lexis 259 (Dep't Tax. Fin. Nov. 12, 2004), www.tax.ny.gov/pdf/advisory_opinions/income/a04_7i.pdf. See 4, d, below.

[188] N.Y. Tax Law § 605(b)(3)(D)(ii).

Thus, if a trust only has nonresident 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.[189]

Regarding (III) above, a single dollar of source income might prevent a trust from satisfying the Exempt Resident Trust exemption. 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.[190]

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.[191] 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:[192]

> [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

[189] See 5, below.

[190] See 5, below.

[191] See Kassner, 28 N.J. Tax at 548. See III, F, 2, above. Accord Hill v. Director, State Div. of Taxation, 2016 WL 3351959 (N.J. Sup. Ct. App. Div. June 2, 2016).

[192] N.Y. TSB-M-10(5)I, 2010 State Tax Today 145-10 (N.Y. Dep't Tax. Fin. July 23, 2010), www.tax.ny.gov/pdf/memos/income/m10_5i.pdf. See instructions to 2015 N.Y. Form IT-205 at 3.

a return . . .

> 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.[193]

> 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:[194]

> 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

[193] N.Y. TSB-A-11(4)I, 2011 WL 7113861, at *2 (N.Y. Dep't Tax. Fin. July 27, 2011), www.tax.ny.gov/pdf/advisory_opinions/income/a11_4i.pdf.

[194] N.Y. Tax Law § 658(f)(2), added by 2014 N.Y. Laws 59, Pt. I, § 4 (Mar. 31, 2014).

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:[195]

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

[195] N.Y. Tax Law § 612(b)(40), added by 2014 N.Y. Laws 59, Pt. I, § 1 (Mar. 31, 2014).

> 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.[196] The bill also imposes reporting requirements on trustees making accumulation distributions.[197]

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 IRC § 667(a).[198] Hence, the accumulation tax will 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.

(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:[199]

> In the case of a taxpayer who

[196] 2014 N.Y. Laws 59, Pt. I, § 9 (Mar. 31, 2014).

[197] N.Y. Tax Law § 658(f)(1), added by 2014 N.Y. Laws 59, Pt. I, § 4 (N.Y. Dep't Tax. Fin. Mar. 31, 2014).

[198] See N.Y. TSB-M-14(3)I, 2014 State Tax Today 96-38 (N.Y. Dep't Tax. Fin. May 16, 2014), www.tax.ny.gov/pdf/memos/income/m14_3i.pdf. 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.

[199] N.Y. Tax Law § 612(b)(41), added by 2014 N.Y. Laws 59, Pt. I, § 2 (Mar. 31, 2014).

> 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 are liquidated before June 1, 2014.[200] The validity of this provision is questionable unless or until Mercantile-Safe Deposit and Trust Company v. Murphy[201] is overruled.

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.[202]

New York City treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[203] and the City permits a distribution deduction.[204] In 2015, the City taxed the City taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 3.876% on such

[200] 2014 N.Y. Laws 59, Pt. I, § 9 (Mar. 31, 2014).

[201] Mercantile-Safe Deposit and Trust Company, 203 N.E.2d 490. See III, C, 2, above.

[202] N.Y. Tax Law § 1306(a), (e); instructions to 2015 N.Y. Form IT-205 at 14.

[203] N.Y. Tax Law § 1303; Admin. Code City of N.Y. §§ 11-1711, 11-1712.

[204] See N.Y. Tax Law § 1303.

income over $500,000,[205] and the current rate schedule is not scheduled to change until 2018,[206] except that, beginning in 2015, the bracket amount for the top bracket is increased by $994 pursuant to the 2015–2016 budget bill.[207]

Like New York State, New York City defines "Resident Trust" as a trust that is created by a New York City testator or trustor as follows:[208]

> (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.
>
> For the purposes of the foregoing, a trust or portion of a trust is revocable if it is subject to a power, exercisable

---

[205] N.Y. Tax Law §§ 1304(a)(3)(A), 1304-B(a)(1)(ii); Admin. Code City of N.Y. §§ 11-1701, 11-1704.1; instructions to 2015 N.Y. Form IT-205 at 15. See N.Y. TSB-M-10(7)I, 2010 State Tax Today 161-19 (N.Y. Dep't Tax. Fin. Aug. 17, 2010), www.tax.ny.gov/pdf/memos/income/m10_7i.pdf.

[206] N.Y. Tax Law § 1304(b)(3). See N.Y. TSB-M-15(2)I, 2015 State Tax Today 32-20 (N.Y. Dep't Tax. Fin. Feb. 13, 2015), www.tax.ny.gov/pdf/memos/income/m15_2i.pdf.

[207] N.Y. Finance Law § 54-f; N.Y. Tax Law § 1304(a), Admin. Code City of N.Y. § 11-1701(a), as amended by 2015 N.Y. Laws 59, Part B, §§ 1–3 (Apr. 13, 2015). See New York State Department of Taxation and Finance, Summary of Tax Provisions in SFY 2015–16 Budget, at 7 (Apr. 2015), www.tax.ny.gov/pdf/stats/sumprovisions/Summary_of_2015-16_Tax_Provisions.pdf.

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

> 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."[209]

New York City taxes all City taxable income of Resident Trusts; it does not tax Nonresident Trusts.[210] In New York City, trustees must make estimated tax payments for trusts.[211]

Also like New York State, New York City does not tax trustees of Exempt Resident Trusts but requires them to file informational returns:[212]

> (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

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

[210] N.Y. Tax Law § 1303; Admin. Code City of N.Y. § 11-1718.

[211] See N.Y. Tax Law § 1301(b).

[212] Admin. Code City of N.Y. § 11-1705(b)(3)(D).

> a trustee of the trust shall be deemed to continue to be a trustee domiciled outside the city of 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[213] and the incomplete gift nongrantor trust rules[214]described above to the taxation of New York City trusts and their beneficiaries.

c. New York State and City

If a trust was a Resident Trust for New York State and New York City purposes in 2015, then the trustee was subject to tax at rates up to 12.696% on taxable income over $1,062,650.[215]

d. CRTs

A charitable-remainder trust ("CRT") is exempt from federal income tax.[216] It therefore is exempt from New York State and City income tax under the following statute:[217]

> (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).

4. Cases and Rulings

a. Introduction

In addition to Mercantile and Taylor, New York courts and

---

[213] Admin. Code City of N.Y. § 11-1712(b)(36), added by 2014 N.Y. Laws 59, Pt. I, § 6 (Mar. 31, 2014).

[214] Admin. Code City of N.Y. § 11-1712(b)(37), added by 2014 N.Y. Laws 59, Pt. I, § 7 (Mar. 31, 2014).

[215] N.Y. Tax Law §§ 601(c)(1)(A), 1304(b)(3), 1304-B(a)(1)(ii).

[216] IRC § 664(c)(1).

[217] N.Y. Tax Law § 601(h). See instructions to 2015 N.Y. Form IT-205 at 3.

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.

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

This 2010 decision of the New York State Division of Tax Appeals illustrates the importance of paying attention to detail.[218] 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 resident, 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 residences. 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.[219] The amount of tax was not disclosed, but the trustee and/or the accountant might face liability for the tax erroneously paid for those years.

c. N.Y. TSB-A-04(7)I (2004)—Rules Set For Determining Residence 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:[220]

> 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

[218] Rice III Family 1992 Trust, 2010 N.Y. Tax Lexis 268.

[219] See N.Y. Tax Law § 697(d).

[220] N.Y. TSB-A-04(7)I, 2004 N.Y. Tax Lexis 259 at 1 (N.Y. Dep't Tax. Fin. Nov. 12, 2004), www.tax.ny.gov/pdf/advisory_opinions/income/a04_7i.pdf.

> 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:[221]

> [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.

Next, the two members of the committee who resided in New York proposed to resign. The ruling observed:[222]

> Since the Committee is an advisor having the controlling power over the Trustee . . . 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.

d. 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.[223] The ruling concluded that:[224]

---

[221] N.Y. TSB-A-04(7)I, 2004 N.Y. Tax Lexis 259 at 20.

[222] N.Y. TSB-A-04(7)I, 2004 N.Y. Tax Lexis 259 at 23 (citations omitted).

[223] N.Y. TSB-A-03(6)I, 2003 WL 22970581 (N.Y. Dep't Tax. Fin. Nov. 21, 2003), www.tax.ny.gov/pdf/advisory_opinions/income/a03_6i.pdf.

[224] N.Y. TSB-A-03(6)I, 2003 WL 22970581, at *5 (citation omitted).

> [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.

5. Source Income

a. Introduction

In New York, trustees of Nonresident Trusts are taxed on source income[225] and a single dollar of source income apparently will prevent a Resident Trust from meeting the Exempt Resident Trust exemption.[226] The New York State Department of Taxation and Finance has announced what constitutes and doesn't constitute source income.[227]

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 or real property might consider transferring the property into an FLP or LLC 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

[225] N.Y. Tax Law §§ 633, 631.

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

[227] N.Y. Tax Bull. TB-IT-615, 2011 State Tax Today 244-15 (N.Y. Dep't Tax. Fin. Dec. 15, 2011), www.tax.ny.gov/pdf/tg_bulletins/pit/b11_615i.pdf.

New York real property as source income.[228] 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 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.[229] 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.[230] 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 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.[231] The New York State Department of Taxation and Finance has issued a Technical Services Bulletin that illustrates the operation of the provision and describes its application to trusts at the end.[232]

6. Planning

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[233] and because tax rates might go down in the future, beneficiaries might leave New York, and distributions might go to non-New York beneficiaries. The potential tax saving for a New York State and City Resident Trust that incurred a $1 million long-term capital gain in 2015 was at least $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. Residents of other states should

---

[228] N.Y. Tax Law § 631(b)(1)(A)(1).

[229] N.Y. Tax Law § 631(b)(1)(A)(1).

[230] N.Y. Tax Law § 631(b)(1)(A)(1).

[231] N.Y. Tax Law § 631(b)(1)(A)(1).

[232] TSB-M-09(5)I, 2009 State Tax Today 91-26 (N.Y. Dep't Tax. Fin. May 5, 2009), www.tax.ny.gov/pdf/memos/income/m09_5i.pdf.

[233] See 3, (a), (3), above. Neither the 2015–2016, New York budget bill, 2015 N.Y. Laws 59 (Apr. 13, 2015), nor the 2016–2017 New York budget bill, 2016 N.Y. Laws 60 (Apr. 13, 2016), made substantive changes in these provisions. See New York State Department of Taxation and Finance, Summary of Tax Provisions in SFY 2015-16 Budget at 7–9 (Apr. 2015), www.tax.ny.gov/pdf/stats/sumprovisions/Summary of 2015-16 Tax Provisions.pdf.

consider creating trusts in New York because the state does not tax trusts created by nonresidents.

B. Northeast (Other Than New York)

1. Delaware

In Delaware, a trustee must file a return if it must file a federal return except as provided below.[234]

Delaware treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[235] and the First State permits trustees of nongrantor trusts to take a distribution deduction.[236] In 2015, Delaware taxed the taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 6.60%, and the rate schedule is not scheduled to change.[237]

Delaware defines "Resident Trust" as a trust that is created by a Delaware resident testator or trustor or that has one or more Delaware resident individual or corporate trustees as follows:[238]

> "Resident trust" means a trust:
>
> a. Created by the will of a decedent who at death was domiciled in this State;
>
> b. Created by, or consisting of property of, a person domiciled in this State; or
>
> c. With respect to which the conditions of 1 of the following paragraphs are met during more than ½ of any taxable year:
>
> 1. The trust has only 1 trustee who or which is:
>
>   A. A resident individual of this State, or
>
>   B. A corporation, partnership or other

[234] 30 Del. C. § 1605(b)(1)(a); 2015 Del. Form 400-I at 1.

[235] 30 Del. C. § 1601(9). See 30 Del. C. § 1105.

[236] See 30 Del. C. § 1635(a).

[237] 30 Del. C. § 1102(a)(14); 2015 Del. Form 400 at 2.

[238] 30 Del. C. § 1601(8). See 2015 Del. Form 400-I at 2.

entity having an office for the conduct of trust business in this State;

2. The trust has more than 1 trustee, and 1 of such trustees is a corporation, partnership or other entity having an office for the conduct of trust business in this State; or

3. The trust has more than 1 trustee, all of whom are individuals and ½ or more of whom are resident individuals of this State.

Note that, for purposes of the third test, an individual is a Delaware resident if he or she is domiciled in the state or if he or she maintains a place of abode and spends more than 183 days in Delaware during the year.[239]

A "Nonresident Trust" is a trust that is not a "Resident Trust."[240]

Delaware taxes all taxable income of Resident Trusts[241] but only Delaware source taxable income of Nonresident Trusts.[242] In Delaware, trustees must make estimated tax payments for trusts.[243]

Importantly, Delaware allows Resident Trusts to deduct taxable income set aside for future distribution to nonresidents as follows:[244]

> A resident . . . trust shall be allowed a deduction against the taxable income otherwise computed under Chapter 11 of this title for any taxable year for the amount of its federal taxable income, as modified by § 1106 of this title which is, under the terms of the governing instrument, set aside for future distribution to nonresident beneficiaries.

In calculating comparable deductions, some states deem all unknown or unascertained beneficiaries to be residents,[245] but Delaware makes this

[239] 30 Del. C. § 1104 (emphasis added).

[240] 30 Del. C. § 1601(5); 2015 Del. Form 400-I at 2.

[241] 30 Del. C. §§ 1632, 1635(a), 1636.

[242] 30 Del. C. §§ 1632, 1639.

[243] 30 Del. C. §§ 1169(a), 1170; 2015 Del. Form 400-I at 1.

[244] 30 Del. C. § 1636(a).

[245] See, e.g., Mass. Gen. Laws ch. 62, § 10(a).

determination based on the residences of relevant existing beneficiaries on the last day of the tax year.[246] The combination of Delaware's small population (about 900,000 according to the 2010 census) and its favorable rule for determining the residences of future beneficiaries means that few trusts created by nonresidents pay Delaware income tax. If this deduction covers all taxable income, which often is the case, the trustee does not have to file a return.[247]

A CRT generally is exempt from federal income tax.[248] Consequently, it usually is exempt from Delaware income tax in accordance with the following statute which exempts:[249]

> An association, trust, or other unincorporated organization which by reason of its purpose or activities is exempt from tax on its income under the laws of the United States or this State.

No case or ruling addresses whether the trustee of a trust created by a Delaware testator or trustor that has minimal ties to Delaware still must pay tax, but, based on <u>Mercantile-Safe Deposit and Trust Company v. Murphy</u>[250] and other cases involving similar statutes of other jurisdictions, the trustee of a nongrantor trust created by a Delaware resident might take the position that the trust is not subject to Delaware income tax if it has no Delaware trustees, assets, or source income.[251] The potential tax saving for a Delaware Resident Trust on a $1 million long-term capital gain incurred in 2015 was at least $64,977. Residents of other states should consider establishing trusts in Delaware because it will not tax trusts without Delaware resident beneficiaries.

2. <u>Maryland</u>

In Maryland, a trustee must file a return if such trustee must file a federal return and if such trust has Maryland taxable income.[252]

Maryland treats a trust as a grantor trust if the trust is classified as a

[246] 30 Del. C. § 1636(b).

[247] 30 Del. C. § 1605(b)(1)(a).

[248] IRC § 664(c)(1).

[249] 30 Del. C. § 1633(2).

[250] <u>Mercantile-Safe Deposit & Trust Co.</u>, 203 N.E.2d 490. <u>See</u> III, C, 2, above.

[251] <u>See</u> Philip J. Michaels & Laura M. Twomey, <u>How, Why, and When to Transfer the Situs of a Trust</u>, Est. Plan., Jan. 2004, at 28, 30–31.

[252] Instructions to 2015 Md. Form 504 at 1. <u>See</u> Md. Code Ann., Tax-Gen. §§ 10-101(g), 10-901(a).

grantor trust for federal purposes,[253] and the Old Line State permits trustees of nongrantor trusts to take a distribution deduction.[254] In 2015, Maryland imposed a state income tax on the Maryland taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 5.75% on such income over $250,000.[255] In 2015, Maryland also imposed a county income tax on the Maryland taxable income of nongrantor trusts at rates between 1.25% and 3.20%, depending on the county.[256] Hence, a Maryland trust was taxed at rates up to 8.95%. The current state and county rate schedules are not scheduled to change.[257]

Maryland defines "Resident Trust" as a trust that is created by a Maryland testator or trustor or that is administered in Maryland as follows:[258]

> (1) "Resident" means: . . .
> (iii) a fiduciary . . . of a trust if:
> 1. the trust was created, or consists of property transferred, by the will of a decedent who was domiciled in the State on the date of the decedent's death;
> 2. the creator or grantor of the trust is a current resident of the State; or
> 3. the trust is principally administered in the State

Note that, for purposes of the second test, an individual is a Maryland resident if he or she is domiciled in Maryland or if he or she spends more than 6 months and maintains an abode in the state during the year.[259]

The term "principally administered" is not defined.

