TAX MANAGEMENT
PORTFOLIOS™

ESTATES, GIFTS, AND TRUSTS

State Income Taxation of Trusts*

by

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

This Portfolio revises and supersedes 869 T.M., *State Income Taxation of Trusts*. Portfolio 869 T.M. should be discarded.

ISBN 978-1-63359-383-1

ISBN 978-1-63359-383-1

TAX MANAGEMENT PORTFOLIOS™

ESTATES, GIFTS, AND TRUSTS

State Income Taxation of Trusts*

PORTFOLIO DESCRIPTION

Managing state income tax liability is a critical aspect of planning and administering a trust. If done properly, the planner may provide substantial benefits to the beneficiaries. If done poorly, the trust may be subjected to significant cost. Tax Management Portfolio 869, *State Income Taxation of Trusts*, covers how all 50 states and the District of Columbia tax trust income, how tax often may be eliminated, how substantial the potential tax savings are, and why a trustee might be surcharged for failing to take steps to avoid tax.

This Portfolio may be cited as Nenno, 869-2nd T.M., *State Income Taxation of Trusts*.

* This Portfolio, with commentary, is for informational purposes only and is not intended as an offer or solicitation for the sale of any financial product or service. It is not designed or intended to provide financial, tax, legal, accounting, or other professional advice since such advice always requires consideration of individual circumstances. If professional advice is needed, the services of a professional advisor should be sought.

Wilmington Trust Company operates offices in Delaware only. Note that a few states, including Delaware, have special trust advantages that may not be available under the laws of your state of residence, including asset protection trusts and directed trusts.

Wilmington Trust is a registered service mark used in connection with various fiduciary and non-fiduciary services offered by certain subsidiaries of M&T Bank Corporation including, but not limited to, Manufacturers & Traders Trust Company (M&T Bank), Wilmington Trust Company (WTC) operating in Delaware only, Wilmington Trust, N.A. (WTNA), Wilmington Trust Investment Advisors, Inc. (WTIA), Wilmington Funds Management Corporation (WFMC), and Wilmington Trust Investment Management, LLC (WTIM). Such services include trustee, custodial, agency, investment management, and other services. International corporate and institutional services are offered through M&T Bank Corporation's international subsidiaries. Loans, credit cards, retail and business deposits, and other business and personal banking services and products are offered by M&T Bank, member FDIC.

ISBN 978-1-63359-383-1

AUTHOR PROFILES

Richard W. Nenno, Esq., is a Senior Trust Counsel and Managing Director in the Wealth Management Division of Wilmington Trust Company, Wilmington, Delaware. Dick has over 40 years of estate-planning experience and is admitted to the practice of law in Delaware and Pennsylvania. He is a Fiduciary Fellow of the American College of Trust and Estate Counsel (ACTEC), a member of the Advisory Committee of the Heckerling Institute on Estate Planning, a Fellow of the American Bar Foundation, a member of the Bloomberg BNA Estates, Gifts, and Trusts Advisory Board, and a Distinguished Accredited Estate Planner. Prior to joining Wilmington Trust Company in 1982, he was an associate in the Estates Department of the Philadelphia law firm of Ballard, Spahr, Andrews and Ingersoll.

Dick is a *cum laude* graduate of Princeton University with an A.B. degree from the Woodrow Wilson School of Public and International Affairs. He earned his J.D. degree from Harvard Law School.

Dick is recognized as a national speaker and published authority on estate-planning issues. He has presented at the Heckerling Institute on Estate Planning, ACTEC national meetings, the Hawaii Tax Institute, the Notre Dame Tax and Estate Planning Institute, the AICPA Advanced Estate Planning Conference, and the NYU Institute on Federal Taxation. He is a member of the American Bar Association, Section of Real Property, Trust & Estate Law (former member of Council) and Section of Taxation; Delaware State Bar Association (former chair: Estates and Trusts Section); Estate Planning Council of Delaware, Inc. (former president); Philadelphia Bar Association. He chaired the committee of the Delaware State Bar Association that updates Delaware trust legislation for many years and still participates in the committee's deliberations.

Dick is the author of numerous publications, including *Matter of Cleopatra Cameron Irrevocable Gift Trust, Dated May 26, 1998: A Closer Look*, 45 Tax Mgmt. Est., Gifts & Tr. J. 331 (Nov. 12, 2020); *Directed Trusts: Making Them Work*, 45 Tax Mgmt. Est., Gifts & Tr. J. 247 (Sept. 10, 2020); *Federal Income- and Transfer-Tax Consequences of Domestic Asset-Protection Trusts*, 45 Tax Mgmt. Est., Gifts & Tr. J. 75 (Mar. 12, 2020); *Minimizing or Eliminating New York Income Taxes on Nongrantor Trusts*, 45 Tax Mgmt. Est., Gifts & Tr. J. 27 (Jan. 9, 2020); *Opportunities to Save State Income Taxes on Nongrantor Trusts Expanded by U.S. Supreme Court's 'Kaestner' Decision*, 44 Tax Mgmt. Est., Gifts & Tr. J. 283 (Nov. 14, 2019); *Forestalling Forties Follies*, 158 Tr. & Est. 18 (June 2019) (with Emily B. Pickering, Esq.); *The Uniform Voidable Transactions Act: Why Transfers to Self-Settled Spendthrift Trusts by Settlors in Non-APT States Are Not Voidable Transfers Per Se*, 42 Tax Mgmt. Est., Gifts & Tr. J. 173 (July 14, 2017) (Coauthors George D. Karibjanian, Esq. and Daniel S. Rubin, Esq.); *A Practitioner-Friendly Guide to the Delaware Asset-Protection Trust*, 30 Prob. & Prop. 53 (Jan./Feb. 2016); *Getting a Stepped-Up Income-Tax Basis and More by Springing—or Not Springing—The Delaware Tax Trap the Old-Fashioned Way*, 40 Tax Mgmt. Est., Gifts & Tr. J. 215 (Sept. 10, 2015); *Delaware Trusts 2017* (Wilm. Tr. Co. 2017); 867 T.M., *Choosing a Domestic Jurisdiction for a Long-Term Trust* (2019); 868 T.M., *Domestic Asset Protection Trusts* (2020).