A "Nonresident Trust" is a trust that is not a "Resident Trust."[260]

Maryland taxes all Maryland taxable income of Resident Trusts[261] but only Maryland source taxable income of Nonresident Trusts.[262] In

---

[253] See Md. Code Ann., Tax-Gen. §§ 10-101(e)(2), 10-102, 10-201; instructions to 2015 Md. Form 504 at 2.

[254] See Md. Code Ann., Tax-Gen. § 10-101(e)(2).

[255] Md. Code Ann., Tax-Gen. § 10-105(a)(1); instructions to 2015 Md. Form 504 at 5.

[256] Md. Code Ann., Tax-Gen. §§ 10-101(d), 10-103, 10-106(a)(1)(iii); instructions to 2015 Md. Form 504 at 6.

[257] Md. Code Ann., Tax-Gen. §§ 10-101(d), 10-103, 10-105(a)(1), 10-106(a)(1)(iii).

[258] Md. Code Ann., Tax-Gen. § 10-101(k)(1)(iii). See instructions to 2015 Md. Form 504 at 1.

[259] Md. Code Ann., Tax-Gen. § 10-101(k)(1)(i).

[260] Md. Code Ann., Tax-Gen. § 10-101(j).

[261] Md. Code Ann., Tax-Gen. §§ 10-601, 10-604; instructions to 2015 Md. Form 504 at 1.

Maryland, trustees must make estimated tax payments for trusts.[263]

The state gives trustees the following deduction for intangible personal property held in trust for nonresidents:[264]

> (o) Intangible personal property held in trust for nonresident.--
>
> (1) In this subsection, "remaindermen" includes a person whose remainder interest is vested, contingent, or vested subject to divestment.
>
> (2) The subtraction under subsection (a) of this section includes:
>
> (i) income derived from intangible personal property that is held in trust for the benefit of a nonresident or a corporation not doing business in the State; and
>
> (ii) to the extent not included under item (i) of this paragraph, capital gain income derived from the sale or other disposition of intangible personal property that is held in trust, if the proceeds thereof are added to the principal of the trust, and if all the remaindermen in being are:
>
> 1. nonresidents during the entire taxable year; or
> 2. corporations not doing business in the State.
>
> (3) <u>The subtraction allowed under paragraph (2)(ii) of this subsection does not apply if there are no remaindermen of the trust in being</u>.

Given the underlined language, this deduction might not be available to the trustee of a long-term trust.

Maryland provides no specific guidance on the taxation and reporting of CRTs.

No case or ruling addresses whether the trustee of a trust created by a

---

[262] Md. Code Ann., Tax-Gen. §§ 10-105(d), 10-210; instructions to 2015 Md. Form 504 at 1.

[263] Md. Code Ann., Tax-Gen. § 10-902.

[264] Md. Code Ann., Tax-Gen. § 10-207(o) (emphasis added). <u>See</u> instructions to 2015 Md. Form 504 at 5.

Maryland testator or living trustor that has minimal ties to Maryland still must pay tax, but, based on Mercantile-Safe Deposit and Trust Company v. Murphy[265] and other cases involving similar statutes of other states, the trustee of a nongrantor trust created by a Maryland resident might take the position that the trust is not subject to Maryland income tax if it has no Maryland trustee, asset, or source income even if there are resident beneficiaries.[266] After a trustor's death, the trustee of an inter vivos trust might take the position that the trust is not taxable because the trustor is not "a current resident" of the state. The potential tax saving for a Baltimore County Resident Trust on a $1 million long-term capital gain incurred in 2015 was at least $87,868. Residents of other states should be cautious about creating trusts in Maryland because it taxes trusts administered in the state.

C. South

1. Florida

Florida (the Sunshine State) does not impose an income tax.

2. North Carolina

In North Carolina, a trustee must file a return if such trustee must file a federal return and if the trust has income from North Carolina sources or for North Carolina resident beneficiaries.[267]

North Carolina treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[268] and the Tar Heel State permits trustees of nongrantor trusts to take a distribution deduction.[269] In 2015, North Carolina taxed the North Carolina taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at 5.75%.[270] The 5.75% rate applies in 2016 as well and will decrease to 5.499% beginning in 2017.[271]

North Carolina does not define "Resident Trust" or "Nonresident Trust." It purports to tax trustees—resident and nonresident—on all income

[265] Mercantile-Safe Deposit and Trust Co.,203 N.E. 2d 490. See III, C. 2, above.

[266] See Michaels & Twomey, supra note 251, at 30–31.

[267] N.C. Admin. Code tit. 17, r. 6B.3716(b); instructions to 2015 N.C. Form D-407 at 1. See N.C. Gen. Stat. § 105-160.5.

[268] See N.C. Gen. Stat. § 105-134.5(a); instructions to 2015 N.C. Form D-407 at 1.

[269] See N.C. Gen. Stat. § 105-160.2; N.C. Admin. Code tit. 17, r. 6B.3716(a).

[270] N.C. Gen. Stat. § 105-153.7(a).

[271] N.C. Gen. Stat. § 105-153.7(a).

attributable to resident beneficiaries and on source income attributable to nonresident beneficiaries as follows:[272]

> The tax is computed on the amount of the taxable income of the . . . trust that is for the benefit of a resident of this State, or for the benefit of a nonresident to the extent that the income (i) is derived from North Carolina sources and is attributable to the ownership of any interest in real or tangible personal property in this State or (ii) is derived from a business, trade, profession, or occupation carried on in this State.

Note that an individual is a North Carolina resident if he or she is domiciled in the state and is presumed to be a resident if he or she spends more than 183 days there during the year.[273]

For the purposes of this paper, "Resident Trust" is a trust that has resident beneficiaries, and "Nonresident Trust" is a trust that has no such beneficiaries.[274] In North Carolina, trustees are not required to make estimated tax payments.[275]

North Carolina provides no specific guidance on the taxation and reporting of CRTs.

Based on the 2016 decision of the Court of Appeals of North Carolina, in Kimberley Rice Kaestner 1992 Family Trust v. North Carolina Department of Revenue,[276] North Carolina residents should consider creating trusts elsewhere if there are North Carolina resident beneficiaries because it might be unconstitutional for the state to impose the tax on a nonresident trustee. The potential tax saving for a North Carolina Rsident Trust on a $1 million long-term capital gain incurred in 2015 was at least $57,494. North Carolina residents and nonresidents might consider establishing trusts in North Carolina if there are no resident beneficiaries.

3. Virginia

In Virginia, a trustee of a Resident Trust must file a return if such trustee must file a federal return; a trustee of a Nonresident Trust must file a

[272] N.C. Gen. Stat. § 105-160.2.

[273] N.C. Gen. Stat. § 105-134.1(12).

[274] See N.C. Gen. Stat. § 105-160.2; N.C. Admin. Code tit. 17, r. 6B.3716(a).

[275] N.C. Admin. Code tit. 17, r. 6B.3718(b).

[276] Kaestner, 789 S.E.2d 645. See III, K, 2, e, above.

return if the trust has Virginia source income and if such trustee must file a federal return.[277]

Virginia treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[278] and the Old Dominion permits trustees of nongrantor trusts to take a distribution deduction.[279] In 2015, Virginia taxed the Virginia taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 5.75% on such income over $17,000,[280] and the current rate schedule is not scheduled to change.[281]

Virginia defines "Resident Trust" as follows:[282]

> 2. A trust created by will of a decedent who at his death was domiciled in the Commonwealth;
> 3. A trust created by or consisting of property of a person domiciled in the Commonwealth; or
> 4. A trust . . . which is being administered in the Commonwealth.

According to a regulation, a trust is administered in Virginia in the following circumstances:[283]

> A trust . . . is "being administered in Virginia" if, for example, its assets are located in Virginia, its fiduciary is a resident of Virginia, or it is under the supervision of a Virginia court.

---

[277] Instructions to 2015 Va. Form 770 at 1. See Va. Code Ann. § 58.1-381; 23 Va. Regs. § 10-115-110. See also Thomas W. Aldous, Taxation of Trust Income: What is a Resident Trust and How Does a Jurisdiction Decide it Should Be Taxed?, 79 Daily Tax Rpt. J-1 (Apr. 24, 2014).

[278] See Va. Code Ann. § 58.1-322(A). See also P.D. 15-230, 2015 WL 9459890 (Va. Dep't Tax. Dec. 11, 2015), www.tax.virginia.gov/law-rules-decisions/rulings-tax-commissioner/15-230 (grantor trust becomes complex trust when grantor relinquishes swap power in accordance with trust instrument).

[279] See Va. Code Ann. § 58.1-361.

[280] Va. Code Ann. §§ 58.1-320, 58.1-360; instructions to 2015 Va. Form 770 at 8.

[281] Va. Code Ann. § 58.1-320.

[282] Va. Code Ann. § 58.1-302. See 23 Va. Regs. § 10-115-10; instructions to 2015 Va. Form 770 at 1. See also P.D. 08-160, 2008 WL 4184911, at *1 (Va. Dep't Tax. Aug. 29, 2008), www.policylibrary.tax.virginia.gov/OTP/Policy.nsf ("the Trust does not meet any of the . . . criteria set out in Va. Code § 58.1-302"); P.D. 99-179 (Va. Dep't Tax. 1999), www.policylibrary.tax.virginia.gov/OTP/Policy.nsf ("The Taxpayer's estate/trust is a nonresident estate/trust"); P.D. 92-147, 1992 WL 238833, at *1 (Va. Dep't Tax. Aug. 19, 1992), www.policylibrary.tax.virginia.gov/OTP/Policy.nsf ("The trust does not possess any of the elements which would entitle Virginia to treat the Trust as a resident trust").

[283] 23 Va. Regs. § 10-115-10.

Note that an individual is a resident of Virginia if he or she is domiciled in the Commonwealth or if he or she spends more than 183 days and has a place of abode there during the year.[284]

A "Nonresident Trust" is a trust that is not a "Resident Trust."[285]

In P.D. 16-62,[286] the Virginia Department of Taxation considered whether a Virginia resident's exercise of a nongeneral power of appointment conferred on him by his nonresident father's trust created a Virginia resident trust. The agency ruled:

> [T]he Decedent created a new trust by exercising the power of appointment over his father's trust, even though the trust assets remained in his father's estate. This conclusion is further supported by the observation of the Supreme Court of Virginia that a power of appointment is not an estate but is an authority to create an estate or interest. Accordingly, the Department affirms its ruling in P.D. 15-12 that the Trust is a Virginia resident trust because it was created by the will of a decedent domiciled in Virginia at his death.

Virginia taxes all Virginia taxable income of Resident Trusts[287] but only Virginia source taxable income of Nonresident Trusts.[288] In Virginia, trustees must make estimated tax payments for trusts.[289]

As shown above, Virginia classifies a trust as a Resident Trust in the following three situations:

- If the trust was created by the Will of a Virginia testator
- If the trust was created or funded by a Virginia trustor

---

[284] Va. Code Ann. § 58.1-302

[285] Va. Code Ann. § 58.1-302; 23 Va. Regs. § 10-115-10; instructions to 2015 Va. Form 770 at 1.

[286] P.D. 16-62, 2016 WL 2940441 (Va. Dep't Tax. Apr. 20, 2016), www.tax.virginia.gov/laws-rules-decisions/rulings-tax-commissioner/16-62 (citation omitted).

[287] Va. Code Ann. §§ 58.1-360, 58.1-361; 23 Va. Regs. § 10-115-40(A). See P.D. 15-230, 2015 WL 9459890, at *1 (Va. Dep't Tax. Dec. 11, 2015), www.tax.virginia.gov/laws-rules-decisions/rulings-tax-commissioner/15-230 (Virginia "starts the computation of Virginia taxable income with federal adjusted gross income"). See also P.D. 15-202, 2015 WL 7149089 (Va. Dep't Tax. Oct. 19, 2015), www.tax.virginia.gov/laws-rules-decisions/search (appeal of assessment barred by statute of limitations).

[288] Va. Code Ann. §§ 58.1-302, 58.1-360, 58.1-362; 23 Va. Regs. § 10-115-10.

[289] Va. Code Ann. §§ 58.1-490(M), 58.1-491; 23 Va. Regs. §§ 10-115-140, 10-115-145, 10-115-150; instructions to 2015 Va. Form 770 at 2.

- If the trust is administered in Virginia.[290]

But, based on two early United States Supreme Court decisions—Safe Deposit and Trust Company v. Virginia[291] and Guaranty Trust Company v. Virginia[292] that involved Virginia law, the Virginia Department of Taxation developed an Exempt Resident Trust exemption.

Thus, the Virginia Department of Taxation provided guidance on when a Resident Trust will be treated as an Exempt Resident Trust under the first category in P.D. 99-110.[293] There, the Virginia Tax Commissioner ruled that a testamentary trust created by a Virginian but having minimal ties to the Commonwealth was not subject to Virginia tax as follows:

> [T]he trustee is domiciled in New York, the beneficiaries have been domiciled in North Carolina since 1992 and the trust property is not located in Virginia. Based on the interpretation contained in P.D. 93-189, the resident trust did not have nexus with Virginia and was not subject to fiduciary income tax in the 1994 through 1997 taxable years.

The Virginia Department of Taxation provided similar guidance for the second category in P.D. 93-189.[294] In that instance, the Commissioner ruled that an inter vivos trust created by a Virginian but having minimal ties to the Commonwealth was not subject to Virginia tax by stating:

> As long as the circumstances remain the same, and the only connection between the Commonwealth of Virginia and the Trust is that Virginia was the domicile of the grantor when the Trust was created, Virginia will not impose the tax. However, it is important to note that under Virginia law the Trust is a Virginia resident trust. As such, the

[290] Va. Code Ann. § 58.1-302.

[291] Safe Deposit & Trust Co. 280 U.S. 83. See III, B, 2, above.

[292] Guaranty Trust Co., 305 U.S. 19. See III, B, 3, above.

[293] P.D. 99-110, 1999 WL 760767 (Va. Dep't Tax. May 13, 1999), www.tax.virginia.gov/laws-rules-decisions/search. But see P.D. 97-147, 1997 WL 336789, at *2 (Va. Dep't Tax. Mar. 27, 1997), www.policylibrary.tax.virginia.gov/OTP/policy.nsf ("Since the beneficiary, who receives the benefit and protection of Virginia law, resides in the Commonwealth, there is sufficient nexus for the taxation of the trust income"); P.D. 91-177, 1991 WL 307533, at *1 (Va. Dep't Tax. Aug. 23, 1991), www.policylibrary.tax.virginia.gov/OTP/Policy.nsf ("the two trusts in question are subject to the Virginia fiduciary income tax as Virginia resident trusts").

[294] P.D. 93-189, 1993 WL 372991 (Va. Dep't Tax. Aug. 26, 1993), www.tax.virginia.gov/laws-rules-decisions/search. But see P.D. 99-168, 1999 WL 760773, at *2 (Va. Dep't Tax. June 22, 1999), www.policylibrary.tax.virginia.gov/OTP/Policy.nsf ("the exception provided by PD. 93-189 does not apply").

> examination of the relationship between the Trust and Virginia is continuous and ongoing. Should either a beneficiary, trustee, or the Trust property become domiciled or located in Virginia, sufficient nexus may then exist to permit taxation of the Trust by the Commonwealth.

The Virginia Department of Taxation has offered similar guidance for the third category five times:

- P.D. 02-101[295]—The Commissioner ruled that a trust created by a non-Virginia resident that had a non-Virginia corporate trustee would not be subject to Virginia tax if a Virginia resident was added to the five-member committee that directed the trustee on distributions and investments in the following circumstances:

  > Because the Trust has no other connection with Virginia, the relevant issue is whether the Trust would be considered to be administered in Virginia if a Virginia resident becomes a member of the Committee. Based on information provided, members of the committee cannot exercise control over the trust individually. Instead, the Committee makes decisions by a majority or consensus of the members. Accordingly, it is the Committee that administers the Trust and not individual members. As such, so long as the Committee does not operate in Virginia or is not controlled in Virginia, membership in the Committee by a Virginia resident or residents would not make the Trust a "resident trust" for Virginia income tax purposes.

- P.D. 07-164[296]—The Commissioner ruled that three trusts, which were created by a non-Virginia resident, would cease to be subject to Virginia income tax if the situs and administration were moved out of Virginia by stating:

[295] P.D. 02-101 (Va. Dep't Tax. June 24, 2002), www.tax.virginia.gov/laws-rules-decisions/search. But see P.D. 97-121, 1997 WL 335111 (Va. Dep't Tax. Mar. 7, 1997), www.tax.virginia.gov/laws-rules-decisions/search. ("[B]ecause the father, as a trustee and resident of Virginia, was responsible for the administration of the Beneficiaries' trusts, these trusts were considered to be resident trusts of Virginia."); P.D. 97-457, 1997 WL 822347, at *4 (Va. Dep't Tax. Nov. 18, 1997), www.policylibrary.tax.virginia.gov/OTP/Policy.nsf ("the reorganization [of the corporate trustee] will not affect the application of the Virginia . . . income tax to the trusts managed by the Bank and the Virginia Subsidiary").

[296] P.D. 07-164, 2007 WL 3233154 (Va. Dep't Tax. Oct. 7, 2007), www.tax.virginia.gov/laws-rules-decisions/search.

> As with the Committee members in P.D. 02-101 the trustees of Trust A, Trust B and Trust C cannot exercise control over the trust as individuals. Rather, the trustees make decisions by a majority or a consensus of the trustees; therefore, a committee of trustees is responsible for the administration of the trust not any individual trustee. Consequently, as long as the committee of trustees does not operate in Virginia and is not controlled in Virginia, the fact that a Virginia resident is a member of the committee does not make Trust B or Trust C a resident trust for Virginia income tax purposes.

- P.D. 13-18[297]—The Commissioner ruled that an irrevocable inter vivos trust created by a Florida resident having a Florida corporate trustee and a Virginia resident individual trustee was not subject to Virginia tax by stating:

> Co-Trustee 2 [the individual co-trustee] is a resident of Virginia, but he cannot make decisions regarding the Trust individually. Instead, any power or discretion that he has over the Trust may be exercised only if Co-Trustee 1 [the corporate co-trustee] agrees. Therefore, the Trust is not being administered in Virginia and is not a resident trust for Virginia income tax purposes. The Trust is not required to file a Virginia fiduciary income tax return.

- P.D. 14-49[298]—The Commissioner ruled that three GST trusts that had been created outside Virginia by grantors who never resided in Virginia, that had no property in Virginia, and that were being administered elsewhere by a corporate trustee would not become taxable by Virginia if a Virginia resident individual became a cotrustee who would be involved in distribution decisions. He ruled:

> According to the request, Co-Trustee 2 is a resident of Virginia who would not make

[297] P.D. 13-18, 2013 WL 2481146 (Va. Dep't Tax. Feb. 5, 2013), www.tax.virginia.gov/laws-rules-decisions/search.

[298] P.D. 14-49, 2014 WL 1496457 (Va. Dep't Tax. Apr. 2, 2014), www.tax.virginia.gov/laws-rules-decisions/search.

> decisions regarding the GSTs individually. Instead, his authority would be limited to participating in committee meetings in State A for the purpose of setting distribution amounts from the GSTs. Under these circumstances, the GSTs would not be administered in Virginia and would not be considered resident trusts for fiduciary income tax purposes. Accordingly, the GSTs would not be required to file Virginia fiduciary income tax returns.

- P.D. 15-156[299]—The Commissioner ruled that the residuary trust under the Will of a Pennsylvania decedent having three cotrustees, one of whom was a Virginia resident and remainder beneficiary, was not subject to Virginia tax by stating:

  > In this case, one trustee is a resident of Virginia, but he cannot make decisions regarding the Trust individually either by the terms of the Trust or under Pennsylvania law, which allows co-trustees to act by majority decision if a unanimous decision cannot be reached. Instead, any power or discretion he has over the Trust may be exercised only if at least one of the other co-trustees agrees, neither of whom are Virginia residents. Therefore, if the committee of co-trustees is not operating or controlled in Virginia, the fact that one trustee is a Virginia resident will not, by itself, cause the trust to be considered to be administered in Virginia. As indicated above, however, the Trust would be considered to be administered in Virginia if its assets are in Virginia or if it is under the supervision of a Virginia court.
  >
  > If the Trust is a nonresident trust, it would not be required to file a Virginia fiduciary income tax return unless it has Virginia taxable income. Virginia Code § 58.1-362 provides that the Virginia taxable income of a nonresident trust is its share of income, gain, loss and deduction attributable to Virginia

[299] P.D. 15-156, 2015 WL 5253741 (Va. Dep't Tax. Aug. 12, 2015), www.tax.virginia.gov/laws-rules-decisions/search (citations omitted).

sources with certain adjustments.

The instructions to the Virginia fiduciary income tax return give trustees of CRTs the following guidance:[300]

> **Charitable Remainder Trust:** The fiduciary of a Charitable Remainder Trust must file a Virginia Fiduciary Income Tax Return (Form 770) and enclose a copy of the federal Split-Interest Trust Information Return (Form 5227).
> **Special instructions**: Check the box for "Exempt-Charitable Remainder Trust" under the FEIN area. On Line 3, enter zero for the amount of Virginia taxable income. Enclose the federal Schedule K-1 and a worksheet reporting the Virginia income received by recipients.

Virginians and non-Virginians should plan their trusts with the above rulings in mind. Based on Mercantile-Safe Deposit and Trust Company v. Murphy[301] and other cases involving similar statutes of other states, the trustee of a nongrantor trust created by a Virginia resident might take the position that the trust is not subject to Virginia income tax if it has no Virginia trustee, asset, or source income even if it has resident beneficiaries.[302] Nonresidents should think carefully before creating trusts in the state because the trusts will be taxable if they are administered there. The potential tax saving for a Virginia Resident Trust on a $1 million long-term capital gain incurred in 2015 was at least $57,237.

D. California

In California, a trustee must file a return if the trust has gross income of more than $10,000, net income of more than $100, or alternative minimum tax liability.[303]

---

[300] Instructions to 2015 Va. Form 770 at 1. See P.D. 02-145, 2002 Va. Tax Lexis 145 (Dep't Tax. Nov. 20, 2002), www.tax.virginia.gov/laws-rules-decisions/search.

[301] Mercantile-Safe Deposit and Trust Co., 203 N.E.2d 490 N.Y. App. Div. 1963). See III, C, 2, above.

[302] See Michaels & Twomey, supra note 251, at 30–31.

[303] Instructions to 2015 Cal. Form 541 at 4. See Cal. Rev. & Tax Code § 18505(e)–(f). See also Matter of Merrill L. Mago Trust 14, 2014 WL 3414962, at *2 (Cal. St. Bd. Eq. Mar. 25, 2014) (trust did not establish reasonable cause for late filing of return); Cal. Franchise Tax Bd. Info. Ltr. 2015-02, 2015 Cal. FTB I.L. Lexis 2 (Franchise Tax Bd. Apr. 21, 2015), www.ftb.ca.gov/law/infoletter/2015/02_04212015.pdf (trust having California trustee but no California source income or noncontingent beneficiary has filing requirement for California nonsource income). See Kathleen K. Wright, The Wacky World of California Trusts, 80 State Tax Notes 433 (May 9, 2016); Matt Brown, David L. Keligian & Gregory E. Lambourne, California Income Tax Issues for Non-California Trusts—Part 2, 20 Cal. Tr. & Est. Q-2 at 15 (2014); Matt Brown, David L. Keligian & Gregory E. Lambourne, California Income Tax Issues for Non-California Trusts—Part I, 19 Cal. Tr. & Est. Q-4 at 24 (2014); Justin T. Miller & Richard S. Kinyon, When Should a Trust Be Subject to California Income Tax?, 2014 State Tax Today 98-6 (May 19, 2014); Gordon A. Schaller, Reduce State Tax With DINGs, NINGs, WINGs, and Other ThINGs, 41 Est. Plan 23, 23–24 (Apr. 2014);

California treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[304] and the Golden State permits trustees of nongrantor trusts to take a distribution deduction.[305] Thanks to Proposition 30,[306] which increased the top marginal rate to 12.30%, and the additional 1.0% Mental Health Services Tax,[307] California taxed the taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 13.30% on such income over $1 million in 2015,[308] and the top 13.30% rate applies through 2018.[309]

Under California's sui generis system, "Resident Trust" is defined using two criteria—the residences of the fiduciaries and the residences of the noncontingent beneficiaries—as follows:[310]

> Except as otherwise provided in this chapter, the income of . . . [a] trust is taxable to the . . . trust. The tax applies to the entire . . . taxable income of a trust, if the fiduciary or beneficiary (other than a beneficiary whose interest in such trust is contingent) is a resident, regardless of the residence of the settlor.

Note that an individual is a resident of California if he or she is in the state for other than a temporary or transitory purpose or if he or she is domiciled there.[311]

Regarding the fiduciary criterion, note that taxation is based on the residence of a fiduciary not of a trustee.[312] Rules are provided for determining whether an individual (presumably including an individual fiduciary) is a resident,[313] but the State Board of Equalization of the State of California has ruled that California

---

Matt Brown & Gregory E. Lambourne, California ING Trusts: A Cautionary Tale of Your Future State Law?, LISI Inc. Tax Plan. Newsl. # 63 (Mar. 11, 2014), www.leimbergservices.com; Richard S. Kinyon, Kim R. Marois & Sonja K. Johnson, California Income Taxation of Trusts and Estates, 39 ACTEC L.J. 69 (Spring/Fall 2013).

304 See Cal. Rev. & Tax. Code § 17731(a).

305 See Cal. Rev. & Tax. Code § 17731(a).

306 Cal. Const. Art. XIII, § 36(f)(2).

307 Cal. Rev. & Tax. Code § 17043(a); instructions to 2015 Cal. Form 541 at 10.

308 Cal. Const. Art XIII, § 36(f)(2); Cal. Rev. & Tax. Code §§ 17041(a)(1), (e), (h), 17043(a); instructions to 2015 Cal. Form 541 at 9.

309 Cal. Const. Art. XIII, § 36(f)(2); Cal. Rev. & Tax. Code § 17041(a)(1).

310 Cal. Rev. & Tax. Code § 17742(a). See Cal. Rev. & Tax. Code §§ 17743–17744.

311 Cal. Rev. & Tax Code § 17014(a).

312 See Cal. Rev. & Tax. Code § 17006.

313 Cal. Rev. & Tax. Code § 17014.

resident individual trustees who delegated their duties to nonresident corporate fiduciaries were not California resident fiduciaries.[314] The residence of a corporate fiduciary is determined as follows:[315]

> For purposes of this article the residence of a corporate fiduciary of a trust means the place where the corporation transacts the major portion of its administration of the trust.

A trust that has multiple trustees is taxed as follows:[316]

> Where the taxability of income under this chapter depends on the residence of the fiduciary and there are two or more fiduciaries for the trust, the income taxable under Section 17742 shall be apportioned according to the number of fiduciaries resident in this state pursuant to rules and regulations prescribed by the Franchise Tax Board.

Regarding the beneficiary criterion, even if a Californian is a beneficiary of a trust that has a non-California trustee, the trustee should be able to defer or eliminate California taxation of accumulated ordinary income and capital gains if distribution of such income and gains is within the trustee's discretion. In this connection, the California State Board of Equalization has ruled that a beneficiary who could receive distributions only on a corporate trustee's exercise of discretion was a contingent beneficiary.[317] Furthermore, in a 2006 Technical Advice Memorandum,[318] that agency ruled that:

(1) A resident beneficiary of a discretionary trust has a noncontingent interest in the trust only as of the time, and to the extent of the amount of income, that the trustee actually decides to distribute;

(2) Accumulated income is taxable to a trust when it is distributed or distributable to a resident beneficiary; and

(3) The conclusion in (1) above is unaffected if the trustee may or does distribute principal (capital gains) to the current beneficiary.[319]

---

[314] Yolanda King Family Trust, 2007 WL 3275357, at *1 (Cal. St. Bd. Eq. Oct. 4, 2007).

[315] Cal. Rev. & Tax. Code § 17742(b). See Ronald Family Trust, 2000 WL 1137423 (Cal. St. Bd. Eq. May 4, 2000).

[316] Cal. Rev. & Tax. Code § 17743. See Cal. Code Regs. tit. 18, § 17743.

[317] Yolanda King Family Trust, 2007 WL 3275357, at *1.

[318] Cal. Franchise Tax Bd. Technical Advice Memorandum 2006-0002, 2006 Cal. FTB TAM Lexis 14 (Franchise Tax Bd. Feb. 17, 2006), www.ftb.ca.gov/law/Technical_Advice_Memorandums/2006/20060002.pdf.

[319] Cal. Franchise Tax Bd. Technical Advice Memorandum 2006-0002.

Moreover, in a 2014 case, an Ohio intermediate appellate court refused to surcharge a trustee for failing to pay California income taxes for 1970 through 2006 because it concluded that:[320]

> In our view the trial court did not err in ruling that Mr. Lisle's interest in the Trust was contingent and did not create any California income tax liability under Cal Rev & Tax 17742(a). Mr. Lisle's interest in the trust was subject to a condition precedent either under the Trust's own terms or by imposition of an ascertainable standard by operation of R.C. 1340.22(B), now re-codified as R.C. 5808.14(B)(1) . . . .

A trust that has multiple beneficiaries is taxed as follows:[321]

> Where the taxability of income under this chapter depends on the residence of the beneficiary and there are two or more beneficiaries of the trust, the income taxable under Section 17742 shall be apportioned according to the number and interest of beneficiaries resident in this state pursuant to rules and regulations prescribed by the Franchise Tax Board.

Rules are provided for the taxation of California resident beneficiaries in pertinent part as follows:[322]

> (a) If, for any reason, the taxes imposed on income of a trust which is taxable to the trust because the fiduciary or beneficiary is a resident of this state are not paid when due and remain unpaid when that income is distributable to the beneficiary, or in case the income is distributable to the beneficiary before the taxes are due, if the taxes are not paid when due, such income shall be taxable to the beneficiary when distributable to him except that in the case of a

---

320 Newcomer v. Nat'l City Bank, 19 N.E.3d 492, 514–15 (Ohio Ct. App. 2014).

321 Cal. Rev. & Tax. Code § 17744. See Cal. Code Regs. tit. 18, § 17744.

322 Cal. Rev. & Tax. Code § 17745(a)–(e). See McCulloch, 390 P.2d 412; In the Matter of the Appeal of the First National Bank of Chicago, 1964 WL 1459 (Cal. St. Bd. Eq. June 23, 1964), www.boe.ca.gov/legal/pdf/64-sbe-054.pdf; In the Matter of the Appeal of C. Pardee Erdman, 1970 WL 2442 (Cal. St. Bd. Eq. Feb. 18, 1970), www.boe.ca.gov/legal/pdf/70-sbe-0007.pdf. See also III, K, 2, b–d, above.

nonresident beneficiary such income shall be taxable only to the extent it is derived from sources within this state.

(b) If no taxes have been paid on the current or accumulated income of the trust because the resident beneficiary's interest in the trust was contingent such income shall be taxable to the beneficiary when distributed or distributable to him or her.

(c) The tax on that income which is taxable to the beneficiary under subdivisions (a) or (b) is a tax on the receipt of that income distributed or on the constructive receipt of that distributable income. For purposes of this section income accumulated by a trust continues to be income even though the trust provides that the income (ordinary or capital) shall become a part of the corpus.

(d) The tax attributable to the inclusion of that income in the gross income of that beneficiary for the year that income is distributed or distributable under subdivision (b) shall be the aggregate of the taxes which would have been attributable to that income had it been included in the gross income of that beneficiary ratably for the year of distribution and the five preceding taxable years, or for the period that the trust accumulated or acquired income for that contingent beneficiary, whichever period is the shorter.

(e) In the event that a person is a resident beneficiary during the period of accumulation, and leaves this state within 12 months prior to the date of distribution of accumulated income and returns to the state within 12 months after distribution, it shall be presumed that the beneficiary continued to be a resident of this state throughout the time of distribution.