ISBN 978-1-63359-383-1

TABLE OF CONTENTS

ISBN 978-1-63359-383-1

ISBN 978-1-63359-383-1

ISBN 978-1-63359-383-1

ISBN 978-1-63359-383-1

DETAILED ANALYSIS

I. Introduction

A. Background

The U.S. Supreme Court has set rules[1] for the state income taxation of residents and nonresidents. Thus, regarding residents, the Court declared in 1995 that:[2]

> [A] jurisdiction, such as Oklahoma, may tax *all* the income of its residents, even income earned outside the taxing jurisdiction:. . . .

Regarding nonresidents, though, the Court stated:[3]

> For nonresidents . . ., jurisdictions generally may tax only income earned within the jurisdiction.

As a result, being classified as a resident or nonresident for state income-tax purposes can make a huge difference. Whereas a resident is taxable on all income, a nonresident only is taxable on income attributable to real property, tangible personal property, and business activity within the state, typically referred to as ''source income.''

These guidelines apply to trusts. Thus, states[4] tax all income of a ''Resident Trust'' but just the ''source income'' of a ''Nonresident Trust.''[5] They define ''Resident Trust'' in several different ways, however, so that a trust might be classified as a ''Resident Trust'' by more than one state, potentially resulting in two (or more) state income taxes being imposed on the same income.

Moreover, as covered in III., below, states do not have free rein as to how Resident Trust is defined. In this regard, the Michigan Court of Appeals observed in 1990:[6]

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

More recently, the District of Columbia Court of Appeals remarked in 1997 that:[7]

> The fact that the District calls some entity — be it a trust, individual, or corporation — a ''resident'' does not, by itself, give the District any greater power over that entity than it would have in the absence of such a statutory classification.

Recognizing the constitutional limits on their ability to tax, some states therefore do not tax trusts that meet the definition of a ''Resident Trust'' as Resident Trusts in certain circumstances. This Portfolio 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.

All income of a trust that is treated as a grantor trust for federal income-tax purposes normally is taxed to the trustor,[8] distributed ordinary income of a nongrantor trust generally is

---

[1] For valuable commentary on this topic, see Carlyn S. McCaffrey, John C. McCaffrey & Toni Ann Kruse, *Rationalizing the State Income Taxation of Trusts: Chasing Quill Feathers in the Wind,* 45 Tax Mgmt. Est., Gifts & Tr. J. 298 (Sept. 10, 2020); 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); Bernard E. Jacob, *An Extended Presence, Interstate Style: First Notes on a Theme From Saenz,* 30 Hofstra L. Rev. 1133 (Summer 2002); 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); Roger J. Traynor, *State Taxation of Trust Income,* 22 Iowa L. Rev. 268 (1937). *See also* Jerome R. Hellerstein, Walter Hellerstein & John A. Swain, *State Taxation* ¶20.09 (3d ed. Nov. 2020). The author would like to thank his Wilmington Trust Company colleague Alison Quinn for preparing the sample calculations in this Portfolio. The author also would like to thank his Wilmington Trust Company colleagues Eileen M. Allen, Megan E. Corcoran, Tammis M. Dowling, and Glenda S. Lewis for their extraordinary efforts in the preparation of this work.

[2] *Okla. Tax Comm'n v. Chickasaw Nation*, 515 U.S. 450, 462–63 (1995) (footnote omitted) (emphasis in original). *Accord New York ex rel. Cohn v. Graves*, 300 U.S. 308, 312–13 (1937); *Shaffer v. Carter*, 252 U.S. 37, 57 (1920).

[3] *Chickasaw Nation*, 515 U.S. 450, 463 n.11. *Accord Shaffer*, 252 U.S. 37, 57.

[4] For convenience, ''state'' refers to the District of Columbia as well as to the 50 states.

[5] Many — but not all — states formally define ''Resident Trust'' and ''Nonresident Trust.'' In this Portfolio, ''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.

[6] *Blue v. Dep't of Treasury*, 462 N.W.2d 762, 764–65 (Mich. Ct. App. 1990). *See* III.B.7., below.

[7] *District of Columbia v. Chase Manhattan Bank*, 689 A.2d 539, 544 (D.C. 1997). *See* III.C.2., below.

[8] 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. This Portfolio will use ''trustor.'' In addition, this Portfolio will use ''testator'' to describe an individual executing a Will.

ISBN 978-1-63359-383-1

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.[9] Thus, the tax-savings opportunities typically are for the accumulated non-source income of nongrantor trusts, particularly their capital gains.

B. The Opportunity

1. Introduction

In 2020, the state fiduciary income-tax rates ranged from a lowest top rate of 2.90% in North Dakota[10] and 3.07% in Pennsylvania[11] to a highest top rate of 9.90% in Oregon,[12] 10.75% in New Jersey,[13] 12.696% in New York City,[14] and 13.3% in California.[15] With proper planning, this tax may be minimized or even 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 2014 (the latest year for which figures have been released), 59,685 resident fiduciaries paid $342,062,000 of New York income tax.[16] Given that the rules for exempting trusts from taxation in New York are straightforward, one wonders how much of that tax could have been saved.

3. The Opportunities Are Great

In many situations, the potential benefits of eliminating state income tax by trustees are clear.

For example, if a nongrantor trust, which had a California trustee but no California noncontingent beneficiaries, incurred a $1 million long-term capital gain in 2020, had no other income, and paid its California income tax by the end of the year, the trustee would have paid $107,549 of California income tax on December 31, 2020, and $236,449 of federal income tax on April 15, 2021. If the trust had a non-California trustee, however,[17] the trustee would have owed $0 of state income tax and $236,449 of federal income tax, producing a net savings of $107,549.[18]

Similarly, if a nongrantor trust, which was created by a New York City domiciliary and was subject to New York State and City tax, incurred a $1 million long-term capital gain in 2020, 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, 2020, and $236,449 of federal income tax on April 15, 2021. If the trust had been structured so that New York tax was not payable, however,[19] the trustee would have owed no state or city tax and $236,449 of federal income tax, producing a net tax savings of $107,124.[20]

Under the Internal Revenue Code of 1986, state income tax was not fully deductible for federal income tax purposes in 2020.[21] Even if such tax had been fully deductible, the state income-tax deduction would have been of limited value because it was a deduction— not a credit— and because, in 2020, 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.[22]

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,[23] trusts reach the top 40.8% bracket for short-term capital gains and ordinary income in 2021 at only $13,050 of taxable income whereas single and joint filers do not do so until $523,600 and $628,300 of such income, respectively.[24] Similarly, in 2021, 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 $13,250 of taxable income whereas single and joint filers do not do so until $445,850 and $501,600 of such income, respectively.[25]

In light of this disparity between the federal income taxation of trusts and individuals, attorneys and trustees may consider increasing distributions to beneficiaries and including capital gains in distributable net income (DNI) to take advantage of the beneficiaries' lower tax burden.[26] Federal income taxation is only part of the picture, however, so that practitioners must analyze nontax and other tax factors as well. From a nontax standpoint, advisers should evaluate the trusts' purposes, the loss of protection from creditor claims, and fairness among beneficiaries. From a tax standpoint, they should factor in potential federal transfer-tax and state death-tax costs as well as the state income-tax impact on the beneficiaries.

[9] *See* VIII.F., below.

[10] N.D. Cent. Code § 57-38-30.3(1)(e). *See* Tax Foundation, *Facts & Figures 2021: How Does Your State Compare* (Mar. 10, 2021), https://taxfoundation.org/2021-state-tax-data; Tax Foundation, *State Individual Income Tax Rates and Brackets for 2021* (Feb. 2021) https://taxfoundation.org/state-income-tax-rates-2021/; American Legislative Exchange Council, *State Tax Cut Roundup* (May 19, 2020), www.alec.org; *See also* Billy Hamilton, *Washington State Weighs a Wealth Tax,* 99 Tax Notes State 815 (Feb. 22, 2021); *Jared* Walczak, *Grading the States on Inflation Indexing,* 93 Tax Notes State 1291 (Sept. 30, 2019); Roxanne Bland, *Soak the Rich!* 93 Tax Notes State 235 (July 15, 2019).

[11] 72 P.S. § 7302.

[12] Or. Rev. Stat. § 316.037.

[13] NJSA § 54A:2-1(b)(7).

[14] N.Y. Tax Law § 601(c)(1)(B)(iii), § 1304(a)(3)(A), § 1304-B(a)(1)(ii); N.Y.C. Admin. Code § 11-1701, § 11-1704.1.

[15] Cal. Rev. & Tax. Code § 17041(a)(1), § 17041(e), § 17041(h), § 17043(a); Cal. Const. Art. XIII, § 36(f)(2).

[16] N.Y. State Dep't of Tax'n and Fin., Office of Tax Policy Analysis, *Analysis of 2014 Personal Income Tax Returns*, Tbl. 57 (Feb. 2017), www.tax.ny.gov/research/stats/stat_pit/personal_income_tax_returns/analysis_of_2014_personal_income_tax_returns.htm.

[17] *See* IV.F., below.

[18] Worksheet 3 compiles figures for all states.

[19] *See* IV.A., below.

[20] Worksheet 3 compiles figures for all states.

[21] § 164(a)(3), § 641(b).

[22] § 1(h)(1).

[23] § 1, § 1411.

[24] Rev. Proc. 2020-45, § 3.01.

[25] Rev. Proc. 2020-45, § 3.03.

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

ISBN 978-1-63359-383-1

The savings from structuring a trust to minimize state income taxes as described in this Portfolio often can offset much— if not all— of the added federal tax costs.

> *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,[27] incurred a $1 million long-term capital gain in 2020 and had no other income, the trustee would have owed $0 of California income tax on December 31, 2020, and $236,449 of federal income tax on April 15, 2021. However, if the trustee distributed $1 million to a California resident beneficiary (who had no other income) in 2020, the trustee caused the $1 million of long-term capital gain to be included in DNI, and the beneficiary paid the California income tax on the distribution by year-end, the beneficiary would have owed $106,983 of California income tax on December 31, 2020, and $202,328 of federal income tax on April 15, 2021. Thus, $106,983 of California income tax was incurred to achieve a $34,121 federal tax reduction, producing a $72,862 added tax cost.[28]

5. People Are Doing It

In 2008, Professor Sitkoff of Harvard Law School and Professor Schanzenbach of Northwestern University School of Law reported that:[29]

> In the timeframe of our data [1987-2003], seventeen states abolished the Rule [Against Perpetuities], implying that through 2003 roughly $100 billion — 10% of total reported trust assets — moved as a result of the Rule's abolition. *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.*

6. The Risks of Inaction Are Real

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.[30] 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.

7. Implications of the 2017 Tax Act

On December 22, 2017, President Trump signed An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018, formerly known as the Tax Cuts and Jobs Act (2017 Tax Act).[31] Passage of the 2017 Tax Act magnifies the importance of considering the income taxation of a trust. This is because, among other things, that Act limits an individual's deduction for state and local taxes to $10,000 per year.[32] Structuring a nongrantor trust to eliminate state income tax entirely can help an individual to preserve that deduction. In addition, given that the 2017 Tax Act increases the federal gift-tax, estate-tax, and GST exemptions to $11,700,000 in 2021,[33] far fewer individuals must concern themselves with federal transfer-tax planning. Such individuals should analyze whether creating grantor trusts (trusts for which income taxes are paid by the trustor)[34] continues to make sense or whether nongrantor trusts designed to minimize state income tax now are the preferable alternative.[35] In this regard, although the Internal Revenue Service (IRS) has approved the modification of a trust to permit the trustee to reimburse the trustor for income taxes attributable to a grantor trust,[36] some trustors of such trusts will find the burden of paying income taxes on income that they do not receive unbearable over time.[37]

---

[27] *See* IV.F., below.

[28] Worksheet 4 compiles figures for all states.

[29] 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).

[30] *See Namik v. Wachovia Bank of Ga.*, 612 S.E.2d 270, 273 (Ga. 2005) (''Wachovia breached its fiduciary and contractual duties by failing to consider the potential estate tax consequences involved in investing the funds of a non-resident alien''). For a case in which executors and attorneys were surcharged for overpaying federal estate tax and Pennsylvania inheritance tax, see *In re Estate of Lohm*, 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'').

[31] Pub. L. No. 115-97 (Dec. 22, 2017). *See* Jennifer McLoughlin, *Article Illustrates TCJA Impact on State Individual Income Taxes,* 93 Tax Notes State 872 (Aug. 26, 2019); Raj A. Malviya & Brandon A.S. Ross, *Subchapter J After Tax Reform: Ten Planning Considerations,* 54 Real Prop., Tr. & Est. L.J. 47 (Spring 2019); Elizabeth L. Pack, *Income Tax Planning Strategies for Estate Plans Under the TCJA,* 46 Est. Plan. 19 (Feb. 2019); Andrew Katzenberg, *New Tax Law, Same Old Tricks: The '1014 Trust',* 226 Daily Tax Rep. 7 (Nov. 23, 2018); Alan F. Kornstein, et al., *The Intersection of Subchapter J and the Qualified Business Income Deduction,* 129 J. Tax'n 18 (Aug. 2018).