A "Nonresident Trust" is a trust that is not a "Resident Trust."[323]

[323] See Cal. Rev. & Tax. Code §§ 17015, 17742(a).

California taxes all taxable income of a trust if such trust has all resident fiduciaries or all resident noncontingent beneficiaries but taxes only California source taxable income attributable to nonresident fiduciaries or beneficiaries.[324] Computation of tax is quite complicated if a trust has resident and nonresident fiduciaries, resident and nonresident noncontingent beneficiaries, and source income.

In such a situation, California taxes all of the California source income of the trust, regardless of the residence of the trustees or beneficiaries. After that, the taxation of the non-California source income depends first on the residence of the trustees and then on the residences of the noncontingent beneficiaries. To illustrate, if a trust has non-California source income of $90,000, three trustees of whom only one is a California resident, and two noncontingent beneficiaries of whom one is a California resident, California taxes $60,000 of the non-California source income ($30,000 attributable to the one resident trustee and an additional $30,000 (one-half of the remaining $60,000 of the non-California source income) attributable to the one resident beneficiary).[325]

In California, trustees must make estimated tax payments for trusts.[326]

A CRT generally is exempt from California income tax in accordance with the following statute:[327]

> Section 664(c) of the Internal Revenue Code, relating to the taxation of trusts, shall not apply and, in lieu thereof, a charitable remainder annuity trust and a charitable remainder unitrust, shall, for any taxable year, not be subject to any tax imposed under this Part, unless that trust, for the taxable year, has unrelated business taxable income, within the meaning of Section 23732, determined as if Chapter 4 (commencing with Section 23701) of Part 11, applied to that trust.

The instructions to the California fiduciary income tax return require trustees of CRTs to file California Forms 541-B and 199.[328]

---

[324] Cal. Rev. & Tax. Code §§ 17041(a)(1), (b), (i)(1)(B), 17043(a), 17301, 17731(a), 17951(a); Cal. Code Regs. tit. 18, §§ 17743–17744. See instructions to 2015 Cal. Form 541 at 14.

[325] Cal. Franchise Tax Board Legal Ruling No. 238 (Oct. 27, 1959), www.ftb.ca.gov/law/rulings/active/1r238.shtml.

[326] See Cal. Rev. & Tax. Code § 19136.

[327] Cal. Rev. & Tax. Code § 17731(a).

[328] Instructions to 2015 Cal. Form 541 at 4.

A 2016 article advises:[329]

> Taxpayers should be wary of naming California fiduciaries if they are not prepared to pay the resulting state taxes. Beneficiaries need to be cognizant of when their contingent status vests and they become non-contingent beneficiaries (and taxable on their share of trust income).

The potential tax saving for the trustee of a California Resident Trust on a $1 million long-term capital gain incurred in 2015 was at least $109,422.

The California Franchise Tax Board may enter into voluntary disclosure agreements with certain fiduciaries and trust beneficiaries.[330]

V. PLANNING CONSIDERATIONS FOR NEW TRUSTS

A. Introduction

The state fiduciary income tax implications of a trust should be considered in the planning stage because it is much easier not to pay a tax in the first place than to obtain a refund.[331] In planning to eliminate one state's tax, the attorney must make sure that the trust will not be taxed in one or more other states.

B. Testamentary Trust Created by Resident

The most legally uncomplicated way for an individual to escape a tax based on the residence of the testator is to move to a state that does not tax according to that basis. One must assume, however, that many clients will not be willing to change their actual physical homes for this reason alone.

The foregoing discussion strongly suggests that taxation based on the testator's residence alone is unconstitutional. Nevertheless, a constitutional battle in the courts should be avoided at all costs because it will be expensive at best and unsuccessful and expensive at worst. With states scrambling for revenue, courts will be hard pressed not to sustain a state's tax system.

Accordingly, as a general rule, a client should not create testamentary trusts if he or she wants to minimize state income taxes. Instead, he or she should fund a

---

[329] Wright, supra note 303, at 437.

[330] Cal. Rev. & Tax. Code §§ 19191–19192.

[331] See Goldstein, 957 N.Y.S.2d at 436 (for years in question, interest on refund ran from date of filing of amended not original return).

revocable trust created and maintained in another state during his or her lifetime because courts are less likely to sustain a tax on the income of an inter vivos trust than on that of a testamentary trust.[332] The inter vivos trust might also escape the income tax that otherwise would be payable by the probate estate.

Of course, some clients will create testamentary trusts. In II, C, above, I listed 16 states that tax a trust solely because the testator lived in the state at death. The highest courts in two of these jurisdictions—the District of Columbia and Connecticut—have upheld the state's ability to tax a testamentary trust on this basis. But, as shown in a 2015 New Jersey case,[333] imposition of tax might be subject to attack in one of the other states.

In New York and New Jersey, the rules for eliminating tax are clear and should be followed strictly. In Idaho and Iowa, where the testator's residence is one of several factors that determine taxability, the attorney should arrange other factors to save tax. Delaware, Massachusetts, Missouri, and Rhode Island tax a testamentary trust that has at least one resident beneficiary, which, as covered in III, K, above, is a constitutionally suspect basis for taxation. If the applicable tax law does not apportion tax based on the number of resident and nonresident beneficiaries, the client might create multiple trusts to free the income attributable to assets held for nonresident beneficiaries from tax.

Because Alabama and Arkansas might tax a testamentary trust that has a resident fiduciary, tax easily can be eliminated by appointing a nonresident fiduciary. Utah tax usually can be eliminated by appointing a Utah corporate trustee.

The courts that sustained a state's right to tax a testamentary trust solely because of the testator's residence did so because of ongoing benefits available to the trust through that state's judicial system. As discussed in VII, below, their reliance on that factor is misplaced. In any event, in the District of Columbia, Connecticut, and other states, a trust might escape taxation if the Will designates the law of another state to govern the trust and gives the courts of that other state exclusive jurisdiction over the trust. The Will also might direct the trustee to initiate a proceeding to have the court of the other state accept jurisdiction.

A state that taxes on this basis is a good place for a resident of another state to create a trust.

C. Inter Vivos Trust Created by Resident

The easiest way for a trustor to eliminate taxation on this basis is to move to a state that does not impose an income tax or that taxes in another way. But, a trustor might not be willing and able to relocate for this purpose.

---

[332] See Blackburn, supra note 1, at 5–9; Fogel, supra note 1, at 210–13.

[333] Kassner, 28 N.J. Tax 541. See III, F, 2, above.

In II, D, above, I listed 12 states that tax a trust solely because the trustor lived in the state. No case has held that a state may tax solely on this basis. Although Chase Manhattan Bank v. Gavin[334] held that Connecticut income taxation was constitutional if a trust had a resident noncontingent beneficiary, Mercantile-Safe Deposit & Trust Company v. Murphy[335] held that New York could not tax a trust that had a resident current discretionary beneficiary and Blue v. Department of Treasury[336] held that Michigan could not tax a trust that held unproductive Michigan real estate. Moreover, in 2013, McNeil v. Commonwealth held that Pennsylvania could not tax resident inter vivos trusts that had resident discretionary beneficiaries[337] and Linn v. Department of Revenue held that Illinois could not tax a resident inter vivos trust that had no Illinois connections for the year in question.[338]

With proper planning, the attorney easily can eliminate taxation by New York and New Jersey in many situations. In Idaho and Iowa, the attorney often can arrange other factors to eliminate taxation. In Alabama, Connecticut, Delaware, Massachusetts, Michigan, Missouri, Ohio, and Rhode Island, the attorney should make sure that portions of trusts attributable to nonresident beneficiaries are not taxed needlessly. The attorney should avoid appointing resident fiduciaries in Alabama, Arkansas, and Massachusetts. In this connection, it is common practice for attorneys in Boston law firms to serve as trustees of trusts created by Massachusetts residents. In such a case, the attorney should discuss the appointment and its implications with the client because such an appointment often will cause the trust's accumulated income and capital gains to be subject to Massachusetts income tax (usually at 5.10%)[339] that could be eliminated by appointing a non-Massachusetts trustee.[340]

As with a testamentary trust, the attorney might increase a trust's ability to escape tax by designating in the trust instrument that the law of another state will govern the trust and that the courts of that state will have exclusive jurisdiction over it.

Many states tax if the trustor was a resident when a trust became irrevocable. To prevent unnecessary taxation, a trustor of such a trust who moves to a state that does not tax on this basis should consider establishing a new trust rather than making additions to the existing trust.

---

[334] Gavin, 733 A.2d 782. See III, E, 3, above.

[335] Mercantile-Safe Deposit & Trust Co., 203 N.E.2d 490. See III, C, 2, above.

[336] Blue, 462 N.W.2d 762. See III, C, 8, above.

[337] McNeil, 67 A.3d 185. See III, F, 3, above.

[338] Linn, 2 N.E.3d at 1211. See III, F, 4, above.

[339] Mass. Gen. Laws ch. 62, § 4; 2015 Mass. Form 2 at 2.

[340] Mass. Gen. Laws ch. 62, § 10(c).

D. Trust Administered in State

An attorney should think long and hard before having a client create a trust in one of the 14 states listed in II, E, above, that tax a trust solely because it is administered in the state. This is a factor that can be managed to eliminate taxation by Idaho and Iowa, which tax based on several factors. Taxation can be eliminated in Hawaii even if the trust has a resident beneficiary. Utah tax generally can be escaped by involving a Utah corporate trustee. In any event, the attorney should ensure that all administration occurs outside the state in question.

E. Resident Trustee

A trust can prevent taxation by the seven states listed in II, F, above, if it does not have a resident fiduciary. This factor may be managed to eliminate taxation by Idaho and Iowa. The attorney must be mindful of this factor if a trust has resident beneficiaries in Delaware and Hawaii.

F. Resident Beneficiary

The five states listed in II, G, above, tax a trust solely because it has resident beneficiaries, which, as noted in III, K, above, is a questionable basis for taxation. The attorney should ensure that income on assets attributable to nonresident beneficiaries won't be taxed unnecessarily. He or she also should make sure that tax on accumulated income and capital gains that might ultimately be distributed to nonresident beneficiaries won't be taxed prematurely.

VI. PLANNING CONSIDERATIONS FOR EXISTING TRUSTS

A. Introduction

With the assistance of counsel, every trustee should review the trusts that he, she, or it administers to identify all trusts that are paying state income tax to determine whether that tax can be reduced or eliminated. If tax has been paid erroneously, the trustee should request refunds for open years.[341] If the trustee discovers that tax can be escaped, the trustee should consider filing a "final" return in the year before the occurrence of a major transaction (e.g., the sale of a large block of low-basis stock). At the same time, the trustee and the advising attorney must make sure that steps taken to eliminate one state's tax won't subject the trust to tax elsewhere.

B. Testamentary Trust Created by Resident

If a state imposes its tax on a testamentary trust if the testator lived there at death, whether or not tax will continue to apply raises complex constitutional issues that

[341] See Goldstein , 957 N.Y.S 2d at 436 (for years in question, interest on refund ran from date of filing of amended not original return).

were discussed in III above. The constitutional issues involve the question of whether the state statute creating the basis on which the income tax is imposed violates various federal and state constitutional mandates, including the Commerce Clause and the Due Process Clause of the United States Constitution, and therefore can be safely ignored in the absence of any continuing nexus between the trust and the original state.

As discussed in IV above, some states recognize the constitutional limits on their ability to tax and therefore identify the Exempt Resident Trust. Thus, they offer clear guidance on how to prevent tax. To escape tax in these states or to improve prospects for eliminating tax in states where the rules are not as clear, the trustee might explore transferring the trust's situs to another state, which might be accomplished by a provision in the governing instrument or by a state statute or court proceeding. Wisconsin recognizes that a change of situs will end a testamentary trust's liability for tax.[342]

C. Inter Vivos Trust Created by Resident

To determine whether a state's income tax on an inter vivos trust created by a resident can be eliminated, the trustee and attorney should go through a process comparable to that described above.

D. Trust Administered in State

Here, it might be possible to escape tax simply by changing the place where the trust is administered, with or without court involvement.

E. Resident Trustee

In states that tax on this basis, it should be possible to escape tax simply by replacing the resident fiduciaries with nonresident fiduciaries.

F. Resident Beneficiary

Short of having the beneficiary move, it is difficult if not impossible to prevent a resident beneficiary from being taxed on current distributions. Nonetheless, the attorney and trustee should make sure that tax is not paid prematurely on accumulated income and capital gains.

G. Effecting the Move

1. Introduction

As discussed throughout this paper, the states tax the income of trusts

[342] See instructions to 2015 Wis. Form 2 at 1.

based on one or more of five criteria—(1) the residence of the testator, (2) the residence of the trustor, (3) the place of administration, (4) the residence of the trustee, and (5) the residence of the beneficiary. Only the testator, trustor, or beneficiary can change residence for criteria (1), (2), and (5). But, it is possible to control the place of administration (criterion (3)) and the residence of the trustee (criterion (4)).

Before doing anything else, the practitioner must examine the tax rules for the state in question to ensure that whatever steps are taken will further the objective of minimizing tax. This is because "administration" and "residence" might have very different meanings for tax and for other purposes. For example, some states provide guidance on when a trust is being administered within the state;[343] other states specify how to establish the residence of a corporate trustee.[344]

2. Changing Place of Administration

As described in II, E, above, 14 states tax trust income solely because the trust is administered in that state and four more states tax such income based on the place of administration and other factors. If needed, the transfer of a trust's situs or place of administration from one state to another might be accomplished through an express provision in the trust instrument, a pertinent statute, or a court petition. A corporate trustee might change the place of administration simply by transferring duties to an office in another state. When examining a governing instrument, the practitioner should look for a clause that allows the trustee, advisor, or protector to change the place of administration.

Many states have statutes that permit a trust's place of administration to be changed without court participation.

Hence, § 108(c) of the Uniform Trust Code ("UTC"),[345] a form of which is in effect in 32 states, authorizes a trustee to initiate a change in a trust's principal place of administration as follows:

> (c) Without precluding the right of the court to order, approve, or disapprove a transfer, the trustee, in furtherance of the duty prescribed by subsection (b), may transfer the trust's principal place of

[343] See VIII, D, below.

[344] See IV, A, 4, d, above.

[345] UTC § 108(c) (amended 2010). The text of the UTC may be viewed at www.uniformlaws.org/shared/docs/trust_code/UTC_Final_2016may24.pdf (last visited Sept. 26, 2016). A list of the states that have enacted the UTC is available at www.uniformlaws.org/LegislativeFactSheet.aspx?title=Trust Code (last visited Sept. 26, 2016).

administration to another State or to a jurisdiction outside of the United States.

Rules are provided for notice to beneficiaries,[346] objections by beneficiaries,[347] and transfers of assets to successor trustees.[348]

Also, UTC § 111, a version of which is in effect in 31 states, allows the "interested persons" to enter into a nonjudicial settlement agreement as follows:[349]

> (b) Except as otherwise provided in subsection (c), interested persons may enter into a binding nonjudicial settlement agreement with respect to any matter involving a trust.

The provision defines "interested persons,"[350] prohibits them from violating a material purpose of the trust and permits them to include only terms and conditions that could be approved by a court,[351] and authorizes an interested person to request court involvement.[352] The matters that may be resolved via nonjudicial settlement agreement include:[353]

> (5) Transfer of a trust's principal place of administration

The place of administration of a trust might also be changed under the nonjudicial settlement agreement statutes of at least nine additional states that have not enacted the UTC.[354]

In some situations, it will be possible to change the place of administration only with court involvement. In this connection, California has had a

---

346 UTC § 108(d) (amended 2010). In 2015, a Michigan intermediate appellate court held that a trustee's attempted transfer of situs from Florida to Michigan under Florida's version of § 108(c) was ineffective because the trustee did not comply with the statute's notice requirements even though language in the governing instrument arguably overrode them (In re Seneker Trust, 2015 WL 847129, at *2 (Mich. Ct. App. Feb. 26, 2015)).