[32] § 164(b)(6)(B), added by § 11042(a) of 2017 Tax Act.

[33] § 2010(c)(3)(C), added by Pub. L. No. 115-97, § 11061, effective for decedents dying and gifts made after 2017 and before 2026. Rev. Proc. 2020-45, § 3.41. *See* Charles A. Redd, *To Give or Not to Give . . .*, 158 Tr. & Est. 15 (Nov. 2019); Bruce L. Paulson & Will Froelich, *To Gift or Not to Gift?* 158 Tr. & Est. 28 (Aug. 2019); Gregory D. Singer & Gordon P. Stone, III, *A Taxing Dilemma,* 158 Tr. & Est. 20 (July 2019); Howard M. Zaritsky, *Getting Irrevocable Trust Assets Back in the Grantor's Gross Estate,* 45 Est. Plan. 46 (Sept. 2018); Howard M. Zaritsky, *Using the Newly Increased GST Exemption,* 45 Est. Plan. 46 (May 2018). For a concise comparison of portability to a traditional credit-shelter trust, see Charles A. Redd, *Assessing the Proper Role of Portability,* 159 Tr. & Est. 12 (Mar. 2020).

[34] For further background on grantor trusts, see 819 T.M., *Grantor Trusts (Section 671-679).*

[35] *See* David L. Case, *Conversion From Non-Grantor to Grantor Trust: Tax Issues,* 46 Est. Plan. 11 (Feb. 2019).

[36] *See* PLR 201647001 (addition of tax-reimbursement clause approved). *But see* Louis S. Harrison, Kim Kamin & Martin M. Shenkman, *The Gumby Trust: Creating Flexibility,* 157 Tr. & Est. 18, 22 (Oct. 2018) (''If a grantor trust is decanted into a non-grantor trust, might the beneficiaries sue the trustee effectuating the decanting for creating a cost to the trust or beneficiaries that had theretofore been borne by the settlor?'').

[37] *See Millstein v. Millstein*, 2018-Ohio-2295, 2018 BL 210635, 2018 WL 3005347 (Ohio Ct. App. June 14, 2018) (court *dismissed* grantor's petition for reimbursement of income taxes). For a summary of *Millstein*, see Charles A. Redd, *Unexpected Consequences of Irrevocable Grantor Trusts,* 157 Tr. & Est. 10, 11-12 (Nov. 2018) (''Almost certainly, the most widely used method for generating grantor trust status is to include in the governing instrument a power, exercisable in a nonfiduciary capacity by the grantor or any person without the approval or consent of any person in a fiduciary capacity, to reacquire the trust corpus by substituting property of an equivalent value (a substitution power)''). For commentary on the ''substitution'' or ''swap power,'' see David Kirk, Nickolas Davidson & Paul Schuh, *Turning Off Grantor Trust Status,* 45 Tax Mgmt. Est., Gifts & Tr. J. 338 (Nov. 12, 2020); Matthew S. Beard, *Curing Basis Discrepancy: Sales and Substitutions of Trust Property,* 98 Tax Notes State 285 (Oct. 19, 2020); L. Paul Hood, Jr., *Snap, Crackle, Swap: The Substitution Power Under the Microscope,* 47 Est. Plan. 12

ISBN 978-1-63359-383-1

C. Scope

This Portfolio 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 all the 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 Portfolio will consider some related issues. Worksheet 1 summarizes the rules for all the states.

The author alerts practitioners to general principles. Attorneys and trustees must consult local counsel in specific cases for state-specific rules.

D. Caveats

1. Resident vs. Domiciliary

Practitioners must be mindful as to whether a state bases taxation of a testator, trustor, fiduciary, or beneficiary on ''domicile'' or on ''residence.'' Residence ordinarily consists of a two-part test— one subjective; one objective. The subjective test considers whether the state is the individual's ''domicile,'' which is understood to be:[38]

> The place at which a person has been physically present and that the person regards as home; a person's true, fixed, principal, and permanent home, to which that person intends to return and remain even though currently residing elsewhere.

The objective test assesses whether the individual has other significant contacts with the state, typically maintaining a place of abode and spending more than 183 days there.[39] That expanded definition of ''resident'' might come into play for that state's rules for taxing trust income.

2. Section 645 Election

Under federal law,[40] the executors of decedents' estates and trustees of their former revocable trusts may elect to treat the trust as part of the estate for tax purposes. Practitioners must consider the state income-tax implications of such elections for revocable trusts established in states other than decedents' states of domicile. For example, such an election might cause trust income to be subject to state tax that would have been tax-free had the election not been made.

(Apr. 2020); Charles A. Redd, *Unexpected Consequences of Irrevocable Grantor Trusts,* 157 Tr. & Est. 10, 12 (Nov. 2018). *See also Manatt v. Manatt*, No. 4:17-cv-00378, 2018 BL 235689, 2018 WL 315461 at *7 (S.D. Iowa May 2, 2018) (''Brad had the unilateral right of substitution of assets held in the BJM Trust unencumbered by Erik's fiduciary duties to determine whether the substitution was of equivalent value''); *Benson v. Rosenthal*, No. 2:15-cv-00782, 2016 BL 155561, 2016 WL 2855456, at *6 (E.D. La. May 16, 2016) (''Plaintiff complied with all of the requirements of the Substitution Provisions of the trusts to effect a substitution on January 24, 2015. Defendants must now comply with their obligations under the trusts in confirming the equivalence of value as of that date.''); *In re Dino Rigoni Intentional Grantor Tr. for Benefit of Rajzer*, No. 321589, 2015 BL 225550, 2015 WL 4255417, at *6 (Mich. App. July 14, 2015) (''Rigoni may reacquire trust assets *by* substituting property of an equivalent value'') (internal quotation marks omitted and emphasis in original).

[38] Black's Law Dictionary 614 (11th ed. 2019).

[39] *See State Tax Chart: Personal Income Tax— Determining Residency,* 26 J. Multistate Tax'n & Incentives 30 (Sept. 2016). *See also* Jennifer S. White, *Leaving the City: Can You Leave Your Big Tax Bill Behind Too?* 98 Tax Notes State 33 (Oct. 5, 2020); Parker F. Taylor & Vanessa Woods, *Changing Domiciles to Save on Taxes,* 158 Tr. & Est. 20 (Apr. 2019); Roxanne Bland, *Double Whammy: State Taxation of Income Earned in Multiple Jurisdictions,* 88 State Tax Notes 339 (Apr. 23, 2018).

[40] § 645. Until 2020, this option was not available in Pennsylvania (instructions to 2020 Form PA-41 at 1, 13). For additional discussion of the § 645 election, see 852 T.M., *Income Taxation of Trusts and Estates.*

ISBN 978-1-63359-383-1

II. State Approaches to Taxation of Trust Income

A. Introduction

As of January 2021, nine states — Alaska, Florida, Nevada, New Hampshire, South Dakota, Tennessee,[41] Texas, Washington, and Wyoming— do not tax the income of nongrantor 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; there is an ongoing effort to enact an income tax in Washington State.[42]

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;[43] and Massachusetts classifies a trust as a grantor trust based on § 671–§ 678 only,[44] so that a trust that falls under § 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,[45] which captures all federal grantor-trust income,[46] making the foregoing planning option unavailable. In this regard, Arkansas taxpayers were unsuccessful in attempting to eliminate Arkansas income tax on long-term capital gain incurred in 2017 by structuring a trust to take advantage of an apparent difference between the federal and Arkansas grantor-trust rules.[47]

Some states explicitly allow trustees to take a distribution deduction. Others make the distribution deduction available by taxing trustees on federal taxable income,[48] which is calculated after the trustee has taken a distribution deduction, if available.[49]

B. Bases of Taxation

All of the 42 taxing states 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 or fiduciaries 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 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 fact, some states specify that the designation of governing law is not a significant factor:

- Iowa — a regulation says that ‘‘[a] statement in the trust instrument that the law of a certain jurisdiction shall govern the administration of the trust is not a controlling factor in determining situs.’’[50]

- Kansas — the instructions to the fiduciary income tax return read:[51]

> A trust being administered outside of Kansas shall not be considered a resident trust merely because the governing instrument or a law requires that the laws of Kansas be followed with respect to interpretation or administration of the trust.

- Mississippi — the instructions to the fiduciary income tax return specify that:[52]

> A trust being administered outside of Mississippi shall not be considered a resident trust merely because the governing instrument or a law requires that the laws of Mississippi be followed with respect to interpretation or administration of the trust.

- Nebraska — a regulation reads:[53]

> No trust shall be deemed to be a resident trust merely because the governing instrument or a rule of conflict of law adopts the law of Nebraska with respect to the

[41] The rate under Tennessee's Hall Income Tax (Tenn. Code Ann. § 67-2-101–§ 67-2-125), which applies only to interest and dividends, reduced to 0% (Tenn. Code Ann. § 67-2-102(5)) as of January 1, 2021. *See* Tenn. Dep't of Revenue Notice 16-05, *Hall Income Tax Notice: Phasing Out of Tax* (July 2016), www.tn.gov/revenue.

[42] For an analysis of why Alaska and Washington should not introduce income taxes based on Connecticut's experience, see Jonathan Williams & Thurston Powers, *Connecticut's Adoption of an Income Tax: A Cautionary Tale,* 86 State Tax Notes 763 (Nov. 20, 2017). *See also* Roxanne Bland, *An Income Tax for Washington? Not Likely,* 97 Tax Notes State 743 (Aug. 17, 2020).

[43] Ark. Admin Code § 006.05.307-26-51-102-4.26-51-102; D.C. Code § 47-1809.08–§ 47-1809.09; La. Rev. Stat. Ann. § 47:187; Mont. Code Ann. § 15-30-2151(5).

[44] Mass. Gen. Laws ch. 62, § 10(e), § 10(f).

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

[46] § 671.

[47] *In the Matter of* * * *, Ark. Dep't of Fin. & Admin., Office of Hearings & Appeals Opinion No. 20-755 (Aug. 7, 2020), https://www.ark.org/dfa-act896/index.php/api/document/download/20-755.pdf. *See* IV.C.2., below.

[48] § 641(b).

[49] § 651, § 661.

[50] Iowa Admin. Code r. 701-89.3(2).

[51] Instructions to 2020 Kan. Form K-41 at 2.

[52] Instruction to 2020 Miss. Form 81-100 at 3.

[53] Neb. Admin. R. & Regs. 316-23-001.05. *See* Neb. Admin. R. & Regs. 316-23-002.04.

ISBN 978-1-63359-383-1

interpretation or administration of the trust. If a trust meets the requirements of the definition of a resident trust, it shall not be deemed to be a nonresident trust only because the governing instrument or a rule of conflicts of law adopts the law of a state other than Nebraska with respect to the interpretation or administration of the trust.

- South Carolina — the instructions to the fiduciary income tax return provide that "Nonresident Trust" includes "a trust administered outside of South Carolina that is required to follow the laws of South Carolina for administration of the trust."[54]

In its 2018 *Fielding v. Commissioner of Revenue* decision,[55] the Supreme Court of Minnesota held that:[56]

> The State cannot fairly ask the Trusts to pay taxes as residents in return for the existence of Minnesota law and the physical storage of trust documents in Minnesota.

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 domiciliary or 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 domicile or residence of the testator or trustor, the place of administration, the domicile or residence of the trustees or fiduciaries, and the domicile or 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.

Worksheet 1 summarizes the criteria that the 42 taxing states employ in taxing trust income.

C. Trust Created by Will of Domiciliary or Resident

Sixteen states — Connecticut, the District of Columbia, Illinois, Louisiana, Maine, Michigan, Minnesota (trusts created or first administered in state after 1995), Nebraska, Ohio, Oklahoma, Pennsylvania, Utah, 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 domiciliary decedent only if the trust has domiciliary trustees, assets, and/or source income, and Idaho taxes if the testator's domicile or residence is one of several connections. Whereas Delaware, Maryland, Massachusetts, Missouri, Montana, and Rhode Island tax if the trust has at least one domiciliary or resident beneficiary, Arkansas taxes if the trust has a resident trustee and apportions tax based on the number of resident and nonresident trustees. Alabama taxes on this basis if a trust has a resident fiduciary or current beneficiary. Utah taxes on this basis, but, after 2003, a Utah trust that has a Utah corporate trustee may deduct all nonsource income.[57]

This criterion must be considered if the 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 the individual is a domiciliary or on another basis (e.g., if the individual has a place of abode and spends a certain amount of time in the state).[58] This must be kept in mind in determining whether a trust is a resident trust in this category. As discussed in II.G., below, basing taxation in whole or in part on the presence of domiciliary or resident beneficiaries is questionable in certain circumstances.