347 UTC § 108(e) (amended 2010).

348 UTC § 108(f) (amended 2010).

349 UTC § 111(b) (amended 2010).

350 UTC § 111(a) (amended 2010).

351 UTC § 111(c) (amended 2010).

352 UTC § 111(e) (amended 2010).

353 UTC § 111(d)(5) (amended 2010).

354 Cal. Prob. Code § 15404(a); 12 Del. C. § 3338(d)(5); Idaho Code §§ 15-8-103(1)(c)(iii), 15-8-301–15-8-305; 760 ILCS 5/16.1(d)(4)(H); Iowa Code § 633A.2202; 2015 Nev. Stat. 524, §§ 61–62; N.Y. Est. Powers & Trusts Law § 7-1.9; S.D. Codified Laws § 55-3-24; Wash. Rev. Code § 11.98.051.

court procedure for transferring a trust to another jurisdiction since 1991.[355] At least two other states have statutes that address the same subject.[356]

To move a trust, the beneficiaries or the trustee customarily must file a petition (often accompanied by an accounting) in the local probate court. In many instances, it also is necessary to file a petition in a court in the new state seeking the court's approval of the transfer of situs and acceptance of jurisdiction over the trust prior to the proceeding in the local probate court. That way, the local court knows of the new court's acceptance of jurisdiction upon the local court's approval of transfer.

For trusts of movables created by Will, a comment under § 271 of the Second Restatement of Conflict of Laws provides that:[357]

> [A] testamentary trustee may be required by statute to qualify as trustee in the court of the testator's domicil having jurisdiction over the testator's estate, when the trust is to be administered in that state. The trustee is then accountable to that court. Thereafter, however, the question may arise whether the administration of the trust may be changed to another state. In such a case, in contrast to the usual situation that prevails in the case of an inter vivos trust, it is necessary to obtain the permission of the court for a change in the place of administration. Since the trustee is accountable to the court, it is necessary to obtain the permission of the court to terminate the accountability of the trustee to it.
>
> The court should permit a change in the place of administration and a termination of the trustee's accountability to it if this would be in accordance with the testator's intention, either express or implied. Such a change may be expressly authorized in the will. It may be authorized by implication, such as when the will contains a power to appoint a new trustee in another state, or simply a power to appoint a new trustee if this is construed to include the power to appoint a trustee in another state.

---

[355] Cal. Prob. Code §§ 17400–17405. See 7 Austin W. Scott, William F. Fratcher & Mark L. Ascher, Scott and Ascher on Trusts § 45.5.3.1 at 3301–02 n.28 (5th ed. 2007) (hereinafter "7 Scott and Ascher on Trusts").

[356] Nev. Rev. Stat. § 164.130; Wash. Rev. Code § 11.98.055.

[357] Restatement (Second) of Conflict of Laws § 271 cmt. g (1971) (cross reference omitted).

> The court may permit a change in the place of administration and a termination of the trustee's accountability to it even though such change was not expressly or impliedly authorized by the testator. The court may authorize such a change when this would be in the best interests of the beneficiaries, as, for example, when the beneficiaries have become domiciled in another state or when the trustee has become domiciled in another state.
>
> The court may refuse to permit a change in the place of administration and termination of the trustee's accountability to it, unless the trustee qualifies as trustee in a court of the state in which the trust is to be thereafter administered.

For trusts of movables created inter vivos, a comment under Restatement § 272 provides that:[358]

> When an inter vivos trust has become subject to the continuing jurisdiction of a court to which it is thereafter accountable, it becomes necessary to obtain the permission of that court to terminate such accountability. The question arises when the court is thereafter asked to appoint a successor trustee, or when the trustee acquires a place of business or domicil in another state, or when by the exercise of a power of appointment a trustee is appointed whose place of business or domicil is in another state. The same rules are applicable as are applicable in the case of a testamentary trustee.

Generally, courts will permit a trust to be moved if the trust instrument does not express a contrary intent, the administration of the trust will be facilitated, and the interests of the beneficiaries will be promoted.[359] Trustees and beneficiaries should not assume, though, that courts automatically will grant petitions to transfer situs. For example, courts have denied such petitions when the accomplishment of the stated objective—the elimination of New York fiduciary income tax—did not

---

[358] Restatement (Second) of Conflict of Laws § 272 cmt. e (1971).

[359] See Est. of Gladys Perkin, N.Y.L.J., June 9, 2010, at 33, col. 2 (Surr. Ct. N.Y. Cty. 2010); In re Estate of McComas, 630 N.Y.S.2d 895, 896 (Surr. Ct. N.Y. Cty. 1995); In re Second Intermediate Accounting of Henry Weinberger, 250 N.Y.S.2d 887 (App. Div. 1964); Application of New York Trust Co., 87 N.Y.S.2d 787, 794–95 (Sup. Ct. N.Y. Cty. 1949).

require the change.[360]

3. Changing a Resident Trustee to a Nonresident Trustee

If the governing instrument provides for the removal and replacement of the trustee without the necessity for court proceedings, the nomination of a trustee in another state might be sufficient in itself to escape the original state's income tax. Frequently, however, the governing instrument is silent on the issues of removal, resignation, and replacement. In such a case, the practitioner should next try to identify a way to change the trustee by nonjudicial means.

This might be accomplished under a state's version of UTC § 111, discussed above, because the matters that may be resolved under it include:[361]

> (4) The resignation or appointment of a trustee . . . .

A change of trustee also might be accomplished via the stand-alone nonjudicial settlement agreement statutes that are in effect in at least nine states.[362]

Otherwise, the beneficiaries must either obtain the trustee's agreement to resign or convince the local probate court to remove the trustee. Courts are beginning to include state income-tax minimization as a pertinent factor when considering petitions under the state's versions of UTC § 706[363] to replace trustees.[364] Many of the considerations in a court proceeding that were described in 2, above, will apply here as well.

H. Duty to Minimize Tax

Discomforting though it may be trustees have a duty to minimize state income taxes on trusts.

[360] See In re Bush, 774 N.Y.S.2d 298 (Surr. Ct. N.Y. Cty. 2003); In re Estate of Rockefeller, 773 N.Y.S.2d 529 (Surr. Ct. N.Y. Cty. 2003). See also In re Hudson's Trust, 286 N.Y.S.2d 327, 330 (App. Div. 1968), aff'd, 245 N.E.2d 405 (N.Y. 1969).

[361] UTC § 111(d)(4) (amended 2010).

[362] Cal. Prob. Code § 15404(a); 12 Del. C. § 3338(d)(4); Idaho Code § 15-8-103(1)(c)(iii); 760 ILCS 5/16.1(d)(4)(F); Iowa Code § 633A.2202; 2015 Nev. Stat. 524, §§ 61–62; N.Y. Est. Powers & Trusts Law § 7-1.9, S.D. Codified Laws § 55-3-24; Wash. Rev. Code § 11.98.051.

[363] UTC § 706 (amended 2010).

[364] See In re McKinney, 67 A.3d 825, 833 (Pa. Super. Ct. 2013) (factors include "location of trustee as it affects trust income tax"); Davis v. U.S. Bank Nat'l Ass'n, 243 S.W.3d 425, 430 (Mo. Ct. App. 2007) ("changing the domicile of the Trust to Delaware would avoid out of state income tax being paid on Trust income").

For example, under the duty to administer the trust in accordance with its terms and applicable law, § 76 of the Third Restatement of Trusts[365] offers the following comment:[366]

> A trustee's duty to administer a trust includes an initial and continuing duty to administer it at a location that is reasonably suitable to the purposes of the trust, its sound and efficient administration, and the interests of its beneficiaries.
>
> Under some circumstances the trustee may have a duty to change or to permit (e.g., by resignation) a change in the place of administration. Changes in the place of administration by a trustee, or even the relocation of beneficiaries or other developments, may result in costs or geographic inconvenience serious enough to justify removal of the trustee.

This is a statutory duty in over half the states. Thus, § 7-305 of the Uniform Probate Code ("UPC"),[367] which is in effect in at least four states,[368] provides as follows:

> A trustee is under a continuing duty to administer the trust at a place appropriate to the purposes of the trust and to its sound, efficient management. If the principal place of administration becomes inappropriate for any reason, the Court may enter any order furthering efficient administration and the interests of beneficiaries, including, if appropriate, release of registration, removal of the trustee and appointment of a trustee in another state. Trust provisions relating to the place of administration and to changes in the place of administration or of trustee control unless compliance would be contrary to efficient administration or the purposes of the trust. Views of adult beneficiaries shall be given weight in determining the suitability of the trustee and the place of administration.

Whereas the Supreme Court of Nebraska refused to replace a corporate trustee

---

[365] Restatement (Third) of Trusts § 76 (2003).

[366] Restatement (Third) of Trusts § 76 cmt. b(2) (2003) (cross references omitted).

[367] UPC § 7-305 (2008).

[368] <u>See, e.g.</u>, Alaska Stat. § 13.36.090; Colo. Rev. Stat. § 15-16-305; Haw. Rev. Stat. § 560:7-305; Idaho Code § 15-7-305.

pursuant to the Nebraska version of § 7-305 in a 1982 case,[369] the Supreme Court of Alaska replaced the corporate trustee and transferred the situs of the trust out of Alaska in a 2004 case,[370] and a Michigan intermediate appellate court replaced the corporate trustee and transferred the trust's situs from Michigan to Georgia in an unpublished 2008 case.[371]

Similarly, § 108(b) of the UTC,[372] a version of which is the law in 25 states, specifies that:

> (a) A trustee is under a continuing duty to administer the trust at a place appropriate to its purposes, its administration, and the interests of the beneficiaries.

Even in the seven states that have enacted § 108 without adopting subsection (b) in the above form, the provision might be helpful in replacing trustees and transferring trusts. For example, Pennsylvania practitioners have told me that they have used Pennsylvania's version of § 108[373] to transfer trusts to Delaware to save Pennsylvania income tax

I. Federal Transfer-Tax Consequences

Taking action (e.g., changing the trustee or place of administration) to eliminate state income tax should not cause a trust that is protected from the federal generation-skipping transfer tax because it was irrevocable on September 25, 1985, to lose that effective date protection.[374] The IRS has issued private letter rulings approving modifications of trusts to which GST exemption has been allocated if the changes would have been acceptable for effective-date-protected trusts.[375] Hence, trustees and attorneys may take steps to prevent state income tax in exempt trusts without adverse tax consequences.

VII. RELIANCE ON AVAILABILITY OF HOME STATE COURTS IS MISPLACED

A. Exercise of Jurisdiction

1. Introduction

---

[369] In re Zoellner Trust, 325 N.W.2d 138 (Neb. 1982).

[370] Marshall v. First Nat'l Bank Alaska, 97 P.3d 830 (Alaska 2004).

[371] In re Wege Trust, 2008 WL 2439904 (Mich. Ct. App. June 17, 2008).

[372] UTC § 108(b) (amended 2010).

[373] 20 Pa. C.S. § 7708.

[374] See Reg. § 26.2601-1(b)(4)(i)(D)(2).

[375] See, e.g., PLRs 201604001 (Aug. 1, 2015); 201525001 (Mar. 12, 2015); 201518002–005 (Nov. 21, 2014).

In sustaining the ability to tax, the courts in District of Columbia v. Chase Manhattan Bank[376] and Chase Manhattan Bank v. Gavin [377]made much of the protections afforded to trusts by the states' courts. This reliance was mistaken.

2. Restatement Approach

For trusts of intangible personal property (such as those involved in District of Columbia and Gavin)—whether created by Will or inter vivos, § 267 of the Second Restatement of Conflict of Laws provides that: [378]

> The administration of a trust of interests in movables is usually supervised . . . by the courts of the state in which the trust is to be administered.

A comment to § 267 indicates that the Will or trust instrument may designate the state of administration,[379] and a later comment describes the implications of such a designation as follows:[380]

> If the trust is to be administered in a particular state, that state has jurisdiction to determine through its courts not only the interests of the beneficiaries in the trust property but also the liabilities of the trustee to the beneficiaries, even though it does not have jurisdiction over the beneficiaries, or some of them . . . .
>
> So also a court of the state in which the trust is administered may give instructions as to the powers and duties of the trustee, although the beneficiaries or some of them are not subject to the jurisdiction of the court, provided they are given opportunity to appear and be heard.

Another comment discusses the role of the court of primary supervision as follows:[381]

---

[376] Chase Manhattan Bank, 689 A.2d 539. See III, E, 2, above.

[377] Gavin, 733 A.2d 782. See III, E, 3, above.

[378] Restatement (Second) of Conflict of Laws § 267 (1971). See 7 Scott and Ascher on Trusts, supra note 355, §§ 45.2.2.4.1, at 3102–14, 45.2.2.4.2 at 3114–22, 45.2.2.5 at 3122–25; Bogert, supra, note 1, § 292, at 22–33.

[379] Restatement (Second) of Conflict of Laws § 267 cmt. c (1971).

[380] Restatement (Second) of Conflict of Laws § 267 cmt. d (1971).

[381] Restatement (Second) of Conflict of Laws § 267 cmt. e (1971).

> Where the trustee has not qualified as trustee in any court and the trust is to be administered in a particular state, the courts of that state have primary supervision over the administration of the trust. They have and will exercise jurisdiction as to all questions which may arise in the administration of the trust. Thus, if an inter vivos trust is created with a trust company as trustee, the courts of the state in which the trust company was organized and does business will exercise jurisdiction over the administration of the trust.

If the home state court has jurisdiction over the trustee or the trust, comment e to § 267 suggests that it should defer to the trust state's courts.[382]

The Scott treatise summarizes the applicable principles as follows:[383]

> Trust administration is ordinarily governed by the law of the state of primary supervision, and the rights of the parties ought not depend on the fact that a court of some other state happens to have acquired jurisdiction. Such a court may give a judgment based on its own local law, or it may attempt to apply the law of the state of primary supervision but apply it incorrectly.

3. UTC Approach

Under the UTC, establishing the "principal place of administration" of a trust is critical in determining which state's courts should handle trust questions because UTC § 202 provides in pertinent part:[384]

> (a) By accepting the trusteeship of a trust having its principal place of administration in this State . . . the trustee submits personally to the jurisdiction of the courts of this State regarding any matter involving the trust.
>
> (b) With respect to their interests in the trust, the beneficiaries of a trust having its principal place

---

[382] Restatement (Second) of Conflict of Laws § 267 cmt. e (1971).

[383] 7 Scott and Ascher on Trusts, supra note 355, § 45.2.2.6, at 3125.

[384] UTC § 202 (amended 2010).

> of administration in this State are subject to the jurisdiction of the courts of this State regarding any matter involving the trust. By accepting a distribution from such a trust, the recipient submits personally to the jurisdiction of the courts of this State regarding any matter involving the trust.

Thirty-one states have enacted a version of UTC § 202.

Section 202's comment explains that "[t]his section clarifies that the courts of the principal place of administration have jurisdiction to enter orders relating to the trust that will be binding on both the trustee and beneficiaries."[385]

To determine a trust's "principal place of administration," UTC § 108(a) stipulates:[386]

> Without precluding other means for establishing a sufficient connection with the designated jurisdiction, terms of a trust designating the principal place of administration are valid and controlling if:
>
> (1) a trustee's principal place of business is located in or a trustee is a resident of the designated jurisdiction; or
>
> (2) all or part of the administration occurs in the designated jurisdiction.

Again, 32 states have adopted a form of § 108.

4. UPC Approach

The UPC's approach is a bit different. UPC § 7-203 provides:[387]

> The Court will not, over the objection of a party, entertain proceedings under Section 7-201

[385] UTC § 202 cmt. (amended 2010).

[386] UTC § 108(a) (amended 2010). See In re Seneker Trust, 2015 WL 847129, at *2 (Mich. Ct. App. Feb. 26, 2015) ("[A]t the time of Stanley's death, the principal place of administration of the Trust was in Florida [not Michigan] . . .").

[387] UPC § 7-203 (amended 2008).

> involving a trust registered or having its principal place of administration in another state, unless (1) when all appropriate parties could not be bound by litigation in the courts of the state where the trust is registered or has its principal place of administration or (2) when the interests of justice otherwise would seriously be impaired. The Court may condition a stay or dismissal of a proceeding under this section on the consent of any party to jurisdiction of the state in which the trust is registered or has its principal place of business, or the Court may grant a continuance or enter any other appropriate order.

Although § 7-203 and the rest of Article 7 do not appear in the 2010 version of the UPC,[388] at least eight states have statutes based on § 7-203.[389] In an unreported 2015 case, a Michigan intermediate appellate court applied Michigan's version of § 7-203 and held that Michigan courts lacked subject-matter jurisdiction because a trust's principal place of administration was in Florida.[390]

Section 7-101 of the UPC defines "principal place of administration" as follows:[391]

> Unless otherwise designated in the trust instrument, the principal place of administration of a trust is the trustee's usual place of business where the records pertaining to the trust are kept, or at the trustee's residence if he has no such place of business. In the case of co-trustees, the principal place of administration, if not otherwise designated in the trust instrument, is (1) the usual place of business of the corporate trustee if there is but one corporate co-trustee, or (2) the usual place of business or residence of the individual trustee who is a professional fiduciary if there is but one such person and no corporate co-trustee, and otherwise (3) the

---

[388] The text of the UPC may be viewed at www.uniformlaws.org/shared/docs/probate%20code/2014_UPC_Final_2016aug1.pdf. (last visited Sept. 26, 2016).

[389] See Alaska Stat. § 13.36.045; Colo. Rev. Stat. § 15-16-203; Haw. Rev. Stat. § 560:7-203; Idaho Code § 15-7-203; Mass. Gen. Laws ch. 203E, § 203; Mich. Comp. Laws § 700.7205; N.C. Gen. Stat. § 36C-2-203; Utah Code Ann. § 75-7-204.

[390] In re Seneker Trust, 2015 WL 847129, at *1.

[391] UPC § 7-101 (amended 2008). See Alaska Stat. § 13.36.005; Colo. Rev. Stat. § 15-16-101; Haw. Rev. Stat. § 560:7-101; Idaho Code § 15-7-101; Mich. Comp. Laws § 700.7209; RSMo § 456.027(3); Neb. Rev. Stat. § 30-3816.

> usual place of business or residence of any of the co-trustees as agreed upon by them.

5. Comment

Caselaw confirms that courts are cautious about construing trust questions governed by the laws of other states and that consequently they often abstain from exercising jurisdiction.[392] To confirm jurisdiction outside a testator's or trustor's state of residence, the trustee and beneficiaries might commence a proceeding (e.g., to appoint a successor trustee, to make a unitrust conversion) early in the trust's existence.

B. Full Faith and Credit

A court in the state where a trust is being administered might not have to give full faith and credit to a judgment rendered by a court in the testator's or trustor's state of residence. Section 103 of the Second Restatement of Conflict of Laws states:[393]

> A judgment rendered in one State of the United States need not be recognized or enforced in a sister State if such recognition or enforcement is not required by the national policy of full faith and credit because it would involve an improper interference with important interests of the sister State.

Section 103's comments emphasize that it has an extremely narrow scope of application,[394] but authorities indicate that this section might apply if a state court is asked to give full faith and credit to a judgment rendered by a home state court.

The Scott treatise frames the issue as follows:[395]

> In some situations, however, the court that has primary supervision over the administration of the trust may regard the judgment as an undue interference with its power to control the administration. It may take the position that the court rendering the judgment applied its own local law, though it should have applied the law of the

[392] See, e.g., Bartlett v. Dumaine, 523 A.2d 1, 14–15 (N.H. 1986); Baltimore Nat'l Bank v. Cent. Pub. Util. Corp., 28 A.2d 244 (Del. Ch. 1942). See also 7 Scott and Ascher on Trusts, supra note 355, § 45.2.2.4.1, at 3112 n.36.

[393] Restatement (Second) of Conflict of Laws § 103 (1971).

[394] Restatement (Second) of Conflict of Laws § 103 cmts. a–b (1971).

[395] 7 Scott and Ascher on Trusts, supra note 355, § 45.2.2.6, at 3126.

> state of primary supervision, or that it incorrectly applied the law of the state of primary supervision. The question then is whether the court of primary supervision is bound to give full faith and credit to the judgment. The final determination of this question rests, of course, with the Supreme Court of the United States.

In 1958, the United States Supreme Court held in Hanson v. Denckla[396] that Delaware courts were not required to give full faith and credit to a judgment of a Florida court that lacked jurisdiction over the trustee and the trust property. The Scott treatise states that: [397]

> It seems clear that the Florida court, in applying its own local law and holding that the Delaware trust and the exercise of the power of appointment were invalid, unduly interfered with the administration of the trust by the Delaware courts . . . .
>
> Since the Delaware court could properly regard the judgment of the Florida court as unduly interfering with the administration of a trust that was fixed in Delaware, it was not bound by that judgment, notwithstanding the fact that the Florida court had jurisdiction over some or all of the beneficiaries. Indeed, it may well be argued that the Delaware court would not be bound by the Florida judgment even if the Florida court had jurisdiction over the trustee as well. A court may acquire jurisdiction over an individual trustee who happens to be in the state or over a corporate trustee that happens to have such a connection with the state as to give the state jurisdiction over it, or the trustee may appear in the action. We submit, however, that such a 102 courts' supervision of the administration of the trust. It might, indeed, be held that not only would the Delaware courts not be bound to give full faith and credit to the Florida judgment, but that the Florida judgment would so interfere with the administration of the trust that it would be invalid as a denial of due process of law.

[396] Hanson v. Denckla, 357 U.S. 235 (1958).

[397] 7 Scott and Ascher on Trusts, supra note 355, § 45.2.2.6, at 3128–29 (footnotes omitted).

The Scott treatise suggests that the same principle should apply in other contexts.[398]

In the related case of Lewis v. Hanson, the Delaware Supreme Court unequivocally stated that Delaware courts would not have given full faith and credit to the Florida judgment even if the Florida courts had jurisdiction over the trustee and/or the trust property. It declared:[399]

> [W]e think the public policy of Delaware precludes its courts from giving any effect at all to the Florida judgment of invalidity of the 1935 trust. We are dealing with a Delaware trust. The trust res and trustee are located in Delaware. The entire administration of the trust has been in Delaware. The attack on the validity of this trust raises a question of first impression in Delaware and one of great importance in our law of trusts. To give effect to the Florida judgment would be to permit a sister state to subject a Delaware trust and a Delaware trustee to a rule of law diametrically opposed to the Delaware law. It is our duty to apply Delaware law to controversies involving property located in Delaware, and not to relinquish that duty to the courts of a state having at best only a shadowy pretense of jurisdiction.

The Supreme Court of New Hampshire applied the above principles in a 1986 case—Bartlett v. Dumaine.[400]

VIII. OTHER ISSUES

A. Simply Paying Tax is Risky

For attorneys and trustees, the easiest course is simply to pay state income taxes on trusts. But, this strategy is fraught with peril.

Section 76 of the Third Restatement of Trusts imposes the following duty on a trustee:[401]

> A trustee's duty to administer a trust includes an initial and continuing duty to administer it at a

[398] 7 Scott and Ascher on Trusts, supra note 355, § 45.2.2.6, at 3129.

[399] Lewis, 128 A.2d at 835 (citation omitted).

[400] Bartlett, 523 A.2d 1.

[401] Restatement (Third) of Trusts § 76 cmt. b(2) (2003).

> location that is reasonably suitable to the purposes of the trust, its sound and efficient administration, and the interests of its beneficiaries.

As covered in VI, H, above, trustees in more than half the states have a statutory duty to locate trusts in appropriate jurisdictions.

I am not aware of any case in which the taxation department of one state has sued a trustee in a court in another state to collect tax allegedly due the first state. Nor am I aware of a reported case in which a trustee has been surcharged for failing to minimize income tax. It is understood that such cases are pending in New York State, and it seems likely that a successful surcharge case is inevitable.

Therefore, attorneys and trustees who ignore the issue of minimizing state income taxes on trusts are inviting malpractice or surcharge claims.

B. Filing Position

In some cases, it will be clear whether a trust must pay a state's fiduciary income tax, while, in others, taxability will not be so evident. In uncertain cases, the attorney might request a ruling from the state's taxation department if it has a procedure for issuing rulings.[402] To minimize penalties and interest in unclear situations, the attorney might advise the trustee to file a timely return reporting that no tax is due and citing comparable cases from the same or other jurisdictions. The attorney might also counsel the trustee to segregate funds to pay taxes, penalties, and interest in case the filing position is unsuccessful.[403] In any event, the attorney and trustee should take a no-tax position in an uncertain case only after advising the trustor and beneficiaries in writing of the proposed action.

In clear cases, my firm—Wilmington Trust Company—will take the position that state fiduciary income tax is not due. If the issue is uncertain, we will file a return and pay tax unless counsel in the relevant state provides a reasoned opinion advising us not to do so.

C. Establishing Residence of Future Beneficiaries

Given that the most significant tax-saving opportunities relate to capital gains incurred by trustees and that those gains often are attributable to principal being held for later distribution, determining whether a state will treat unborn, unknown, and unascertained beneficiaries as residents or nonresidents is crucial in many

---

[402] See, e.g., Cal. Franchise Tax Bd. Notice 2009-08, 2009 State Tax Today 200-13 (Cal. Franchise Tax Bd. Oct. 12, 2009), www.ftb.ca.gov/law/notices/2009/2009_08.pdf. See also Cal. Franchise Tax Bd. Info. Ltr. 2012-01, 2012 Cal. FTB I.L. Lexis 1 (Franchise Tax Bd. Nov. 28, 2012), www.ftb.ca.gov/law/infoletter/Info2012_01.pdf.

[403] See Fogel, supra note 1, at 228–29.

states. Whereas Massachusetts[404] deems all such beneficiaries to be residents, Delaware and Rhode Island determine their residences based on the residences of currently identifiable beneficiaries.[405] The issue also is relevant in Connecticut, Hawaii, Michigan, and North Carolina where no pertinent guidance exists. As described in III, K, above, basing taxation in whole or in part on the presence of resident beneficiaries is problematic.

D. Establishing Place of Administration

Numerous states tax a trustee in whole or in part based on whether it "administers" a trust within the state.[406] Of these states, Oregon, Utah, and Virginia provide rules as to when a trust is being administered within the state, which the attorney or trustee should follow in planning to eliminate tax. Colorado, Hawaii, Iowa, Kansas, Louisiana, Maryland, Mississippi, Montana, New Mexico, North Dakota, and South Carolina offer no such guidance.

E. Choosing a Jurisdiction for a Long-Term Trust

In I, B, above, I mentioned that Professors Sitkoff and Schanzenbach found that trust funds move to states that allow very long or perpetual trusts and that do not levy an income tax on trustees of trusts created by nonresidents. Practitioners should avoid directing clients to Arizona (500-year trusts), Nevada (365-year trusts), North Carolina (perpetual trusts), Tennessee (360-year trusts), and Wyoming (1,000-year trusts) because, even though they enacted statutes that abolished the common-law rule against perpetuities for trusts, they still have constitutional prohibitions on perpetuities.[407] This concern is particularly acute in Nevada where voters disapproved a ballot initiative to repeal the constitutional prohibition. Regarding this issue, Professor Sitkoff and a co-author wrote in 2014 that:[408]

---

404 Mass. Gen. Laws ch. 62, § 10(a). See Mass. Regs. Code tit. 830, § 62.10.1(2)(b); instructions to 2015 Mass. Form 2 at 4.

405 30 Del. C. § 1636(b); R.I. Code R. 46-050-010, PIT 90-13(II)(B).

406 See II, E, above.

407 See Ariz. Const. art. 2, § 29; Nev. Const. art. 15, § 4; N.C. Const. art. 1, § 34; Tenn. Const. art. 1, § 22; Wyo. Const. art. 1, § 30. An intermediate appellate court upheld North Carolina's statute in Brown Bros. Harriman Trust Co. v. Benson, 688 S.E.2d 752 (N.C. App. 2010). But, commentators advise the Supreme Court of North Carolina and other courts not to rely on the case because it is "deeply flawed" (Steven J. Horowitz & Robert H. Sitkoff, Unconstitutional Perpetual Trusts, 67 Vand. L. Rev. 1769, 1811 (Nov. 2014)). Another commentator points out that, "The inclusion of a separate clause, copied from the Pennsylvania Constitution, providing that the legislature 'shall regulate entails, in such a manner as to prevent perpetuities' shows that the framers of the North Carolina Constitution of 1776 were hostile to perpetuities as conventionally defined" (Joshua C. Tate, Perpetuities and the Genius of a Free State, 67 Vand. L. Rev. 1823, 1833 (Nov. 2014)).

408 Horowitz & Sitkoff, supra note 407, at 1803 (Nov. 2014). Accord Jonathan G. Blattmachr, Mitchell M. Gans & William D. Lipkin, What if Perpetual Trusts are Unconstitutional?, LISI Est. Plan. Newsl. # 2263 (Dec. 18, 2014), www.leimbergservices.com..

> [L]egislation authorizing perpetual or long-enduring dynasty trusts is constitutionally suspect in a state with a constitutional prohibition of perpetuities.

A Nevada practitioner contends that a 1941 decision of the Supreme Court of Nevada—Sarrazin v. First National Bank[409]—and a 2015 decision of the same court—Bullion Monarch Mining, Inc. v. Barrick Gold Strike Mines, Inc.[410]—mean that the constitutional limitation no longer is relevant.

The Sarrazin case was decided long before Nevada adopted a 365-year period for trust interests. Its entire description of the law of perpetuities in Nevada is as follows:[411]

> Section 4 of article XV of the constitution of Nevada reads: "No perpetuities shall be allowed except for eleemosynary purposes." There is no Nevada statute defining the rule against perpetuities. The common-law rule is usually stated thus: "No interest is good unless it must vest, if at all, not later than twenty-one years after some life in being at the creation of the interest." Other than the constitutional provision above quoted, there have not been called to our attention any other provisions, either constitutional or statutory, invalidating interests which vest too remotely, or forbidding restraints on alienation.

The above emphasized sentence is dictum at best because the court concluded that all interests in the trust in question would vest within the common-law rule against perpetuities period.[412]

The Bullion Monarch Mining case involved the applicability of Nevada's rule against perpetuities to "commercial mining agreements for the payment of area-of-interest royalties."[413] Not surprisingly, the court held that it did not.[414] In the course of the opinion, the court discussed a 1974 case—Rupert v. Stienne[415]—as

[409] Sarrazin v. First Nat'l Bank, 111 P.2d 49 (Nev. 1941). See Steven J. Oshins, The Rebuttal to Unconstitutional Perpetual Trusts, LISI Est. Plan. Newsl. #2265 (Dec. 22, 2015), www.leimbergservices.com.

[410] Bullion Monarch Mining, Inc. v. Barrick Gold Strike Mines, Inc., 345 P.3d 1040 (Nev. 2015). See Steven J. Oshins, Unconstitutional Perpetual Trusts—Not So Fast Says the Nevada Supreme Court, LISI Est. Plan. Newsl. #2297 (Apr. 6, 2015), www.leimbergservices.com.

[411] Sarrazin, 111 P.2d at 51 (citation omitted; emphasis added).

[412] Sarrazin, 111 P.2d at 53.

[413] Bullion Monarch Mining, 345 P.3d at 1041.

[414] Bullion Monarch Mining, 345 P.3d at 1044.

[415] Rupert v. Stienne, 528 P.2d 1013 (Nev. 1974).

endorsing statutes that depart from the common law. Nevertheless, Rupert, which dealt with the "old common-law rule of interspousal immunity,"[416] did not involve a common-law rule that had been codified in Nevada's constitution.

A decision of the Supreme Court of Nevada validating 365-year trusts might be helpful. It has been suggested that the court would uphold the statute in the interest of supporting Nevada's business-development efforts. That would be a regrettable basis for such a decision if the law is to the contrary.

The best way to resolve the issue would be for the voters to repeal the constitutional prohibition.

F. Source Income

The attorney should make sure that a small amount of source income will not cause an Exempt Resident Trust to be taxed as a Resident Trust.[417] For example, it appears from the statute quoted above, that this is the case in New York.[418]

The practitioner should not assume that income received from an entity that conducts business or owns real or tangible personal property in a state is source income. I covered New York's approach to this issue in IV, A, 5, above. Connecticut adopted a comparable rule in 2014.[419]

New Jersey is less aggressive than New York regarding the taxation of source income. Hence, in 1994, a New Jersey court granted New Jersey income tax refunds to twelve Florida trusts on gain recognized upon the liquidation of a corporation whose stock was owned by a partnership held by the trusts, even though the corporation owned several parcels of New Jersey real estate connected with business activity conducted in the state.[420] The court concluded that:[421]

> The disposition of the corporate stock here constitutes the nontaxable sale of the intangible asset.