D. Inter Vivos Trust Created by Domiciliary or Resident

Twelve states — the District of Columbia, Illinois, Maine, Michigan, 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 was domiciled or 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 domiciliary trustees, assets, and/or source income, and Connecticut, Delaware, Maryland, Missouri, Montana, Ohio, and Rhode Island tax if the trust has at least one domiciliary or 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 decision, the Supreme Judicial Court of Massachusetts held:[59]

> [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.

Arkansas taxes if the trust has a resident trustee and apportions tax based on the number of resident and nonresident trustees. Idaho taxes if this is one of several factors. Alabama taxes on this basis if a trust has a resident fiduciary or current beneficiary.[60] In contrast, the trustor's residence is a nonfactor in Iowa.[61] As discussed in II.G., below, basing taxation in whole or in part on the presence of domiciliary or resident beneficiaries is questionable in certain circumstances.

[54] Instructions to 2020 S.C. Form 1041 at 1.

[55] 916 N.W.2d 323 (Minn. 2018).

[56] 916 N.W.2d 323, 334.

[57] *See* Worksheet 1.

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

[59] *Bank of Am., N.A. v. Comm'r of Revenue*, 54 N.E.3d 13, 21 (Mass. 2016). *See* William P. LaPiana, *Where Does a Corporate Trustee Live?* 43 Est. Plan. 40 (Dec. 2016).

[60] *See* Worksheet 1.

[61] *See* Iowa Admin. Code r. 701-89.3(2) ("The residence of the grantor of a trust, not subject to the grantor trust rules under 26 U.S.C. Sections 671 to 679, is not a controlling factor as to the situs of the trust, unless the person is also a trustee").

ISBN 978-1-63359-383-1

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 on a basis in addition to domicile.[62]

E. Trust Administered in State

Twelve states — Colorado, Indiana, Kansas, Louisiana (unless trust instrument designates law of another state), Minnesota (trusts created or first administered in state before 1996), Mississippi, New Mexico, Oregon, South Carolina, Utah, Virginia (until July 1, 2019), 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, Iowa, Montana, and North Dakota tax on this basis if it is combined with other factors; Hawaii and Maryland do so 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.[63]

As discussed in II.G., below, basing taxation in whole or in part on the presence of domiciliary or resident beneficiaries is questionable in certain circumstances. The Ohio tax return instructions provide that a trust's residency ''is not determined based on the location of . . . the administration of the trust's assets.''[64]

F. Trust Having Domiciliary or Resident Trustee or Fiduciary

Four states — Arizona, California, New Mexico, and Oregon — tax if one or more trustees or fiduciaries are domiciled or reside in the state. Idaho, Iowa, Montana, and North Dakota tax on this basis when combined with other factors. Delaware, Hawaii, and Kentucky 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 or fiduciary is a resident. If some, but not all, of the fiduciaries of a trust are California residents, California taxes only a portion of the income.[65] The domicile or residence of the trustee or fiduciary is immaterial in the following states:

- Connecticut — the instructions to the fiduciary income tax return provide that ''[t]he residence of the fiduciary . . . does not affect the status of a trust . . . as resident or nonresident.''[66]

- District of Columbia — a statute provides ''[t]he residence or situs of the fiduciary shall not control the classification of . . . trusts as resident or nonresident under the provisions of § 47-1809.01.''[67]

- Nebraska — a regulation says that ''[i]n determining whether [a] . . . trust is resident or nonresident, the residence of the . . . trustee shall not be considered.''[68]

- Ohio — the tax return instructions provide that a trust's residency ''is not determined based on the location of . . . the trustee.''[69]

- Oklahoma — a regulation specifies ''[t]he residence of the . . . trustee has no bearing on the residence of the . . . trust.''[70]

- Pennsylvania — a regulation reads ''[t]he residence of the fiduciary . . . of the trust shall be immaterial.''[71]

- West Virginia — the instructions to the fiduciary income tax return read ''[t]he residence of the fiduciary does not affect the classification of the . . . trust as a resident or non-resident.''[72]

The planner must be mindful of whether the state in question might consider an adviser, committee, or protector to be a trustee for tax purposes[73] and how the state in question determines whether an individual or corporate trustee is a domiciliary or resident.[74] As discussed in II.G., below, basing taxation in whole or in part on the presence of domiciliary or resident beneficiaries is questionable in certain circumstances.

G. Trust Having Domiciliary or Resident Beneficiary

Three states — Georgia, North Carolina, and Tennessee — tax a trust if it has one or more resident beneficiaries. California taxes on this basis if the trust has one or more noncontingent beneficiaries; Montana and North Dakota do so when combined with other connections. Again, the planner should be aware of how the state classifies an individual as a domiciliary or resident for tax purposes.[75] If a trust is taxed on this basis, California, Georgia, North Carolina, and Tennessee tax only income attributable to resident beneficiaries.[76] In some states the domiciles or residences of beneficiaries is immaterial in establishing a trust's residency.

- Connecticut — the instructions to the fiduciary income tax return read ''[t]he residence of . . . the beneficiary does not affect the status of a trust . . . as resident or nonresident.''[77]

- Iowa — a regulation states ''[t]he residence of the beneficiaries of a trust is also not relevant in determining situs.''[78]

- Nebraska — a regulation reads that ''[n]either the residence of the beneficiaries . . . nor the situs of the trust

[62] *See, e.g.,* Md. Code Ann., Tax-Gen. § 10-101(k)(1)(iii)(2).
[63] *See* Worksheet 1.
[64] Instructions to 2020 Ohio Form IT 1041 at 3.
[65] *See* Worksheet 1.
[66] Instructions to 2020 Form CT-1041 at 5.
[67] D.C. Code § 47-1809.02; instructions to 2020 D.C. Form D-41 at 7.
[68] Neb. Admin. R. & Regs. 316-23-002.03. *See* instruction to 2020 Neb. Form 1041N at 7.
[69] Instructions to 2020 Ohio Form IT 1041 at 3.
[70] Okla. Admin. Code § 710:50-23-1(c)(5). *See* 2020 Okla. Form 513 at 3.
[71] 61 Pa. Code § 101.1.
[72] Instructions to 2020 W. Va. Form IT-141 at 2.
[73] *See* VIII.G., below.
[74] *See, e.g.,* Cal. Rev. & Tax. Code § 17742(a); 30 Del. C. § 1601(8)(c); 23 Va. Admin. Code § 10-115-10.
[75] *See, e.g.,* Cal. Rev. & Tax. Code § 17742(a); N.C. Gen. Stat. § 105-160.2.
[76] *See* Worksheet 1.
[77] Instructions to 2020 Form CT-1041 at 5.
[78] Iowa Admin. Code r. 701-89.3(2).

ISBN 978-1-63359-383-1

. . . shall be determinative as to the residence or nonresidence of the trust. . . .''[79]

• Pennsylvania— a regulation specifies that ''[t]he residence of . . . the beneficiaries of the trust shall be immaterial.''[80]

[79] Neb. Admin. R. & Regs. 316-23-002.03.
[80] 61 Pa. Code § 101.1.

In 2019, the U.S. Supreme Court stipulated thusly:[81]

When a tax is premised on the in-state residence of a beneficiary, the Constitution requires that the resident have some degree of possession, control, or enjoyment of the trust property or a right to receive that property before the state can tax the asset.

[81] *N.C. Dep't of Revenue v. The Kimberley Rice Kaestner 1992 Family Tr.*, 139 S. Ct. 2213, 2222 (2019). *See* III.A.9., below.

ISBN 978-1-63359-383-1

III. Determining Whether Imposition of Tax Is Valid

A. *Pertinent U.S. Supreme Court Cases*

1. Introduction

Over the past century, the U.S. Supreme Court has decided eight cases that are of particular relevance to this subject.

2. Brooke v. City of Norfolk (1928) — Setting Constitutional Standards for Nexus to Impose Tax on Trustee (Ad Valorem Tax)

In *Brooke v. City of Norfolk*,[82] the Court described the controversy as follows:[83]

> The assessments complained of were for City and State taxes upon the corpus of a trust fund created by the will of a citizen of Maryland resident in Baltimore at the time of her death. This will bequeathed to the Safe Deposit & Trust Company of Baltimore $80,000 in trust to pay the income to the petitioner for life, then to her daughters for their lives, and, upon the death of the last survivor, to divide the principal between the descendants then living of the daughters per stirpes. The will was proved in Maryland and in 1914 was admitted to probate in the Corporation Court of Norfolk as a foreign will. The property held in trust has remained in Maryland and no part of it is or ever has been in Virginia.
>
> The petitioner has paid without question a tax upon the income received by her. But the doctrine contended for now is that the petitioner is chargeable as if she owned the whole.

The Court held:[84]

> No doubt in the case of tangible property lying within the State and subject to a paramount lien for taxes, the occupant actually using it may be made personally liable. But here the property is not within the State, does not belong to the petitioner and is not within her possession or control. The assessment is a bare proposition to make the petitioner pay upon an interest to which she is a stranger. This cannot be done.

3. Safe Deposit and Trust Company v. Virginia (1929) — Also Setting Constitutional Standards for Nexus to Impose Tax on Trustee (Ad Valorem Tax)

In *Safe Deposit and Trust Company v. Virginia*,[85] the 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:[86]

> 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.

The Court confirmed in 2019 that *Safe Deposit* remains good law.[87]

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

In *Guaranty Trust Company v. Virginia*,[88] 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.[89] The Court sustained Virginia's right to tax the beneficiary as follows:[90]

> 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.

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

In *Greenough v. Tax Assessors of Newport*,[91] the Court held that an ad valorem tax could be imposed upon a trustee with respect to its interest in the trust. The Court explained:[92]

> 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.

The above cases established the following logical framework for the taxation of trustees and beneficiaries:

- The presence of resident beneficiaries does not give a state the right to tax a nonresident trustee — *Brooke* and *Safe Deposit*.
- A state may tax its residents on income that they receive from nonresident trustees— *Guaranty Trust*.
- A state may tax a trustee on trust income if the trustee is a resident of that state— *Greenough*.

6. Hanson v. Denckla (1958) — No Purposeful Availment to Justify Personal Jurisdiction

The leading personal-jurisdiction case in the trust field is *Hanson v. Denckla*, which was not a tax case. *Hanson* involved

---

[82] 277 U.S. 27 (1928).
[83] 277 U.S. 27, 28.
[84] 277 U.S. 27, 28–29 (citations omitted).
[85] 280 U.S. 83 (1929). *See* Bradley E.S. Fogel, *What Have You Done for Me Lately? Constitutional Limitations on State Taxation of Trusts,* 32 U. Rich. L. Rev. 165, 179-84 (Jan. 1998).
[86] 280 U.S. 83, 93.
[87] *Kaestner*, 139 S. Ct. 2213, 2221 n.6 (2019). *See* III.A.9., below.
[88] 305 U.S. 19 (1938).
[89] 305 U.S. 19, 21.
[90] 305 U.S. 19, 23 (citations omitted).
[91] 331 U.S. 486 (1947).
[92] 331 U.S. 486, 495.

ISBN 978-1-63359-383-1

a controversy concerning the right to part of the principal of a trust established in Delaware by a Pennsylvania trustor who subsequently moved to Florida. The Court held that a Delaware court was under no obligation to give full faith and credit to a judgment of a Florida court that lacked jurisdiction over the trust's assets and the trustee. The Court, affirming the decision of the Supreme Court of Delaware,[93] discussed the jurisdictional issues as follows:[94]

> [I]t is essential in each case that there be some act by which the defendant purposefully avails itself of the privilege of conducting activities within the forum State, thus invoking the benefits and protections of its laws. The settlor's execution in Florida of her power of appointment cannot remedy the absence of such an act in this case.

In the course of the opinion, the Court noted that ''It is urged that because the settlor and most of the appointees and beneficiaries were domiciled in Florida the courts of that State should be able to exercise personal jurisdiction over the nonresident trustees. This is a nonsequitur.''[95]

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

a. *The Case*

In *Quill Corporation v. North Dakota*,[96] the 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:[97]

> 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 Process Clause, Justice Stevens stated:[98]

> 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:[99]

> 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*,[100] 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.[101]

He explained the difference between Due-Process-Clause and Commerce-Clause analysis as follows:[102]

> 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 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

---

[93] *Lewis v. Hanson*, 128 A.2d 819 (Del. 1957), *aff'd sub nom.*, *Hanson v. Denckla*, 357 U.S. 235 (1958).

[94] *Hanson*, 357 U.S. 235, 253–54 (citation omitted).

[95] 357 U.S. 235, 254.