Similarly, in 2015, the appellate division of the New Jersey superior court ruled that a testamentary trust created by a New Jersey decedent having a New York trustee and administration outside New Jersey was not taxable on interest income

---

416 Bullion Monarch Mining, 345 P.3d at 1042.

417 See Michaels & Twomey, supra note 251, at 29.

418 See IV, A, 3, above.

419 Conn. Gen. Stat. § 12-711(b)(5).

420 Tina Schiller Trust,14 N.J. Tax 173.

421 Tina Schiller Trust, 14 N.J. Tax at 181.

and S corporation income allocated outside New Jersey.[422]

In Minnesota, gain on the sale of a partnership interest is allocable to Minnesota in the ratio of the original cost of partnership tangible property in Minnesota to the original cost of partnership tangible property everywhere, determined at the time of the sale.[423] The Supreme Court of Ohio held in 2016 that the gain from the sale of a nonresidents' interest in an LLC was not Ohio-source income.[424]

G. Combining Nonresident Trustee With Resident Advisor, Protector, or Committee

I often am asked whether New York tax or the tax of another state can be prevented by appointing resident advisors, protectors, or committee members to work with a nonresident trustee. This approach is risky—and should be avoided if at all possible—if the advisor is a fiduciary and/or exercises investment, distribution, or other management duties.[425] There is authority though, that the strategy will work if the advisor is only a custodian or agent[426] or if he or she delegates the fiduciary/management responsibilities.[427]

H. Changing Testator or Trustor by Exercise of Power

I sometimes am asked whether the identity of the testator or trustor in a state that taxes based on the residence of such an individual may be changed by:

- The exercise of a power of appointment
- The exercise of a decanting power

Resolution of the first issue necessarily depends on the law of the state in question. The exercise of a general power of appointment in New York or Connecticut will achieve this result but the exercise of a nongeneral power will not.[428] In Virginia, though, the exercise of a nongeneral power of appointment by a Virginia resident over a nonresident's trust does create a Virginia Resident

[422] Kassner, 28 N.J. Tax at 548. See III, F, 2, above. Accord Hill v. Director, State Div. of Taxation, 2016 WL 3351959 (N.J. Sup. Ct. App. Div. June 2, 2016).

[423] See Minn. Stat. § 290.17 subd. 2(c).

[424] Corrigan, 2016 WL 2341977. See William T. Thistle, II, Bruce P. Ely & Christopher R. Grissom, Blurred Lines: State Taxation of Nonresident Partners, 81 State Tax Notes 689 (Aug. 29, 2016); Timothy Noonan & Joshua K. Lawrence, Could Ohio's Latest Due Process Case Spell Trouble for New York, 81 State Tax Notes 117 (July 11, 2016); Walter Hellerstein, Substance and Form in Jurisdictional Analysis: Corrigan v. Testa, 80 State Tax Notes 849 (June 13, 2016).

[425] See IV, A, 4, d, above.

[426] See, e.g., III, C, 4, above.

[427] See IV, F, above.

[428] See N.Y. TSB-A-03(6)I, 2003 WL 22970581 (N.Y. Dep't Tax. Fin. Nov. 21, 2003), www.tax.ny.gov/pdf/advisory_opinions/income/a03_6i.pdf; Ct. Ruling 2005-2, 2005 WL 578844 (Conn. Dep't Rev. Serv. Jan. 14, 2005), www.ct.gov/drs/cwp/view.asp?A=1513&Q=289024. See also IV, A, 4, e, above.

Trust.[429] This could produce the undesired result of having a trust established by the exercise of a nongeneral power being taxed as a Resident Trust in two states.

The authorities for decanting are not encouraging. For example, regulations under IRC § 671[430] say that the identity of the grantor would not change in these circumstances. In addition, several of the state decanting statutes specify that a decanting power is a nongeneral power of appointment[431] and the available state tax rulings, other than in Virginia, indicate that the identity of the trust creator would not change.[432] In the 2013 Linn v. Department of Revenue case,[433] a trust created through the exercise of a trustee decanting power escaped Illinois income tax because: [434]

> The parties agree the Autonomy Trust 3 is an irrevocable trust, and A.N. Pritzker, who was an Illinois resident, is considered to be the grantor of the Autonomy Trust 3. Thus, under the Tax Act, the Autonomy Trust 3 is an Illinois resident and subject to Illinois income tax.

The Illinois statute,[435] which took effect in 2013, addresses the issue directly. It specifies, "[t]he settlor of a first trust is considered for all purposes to be the settlor of any second trust established in accordance with this Section."[436] The Texas statute,[437] which took effect later that year has a comparable provision.[438]

I. State Income Taxation of CRTs

---

[429] See P.D. 16-62, 2016 WL 2940441 (Va. Dep't Tax. Apr. 20, 2016), www.tax.virginia.gov/laws-rules-decisions/rulings-tax-commissioner/16-62. See also IV, C, 4, above.

[430] See Reg. § 1.671-2(e)(5). See also PLR 200736002 (May 22, 2007) (["B]ecause the creation of the successor trusts is a modification of Trust for Federal income tax purposes, the successor trusts are treated as a continuation of Trust").

[431] See, e.g., Alaska Stat. § 13.36.158(a); Ariz. Rev. Stat. § 14-10819(C); Conn. Gen. Stat. § 45a-572; 12 Del. C. § 3528(c); Fla. Stat. § 736.04117(3); Ind. Code § 30-4-3-36(c); Ky. Rev. Stat. Ann. § 386.175(6)(a); Mich. Comp. Laws § 556.115a(6); Minn. Stat. § 502.851, subd. 5; Nev. Rev. Stat. § 163.556(10); N.Y. Est. Powers & Trusts Law § 10-6.6(d); N.C. Gen. Stat. § 36C-8-816.1(e); Ohio Rev. Code Ann. § 5808.18(E); R.I. Gen. Laws § 18-4-31(c); S.C. Code Ann. § 62-7-816A(f)(1); S.D. Codified Laws § 55-2-19; Tenn. Code Ann. § 35-15-816(b)(27)(E); Va. Code Ann. 64.2-778.1(E)(2); Wis. Stat. § 701.0418(8)(a).

[432] See IV, A, 4, e, above.

[433] Linn, 2 N.E.3d 1203.

[434] Linn, 2 N.E.3d at 1208.

[435] 760 ILCS 5/16.4.

[436] 760 ILCS 5/16.4(t).

[437] Tex. Prop. Code §§ 112.071–112.087.

[438] Tex. Prop. Code § 112.077.

Determining the taxability of and the reporting requirements for CRTs for state income-tax purposes is quite challenging in several states.

Many practitioners will be surprised to learn that three states—New Jersey, Pennsylvania, and Illinois—tax CRTs at the trust level.

Accordingly, in 2009, the New Jersey Division of Taxation announced that:[439]

> Only exclusively charitable trusts qualify for income tax exemption under the New Jersey Gross Income Tax Act. A Charitable Remainder Trust, in contrast to a charitable trust, has "noncharitable" beneficiaries and does not operate exclusively for charitable purposes. Accordingly, a Charitable Remainder Trust is not an exclusively "charitable trust" exempt from New Jersey income tax under N.J.S.A. 54A:2-1 and income that is not distributed and which is not deemed to be permanently and irrevocably set aside or credited to a charitable beneficiary is taxable income to the trust.

Similarly, the instructions to the Pennsylvania fiduciary income tax return provide in relevant part:[440]

> Charitable Remainder Annuity Trusts (CRAT) and Charitable Remainder Unitrusts (CRUT)
>
> Charitable Remainder Annuity Trusts (CRATS) and Charitable Remainder Unitrusts (CRUT) are trusts consisting of assets that are designated for a charitable purpose and are paid over to the trusts after the expiration of a life estate or intermediate estate.
>
> Federally qualified CRATs and CRUTs are not charitable trusts if during the current taxable year:
>
> - Any part of the trust's retained earnings may benefit any private individual in subsequent years; or

---

439 N.J. Div. of Tax'n Tech. Bull. 64, 2009 N.J. Tax Tech. Bull. Lexis 34 (Div. of Tax'n June 29, 2009), www.state.nj.us/treasury/taxation/pdf/pubs/tb/tb64.pdf.

440 Instructions to 2015 Form PA-41 at 3. See 72 P.S. § 7301(c.1).

- Any part of the trust's current income is required under the governing instrument or any applicable state law to be distributed currently or is actually distributed or credited to a beneficiary that is not a charitable organization for which a donor may receive a charitable contribution deduction for federal income tax purposes.

  Important. CRATs, charitable remainder trusts, CRUTs and pooled income fund trusts of public charities are ordinary trusts that are not exempt from PA-41, Fiduciary Income Tax Return, filing requirements or taxation. These types of charitable trusts must file a Pennsylvania trust tax return, pay tax on any retained earnings, and report the income to the beneficiary on the same basis as any other ordinary trust.

Finally, in 2011, the Illinois Department of Revenue announced that CRTs are taxed for the following reason:[441]

> Charitable remainder trusts have the same obligations in regard to the reporting of income and payment of income tax as any other trust. Section 502(a)(1) of the Illinois Income Tax Act provides that an income tax return is required by every person liable for an income tax. If, after making addition and subtraction modifications to taxable income as required by Section 203(c)(2), and any other adjustments, there remains a net income subject to tax, a form IL-1041 is required to be filed along with payment of tax.
>
> Also, if the charitable remainder unitrust is a "resident" as defined by Section 1501(a)(20)(C) or (D), such a trust is required to file a form IL-1041 if the trust was required to file a federal income tax return, regardless of whether the trust is liable for an Illinois income tax. IITA Section 502(a)(2).

Clients often create CRTs to diversify portfolios of low-basis securities without

[441] Ill. PLR 12-0008, 2012 WL 1257370 (Ill. Dep't Rev. Mar. 23, 2012), tax.illinois.gov/LegalInformation/Letter/rulings/it/2012/IT-12-0008.pdf.

incurring immediate income tax on the gain. Such clients might be dismayed to learn that state tax is due on the entire gain right away. That tax easily can be eliminated in New Jersey, and it might be escaped in Pennsylvania and Illinois as well.

To my knowledge, every other state that imposes an income tax generally exempts CRTs from taxation.

J. Self-Settled Trust Option—The "DING Trust"

Most domestic asset-protection trusts ("APTs") are grantor trusts for federal income-tax purposes under IRC § 677(a) because the trustee may distribute income to—or accumulate it for—the trustor without the approval of an adverse party. But, a client might use a type of domestic APT known as the Delaware Incomplete Nongrantor Trust ("DING Trust"), to save income tax on undistributed ordinary income and capital gains imposed by a state (i.e., Pennsylvania) that has not adopted the federal grantor-trust rules for irrevocable trusts or, if the client is willing to subject distributions to himself or herself to the control of adverse parties, to eliminate income tax on such income imposed by one of the 43 states that have adopted the federal grantor-trust rules. In dozens of private letter rulings issued since 2013,[442] the IRS ruled that domestic APTs that followed the DING-Trust approach qualified as nongrantor trusts. Most—if not all—of the trusts in question were created under Nevada law in large part because, at the time, Nevada was the only domestic APT state that allowed a trustor to keep a lifetime nongeneral power of appointment. In the meantime, other domestic APT states have added that option.[443]

The trustor of a DING Trust might be able to receive tax-free distributions of the untaxed income in later years.[444] As covered in IV, A, 3, above, DING Trusts might no longer work in New York, but the technique still is viable for residents of other states. In 2015, my employer—Wilmington Trust Company—successfully resisted the California Franchise Tax Board's efforts to tax a DING Trust, saving the trustor millions of dollars of California income tax.

The author of a 2015 article concludes:[445]

> Few advisers are likely to say that the NING or DING trust is guaranteed to provide the desired results. A better

[442] See, e.g., PLRs 201636027–032 (May 23, 2016); 201628010 (Apr. 11, 2016); 201614006–008 (Dec. 4, 2015); 201613007 (Dec. 4, 2015).

[443] See, e.g. 12 Del. C. § 3570(11)(b)(2).

[444] See Gordon P. Stone, III, Tax Planning Techniques for Client Selling a Business, Est. Plan., Oct. 2016, at 3; Robert W. Wood, Sellers and Settling Litigants Lured by Tax Savings of NING and DING Trusts, 77 State Tax Notes 565 (Aug. 10, 2015).

[445] Wood, supra note 444, at 568 (Aug. 10, 2015).

question is: Are they worth the effort? This can be debated, but in some cases they will be.

With every i dotted and t crossed, the informed and non-risk-averse client may go from the certainty of paying significant state income tax to the reporting position of paying little. Of course, the facts, documents, and details matter. The entire exercise can also be a helpful push into the related and often uncomfortable topic of estate planning.

K. Ethical Concerns

In some instances, it will be clear to the attorney that a trust will not be subject to state fiduciary income tax. In other situations, however, it will not be clear whether the tax of a given state applies to the trust or, if it does, whether imposition of the tax is constitutional in the circumstances. The ABA Committee on Ethics and Professional Responsibility has advised that:[446]

> [A] lawyer may advise reporting a position on a return even where the lawyer believes the position probably will not prevail, there is no "substantial authority" in support of the position, and there will be no disclosure of the position in the return. However, the position to be asserted must be one which the lawyer in good faith believes is warranted in existing law or can be supported by a good faith argument for an extension, modification or reversal of existing law. This requires that there is some realistic possibility of success if the matter is litigated. In addition, in his role as advisor, the lawyer should refer to potential penalties and other legal consequences should the client take the position advised.

L. Practical Concerns

Attorneys, accountants, trust officers, and other advisors understandably are concerned that they may lose business if they take steps to enable a trust to save state income tax because doing so will put the beneficiaries in touch with new and possibly distant advisors. Nevertheless, they have a duty to put the interests of clients before their own and risk liability for not doing so. In my experience, attorneys' and accountants' fears in this regard are unwarranted. As an attorney for a Delaware trust company, I frequently work with attorneys from throughout the country and never have seen a non-Delaware attorney lose a client to a Delaware attorney because the latter always appreciates his or her limited role.

---

[446] ABA Comm. on Ethics and Prof'l Responsibility, Formal Op. 352 (1985). See Dennis J. Ventry, Jr., Lowering The Bar: ABA Formal Opinion 85-352, 112 Tax Notes 69 (July 3, 2006).

Trust officers may be able to achieve the desired tax result within their own organizations.

M. What Can States Do?

States have limited choices for structuring constitutionally valid systems to tax the income of trusts that cannot easily be escaped. Hence, as discussed in III, A, above, a state may tax based on the residence of the fiduciary and the place of administration, but practitioners can plan around these options. Taxing nonresident trustees based on the residences of testators, trustors, and beneficiaries is problematic. The best choice might be to tax resident beneficiaries on current and past distributions as is done in California and New York with the recognition that beneficiaries might move to eliminate tax.

APPENDIX

BASES OF STATE INCOME TAXATION OF NONGRANTOR TRUSTS

Bases of State Income Taxation of Nongrantor Trusts (Revised 3/9/16)

State	Citations	Top 2015 Rate	Trust Created by Will of Resident	Inter Vivos Trust Created by Resident	Trust Administered in State	Trust With Resident Trustee	Trust With Resident Beneficiary	Tax Dept. Website
Alabama	Ala. Code §§ 40-18-1(33), 40-18-5(l)(c); instructions to 2015 Ala. Form 41 at 2.	5.00% on inc. over $3,000	✓[1]	✓[1]				**www.revenue.alabama.gov**
Alaska	No income tax imposed on trusts.							**dor.alaska.gov**
Arizona	Ariz. Rev. Stat. §§ 43-1011(5)(a), 43-1301(5), 43-1311(B); instructions to 2015 Ariz. Form 141AZ at 1, 17.	4.54% on inc. over $152,434				✓		**www.azdor.gov**
Arkansas	Ark. Code Ann. §§ 26-51-201(a)(6)(A), (b), (d), 26-51-203(a); instructions to 2015 Ark. AR1002 at 1; 2015 Ark. Regular Tax Tables at 4.	7.00% on inc. on or over $35,300	✓[2]	✓[2]				**www.dfa.arkansas.gov**
California	Cal. Rev. & Tax. Code §§ 17041(a)(1), 17043(a), 17742(a); Cal. Const. Art. XIII, § 36(f)(2); instructions to 2015 Cal. Form 541 at 4, 9, 10.	13.30% on inc. over $1 million				✓	✓	**www.ftb.ca.gov**
Colorado	Colo. Rev. Stat. §§ 39-22-103(10), 39-22-104(1.7); instructions to 2015 Colo. Form 105 at 3, 4; 2015 Colo. Form 105 at 1.	4.63%			✓			**www.taxcolorado.com**

Bases of State Income Taxation of Nongrantor Trusts

State	Citations	Top 2015 Rate	Trust Created by Will of Resident	Inter Vivos Trust Created by Resident	Trust Administered in State	Trust With Resident Trustee	Trust With Resident Beneficiary	Tax Dept. Website
Connecticut	Conn. Gen. Stat. §§ 12-700(a)(8)(E), (a)(9), 12-701(a)(4)(C)–(D); Conn. Agencies Regs. § 12-701(a)(4)-1; instructions to 2015 Form CT-1041 at 4, 5; 2015 Form CT-1041 at 1.	6.99%	✓	✓[3]				**www.ct.gov/drs**
Delaware	30 Del. C. §§ 1102(a)(14), 1601(8); 2015 Del. Form 400-I at 1, 2; 2015 Del. Form 400 at 2.	6.60% on inc. over $60,000	✓[4]	✓[4]		✓[4]		**www.revenue.delaware.gov**
District of Columbia	D.C. Code §§ 47-1806.03(a)(8), 47-1809.01, 47-1809.02; instructions to 2015 D.C. Form D-41 at 6, 8.	8.95% on inc. over $350,000	✓	✓				**otr.cfo.dc.gov**
Florida	No income tax imposed on trusts; Florida intangible personal property tax repealed for 2007 and later years.							**dor.myflorida.com/dor**
Georgia	O.C.G.A. §§ 48-7-20(b)(1), (d), 48-7-22; Ga. Comp. R. & Regs. r. 560-7-3-.07(1); instructions to 2015 Ga. Form 501 at 6.	6.00% on inc. over $7,000					✓[5]	**dor.georgia.gov**

Bases of State Income Taxation of Nongrantor Trusts

State	Citations	Top 2015 Rate	Trust Created by Will of Resident	Inter Vivos Trust Created by Resident	Trust Administered in State	Trust With Resident Trustee	Trust With Resident Beneficiary	Tax Dept. Website
Hawaii	Haw. Rev. Stat. §§ 235-1, 235-4.5, 235-51(d); Haw. Admin. Rules § 18-235-1.17; instructions to 2015 Haw. Form N-40 at 1, 12.	8.25% on inc. over $40,000			✓[4]	✓[4]		**tax.hawaii.gov**
Idaho	Idaho Code §§ 63-3015(2), (7), 63-3024(a); Idaho Admin. Code Regs. 35.01.01.035.01, 35.01.01.075.03(e); instructions to 2015 Idaho Form 66 at 1, 10.	7.40% on inc. over $10,890	✓[6]	✓[6]	✓[6]	✓[6]		**www.tax.idaho.gov**
Illinois	35 Ill. Comp. Stat. 5/201(a), (b)(5), (c), (d), 5/1501(a)(20)(C)–(D); Ill. Admin. Code tit. 86, § 100.3020(a)(3)–(4); instructions to 2015 Form IL-1041 at 4; 2015 Form IL-1041 at 2, 3.	5.25%	✓	✓				**www.tax.illinois.gov**
Indiana	Ind. Code §§ 6-3-1-12(d), 6-3-1-14, 6-3-2-1(a)(1); Ind. Admin. Code tit. 45, r. 3.1-1-21(d); instructions to 2015 Ind. Form IT-41 at 1, 5; 2015 Ind. Form IT-41 at 1.	3.30%			✓			**www.in.gov/dor**

Bases of State Income Taxation of Nongrantor Trusts

State	Citations	Top 2015 Rate	Trust Created by Will of Resident	Inter Vivos Trust Created by Resident	Trust Administered in State	Trust With Resident Trustee	Trust With Resident Beneficiary	Tax Dept. Website
Iowa	Iowa Code § 422.5(1)(i), (6); Iowa Admin. Code r. 701-89.3(1)–(2); instructions to 2015 Iowa Form IA 1041 at 1; 2015 Iowa Form IA 1041 at 2.	8.98% on inc. over $69,255	✓[6]	✓[6]	✓[6]	✓[6]		**tax.iowa.gov**
Kansas	Kan. Stat. Ann. §§ 79-32,109(d), 79-32,110(a)(2)(C), (d); instructions to 2015 Kan. Form K-41 at 2; 2015 Kan. Form K-41 at 4.	4.60% on inc. over $15,000			✓			**www.ksrevenue.org**
Kentucky	Ky. Rev. Stat. Ann. §§ 141.020(2)(b)(6), 141.030(1); 103 Ky. Admin. Regs. 19:010(1)–(2); instructions to 2015 Ky. Form 741 at 1, 2.	6.00% on inc. over $75,000				✓		**revenue.ky.gov**
Louisiana	La. Rev. Stat. Ann. §§ 47:300.1(3), 47:300.10(3); instructions to 2015 La. Form IT-541 at 1.	6.00% on inc. over $50,000	✓		✓[7]			**www.revenue.louisiana.gov**
Maine	Me. Rev. Stat. Ann. tit. 36, §§ 5102(4)(B)–(C), 5111(1-D), 5403; instructions to 2015 Form 1041ME at 1, 2.	7.95% on inc. over $20,900	✓	✓				**www.maine.gov/revenue**

Bases of State Income Taxation of Nongrantor Trusts

State	Citations	Top 2015 Rate	Trust Created by Will of Resident	Inter Vivos Trust Created by Resident	Trust Administered in State	Trust With Resident Trustee	Trust With Resident Beneficiary	Tax Dept. Website
Maryland	Md. Code Ann., Tax–Gen. §§ 10-101(k)(1)(iii), 10-105(a)(1), 10-106(a)(1)(iii); instructions to 2015 Md. Form 504 at 1, 5, 6.	5.75% (plus county tax between 1.25% and 3.20%) on inc. over $250,000	✓	✓	✓			www.marylandtaxes.com
Massachusetts	Mass. Gen. Laws ch. 62, §§ 4, 10(c); Mass Regs. Code tit. 830, § 62.10.1(1); instructions to 2015 Mass. Form 2 at 3–4, 22; 2015 Mass. Form 2 at 2.	5.15% (12.00% for short-term gains and gains on sales of collectibles)	✓[4]	✓[4, 8]				www.mass.gov/dor
Michigan	Mich. Comp. Laws §§ 206.16, 206.18(1)(c), 206.51(1)(h); instructions to 2015 MI-1041 at 2; 2015 MI-1041 at 1.	4.25%	✓	✓[9]				www.michigan.gov/taxes
Minnesota	Minn. Stat. §§ 290.01 Subd. 7b, 290.06 Subd. 2c, Subd. 2d; instructions to 2015 Minn. Form M2 at 1, 13.	9.85% on inc. over $129,130	✓[10]	✓[10]	✓[11]			www.revenue.state.mn.us
Mississippi	Miss. Code Ann. § 27-7-5(1); instructions to 2015 Miss. Form 81-110 at 3, 11.	5.00% on inc. over $10,000			✓			www.dor.ms.gov

Bases of State Income Taxation of Nongrantor Trusts

State	Citations	Top 2015 Rate	Trust Created by Will of Resident	Inter Vivos Trust Created by Resident	Trust Administered in State	Trust With Resident Trustee	Trust With Resident Beneficiary	Tax Dept. Website
Missouri	RSMo §§ 143.011, 143.061; 143.331(2)–(3); instructions to 2015 Form MO-1041 at 4, 10.	6.00% on inc. over $9,000	✓[12]	✓[12]				**dor.mo.gov**
Montana	Mont. Code Ann. § 72-38-103(14); instructions to 2015 Mont. Form FID-3 at 2, 12, 15; 2015 Mont. Form FID-3 at 2.	6.90% on inc. over $17,100			✓			**revenue.mt.gov**
Nebraska	Neb. Rev. Stat. §§ 77-2714.01(6)(b)–(c), 77-2715, 77-2715.02, 77-2715.03(1), 77-2717(1)(a); Neb. Admin. Code tit. 316, Ch. 23, REG-23-001; instructions to 2015 Neb. Form 1041N at 7, 8.	6.84% on inc. over $15,390	✓	✓				**www.revenue.nebraska.gov**
Nevada	No income tax imposed on trusts.							**tax.nv.gov**
New Hampshire	No income tax imposed on trusts.							**www.revenue.nh.gov**
New Jersey	NJSA §§ 54A:1-2(o)(2)–(3), (p), 54A:2-1(b)(5); instructions to 2015 Form NJ-1041 at 1, 23.	8.97% on inc. over $500,000	✓[13]	✓[13]				**www.state.nj.us/treasury/ taxation**

Bases of State Income Taxation of Nongrantor Trusts

State	Citations	Top 2015 Rate	Trust Created by Will of Resident	Inter Vivos Trust Created by Resident	Trust Administered in State	Trust With Resident Trustee	Trust With Resident Beneficiary	Tax Dept. Website
New Mexico	N.M. Stat. Ann. §§ 7-2-2(I), (S), 7-2-7(C); instructions to 2015 N.M. Form F1D-1 at 2, 5.	4.90% on inc. over $16,000			✓	✓		**www.tax.newmexico.gov**
New York State	N.Y. Tax Law §§ 601(c)(1)(A), 605(b)(3)–(4); N.Y. Comp. Codes R. & Regs. tit. 20, § 105.23; instructions to 2015 N.Y. Form IT-205 at 2, 10.	8.82% on inc. over $1,062,650	✓[13]	✓[13]				**www.tax.ny.gov**
New York City	N.Y. Tax Law §§ 1304(a)(3), 1304-B, 1305; Admin. Code City of N.Y. §§ 11-1704.1, 11-1705; instructions to 2015 N.Y. Form IT-205 at 14, 15.	3.876% on inc. over $500,000	✓[13]	✓[13]				**www.tax.ny.gov**
North Carolina	N.C. Gen. Stat. §§ 105-153.7(a), 105-160.2; N.C. Admin. Code tit. 17, r. 6B.3718(a); instructions to 2015 N.C. Form D-407 at 1; 2015 N.C. Form D-407 at 1.	5.75%					✓	**www.dor.state.nc.us**

Bases of State Income Taxation of Nongrantor Trusts

State	Citations	Top 2015 Rate	Trust Created by Will of Resident	Inter Vivos Trust Created by Resident	Trust Administered in State	Trust With Resident Trustee	Trust With Resident Beneficiary	Tax Dept. Website
North Dakota	N.D. Cent. Code §§ 57-38-07, 57-38-30.3(1)(e), (g); N.D. Admin. Code § 81-03-02.1-04(2); instructions to 2015 N.D. Form 38 at 2; 2015 N.D. Form 38 at 2.	2.90% on inc. over $12,300			✓	✓	✓	**www.nd.gov/tax**
Ohio	Ohio Rev. Code Ann. §§ 5747.01(I)(3), 5747.02(A)(8), (D); instructions to 2015 Ohio Form IT 1041 at 4, 12.	4.997% on inc. over $208,500	✓	✓[4]				**www.tax.ohio.gov**
Oklahoma	Okla. Stat. tit. 68, §§ 2353(6) 2355(B)(1)(h), (F); Okla. Admin. Code § 710:50-23-1(c); instructions to 2015 Okla. Form 513 at 2, 14.	5.25% on inc. over $8,700	✓	✓				**www.tax.ok.gov**
Oregon	Or. Rev. Stat. §§ 316.037, 316.282(1)(d); Or. Admin. R. 150-316.282(3); instructions to 2015 Or. Form 41 at 2; 2015 Or. Form 41 at 2.	9.90% on inc. over $125,000			✓	✓		**www.oregon.gov/dor**
Pennsylvania	72 P.S. §§ 7301(s), 7302; 61 Pa. Code § 101.1; instructions to 2015 Form PA-41 at 4; 2015 Form PA-41 at 1.	3.07%	✓[14]	✓[14]				**www.revenue.pa.gov**

Bases of State Income Taxation of Nongrantor Trusts

State	Citations	Top 2015 Rate	Trust Created by Will of Resident	Inter Vivos Trust Created by Resident	Trust Administered in State	Trust With Resident Trustee	Trust With Resident Beneficiary	Tax Dept. Website
Rhode Island	R.I. Gen. Laws §§ 44-30-2.6(c)(3)(A)(II), (E), 44-30-5(c)(2)–(4); R.I. Code R. PIT 90-13(I); instructions to 2015 Form RI-1041 at 1-1; 2015 RI-1041 Tax Rate Schedules at 1.	5.99% on inc. over $7,700	✓[4]	✓[4]				**www.tax.ri.gov**
South Carolina	S.C. Code Ann. §§ 12-6-30(5), 12-6-510(A), 12-6-520; instructions to 2015 Form SC1041 at 1, 3.	7.00% on inc. over $14,550			✓			**www.sctax.org**
South Dakota	No income tax imposed on trusts.							**dor.sc.gov**
Tennessee	Tenn. Code Ann. §§ 67-2-102, 67-2-110(a); instructions to 2015 Tenn. Form INC. 250 at 1, 3, 4.	6.00% (interest and dividends only)					✓	**www.tn.gov/revenue**
Texas	No income tax imposed on trusts.							**www.window.state.tx.us/taxes**
Utah	Utah Code Ann. §§ 59-10-103(1)(g), (r), 59-10-104(2)(b), 59-10-201(1), 75-7-103(1)(i)(ii)–(iii), 75-7-107(4), (7); instructions to 2015 UT Form TC-41 at 3, 6; 2015 UT Form TC-41 at 1.	5.00%	✓[15]		✓[15, 16]			**www.tax.utah.gov**

Bases of State Income Taxation of Nongrantor Trusts

State	Citations	Top 2015 Rate	Trust Created by Will of Resident	Inter Vivos Trust Created by Resident	Trust Administered in State	Trust With Resident Trustee	Trust With Resident Beneficiary	Tax Dept. Website
Vermont	32 V.S.A. §§ 5811(11)(B), 5822(a)(5), (b)(2); instructions to 2015 Vt. Form FIT-161 at 2; 2015 Vt. Form FIT-161 at 2.	8.95% on inc. over $12,300	✓	✓				www.tax.vt.gov
Virginia	Va. Code Ann. §§ 58.1-302, 58.1-320, 58.1-360; 23 Va. Admin. Code § 10-115-10; instructions to 2015 Va. Form 770 at 1, 8.	5.75% on inc. over $17,000	✓	✓	✓	✓		www.tax.virginia.gov.
Washington	No income tax imposed on trusts.							dor.wa.gov
West Virginia	W. Va. Code §§ 11-21-4e(a), 11-21-7(c); W. Va. Code St. Rs. § 110-21-4, 110-21-7.3; instructions to 2015 W. Va. Form IT-141 at 1, 5.	6.50% on inc. over $60,000	✓	✓				www.wva.state.wv.us/wvtax
Wisconsin	Wis. Stat. §§ 71.06(1q), (2e)(b), 71.125(1), 71.14(2), (3), (3m); instructions to 2015 Wis. Form 2 at 1, 19.	7.65% on inc. over $244,270	✓	✓[17]	✓[18]			www.revenue.wi.gov

Bases of State Income Taxation of Nongrantor Trusts

State	Citations	Top 2015 Rate	Trust Created by Will of Resident	Inter Vivos Trust Created by Resident	Trust Administered in State	Trust With Resident Trustee	Trust With Resident Beneficiary	Tax Dept. Website
Wyoming	No income tax imposed on trusts.							revenue.wyo.gov

[1] Provided that trust has resident fiduciary or current beneficiary.
[2] Provided that trust has resident trustee.
[3] Provided that trust has resident noncontingent beneficiary.
[4] Provided that trust has resident beneficiary.
[5] Tax also applies if trustee receives income from business done in state or manages funds or property located in state.
[6] Provided that other requirements are met.
[7] Unless trust designates governing law other than Louisiana.
[8] Provided that trust has Massachusetts trustee.
[9] Unless trustees, beneficiaries, and administration are outside Michigan.
[10] Post-1995 trust only.
[11] Pre-1996 trust only.
[12] Provided that trust has resident income beneficiary on last day of year.
[13] Unless trustees and trust assets are outside state and no source income; trustee should file informational return.
[14] Unless settlor is no longer resident or is deceased and trust lacks sufficient contact with Pennsylvania to establish nexus.
[15] Post-2003 irrevocable resident nongrantor trust having Utah corporate trustee may deduct all nonsource income but must file Utah return if must file federal return.
[16] Testamentary trust created by non-Utah resident; inter vivos trust created by Utah or non-Utah resident.
[17] Trust created or first administered in Wisconsin after October 28, 1999, only.
[18] Irrevocable inter vivos trust administered in Wisconsin before October 29, 1999, only.