[96] 504 U.S. 298 (1992). *See* Bradley E.S. Fogel, *What Have You Done for Me Lately? Constitutional Limitations on State Taxation of Trusts,* 32 U. Rich. L. Rev. 165, 186-89 (Jan. 1998).

[97] 504 U.S. 298, 306–07 (citations and internal quotation marks omitted).

[98] 504 U.S. 298, 308.

[99] 504 U.S. 298, 309 (citation and internal quotation marks omitted).

[100] 430 U.S. 274 (1977).

[101] *Quill Corp.*, 504 U.S. 298, 311.

[102] 504 U.S. 298, 312–13 (footnotes, citations, and internal quotation marks omitted).

ISBN 978-1-63359-383-1

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.[103]

b. Implications of the Case

With respect to the income taxation of trusts, *Quill* made 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. As covered in III.A.8., below, the third point no longer is the law.

8. South Dakota v. Wayfair, Inc. (2018) — Reducing Level of Contacts Required by Commerce Clause

a. The Case

In his concurring opinion in *Direct Marketing Association v. Brohl*,[104] Justice Kennedy called in 2015 for a reconsideration of *Quill's* physical-presence requirement for the substantial-nexus test under the dormant Commerce Clause.[105] He got his wish three years later. Accordingly, on June 21, 2018, in a 5-4 decision, the Court eliminated the physical-presence requirement for substantial nexus to justify sales taxation under the Commerce Clause, declaring:[106]

> [T]he court concludes that the physical presence rule of *Quill* is unsound and incorrect. The Court's decisions in *Quill Corp. v. North Dakota*, 504 U.S. 298, 112 S. Ct. 1904, 119 L.Ed.2d 91 (1992); and *National Bellas Hess, Inc. v. Department of Revenue of Ill.*, 386 U.S. 753, 87 S. Ct. 1389, 18 L.Ed.2d 505 (1967), should be, and now are, overruled.

b. Implications of the Case

In the author's view, the *Wayfair* decision will have minimal impact on the state income taxation of trusts.[107] This is because a taxing state still must satisfy the yet-to-be-developed new substantial nexus test and, as demonstrated by *McNeil v. Commonwealth*,[108] the other three prongs of *Complete Auto Transit, Inc. v. Brady*.[109] Furthermore, *Linn v. Department of Revenue*[110] and *Fielding v. Commissioner of Revenue*[111] show that a nonresident trustee may win under the Due Process Clause, which has not required physical presence since the *Quill* decision in 1992.[112] In fact, less than a month after the Court decided *Wayfair*, the Supreme Court of Minnesota affirmed the Minnesota Tax Court's decision and held 4-2 in *Fielding v. Commissioner of Revenue* that:[113]

> [E]ven when the additional contacts the Commissioner cites are considered in combination, the State lacks sufficient contacts with the Trusts to support taxation of the Trusts' entire income as residents consistent with due process. The State cannot fairly ask the Trusts to pay taxes as residents in return for the existence of Minnesota law and the physical storage of trust documents in Minnesota. Attributing all income, regardless of source, to Minnesota for tax purposes would not bear a rational relationship with the limited benefits received by the Trusts from Minnesota during the tax year at issue. We therefore hold that Minn. Stat. § 290.01, subd.7b(a)(2), is unconstitutional as applied to the Trusts.

9. North Carolina Department of Revenue v. The Kimberley Rice Kaestner 1992 Family Trust (2019) — Taxation Based Solely on Presence of Resident Discretionary Beneficiaries Violates Due Process Clause

a. Introduction

Although North Carolina does not formally define ''resident trust,'' the state provides a functional definition of the term by taxing trustees — resident and nonresident — ''on the amount of the taxable income of the . . . trust that is *for the benefit of a resident of this State. . . .*''[114] In *North Carolina Department of Revenue v. The Kimberley Rice Kaestner 1992 Family Trust*,[115] the Court held unanimously on June 21, 2019, that the Due Process clause of the U.S. Constitution[116] prohibited North Carolina from taxing a nonresident trustee on the accumulated ordinary income and capital gains of a nongrantor trust based exclusively on the existence of resident discretionary beneficiaries, saving the trustee over $1.3 million.

---

[103] 504 U.S. 298, 311, 318–19.

[104] 575 U.S. 1 (2015).

[105] 575 U.S. 1, 18–19.

[106] *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080, 2099 (2018). *See* Adam Thimmesch, Darien Shanske & David Gamage, *Wayfair: Substantial Nexus and Undue Burden,* 89 State Tax Notes 447 (July 30, 2018); Jeffrey S. Reed, *What Is the New Constitutional Test After Wayfair?* 89 State Tax Notes 335 (July 23, 2018); Jaye Calhoun & William J. Kolarik, II, *Implications of the Supreme Court's Historic Decision in Wayfair,* 89 State Tax Notes 125 (July 9, 2018); Jad Chamseddine, *U.S. Supreme Court Overturns Quill,* 88 State Tax Notes 1273 (June 25, 2018).

[107] *Accord* Jad Chamseddine, *Fiduciary Income Tax Unaffected by Wayfair,* 91 State Tax Notes 362 (Jan. 28, 2019); Larry Katzenstein & Jeff Pennell, *How Does South Dakota v. Wayfair Impact a State's Ability to Tax Undistributed Trust Income?* LISI Inc. Tax Plan. Newsl. #148 (July 12, 2018), www.leimbergservices.com (''there does not appear to be a change in the standards that will apply in the future'').

[108] 67 A.3d 185 (Pa. Commw. Ct. 2013). *See* III.D.5., below.

[109] 430 U.S. 274 (1977). *See* III.D.5., below, and III.E., below.

[110] 2 N.E.3d 1203 (Ill. App. Ct. 2013). *See* III.D.3., below.

[111] 916 N.W.2d 323 (Minn. 2018). *See* III.D.4., below.

[112] *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). *See* III.A.7., above.

[113] *Fielding*, 916 N.W.2d 323, 334 (footnote omitted).

[114] N.C. Gen. Stat. § 105-160.2 (emphasis added). *See* IV.C.7., below.

[115] 139 S. Ct. 2213 (2019). *See* Andrea Muse, *Supreme Court Finds North Carolina Can't Tax Trust Income,* 93 Tax Notes State 40 (July 1, 2019).

[116] U.S. Const. amend. XIV, § 1.

ISBN 978-1-63359-383-1

b. Facts

- 1992 — New York trustor created irrevocable inter vivos trust for his children naming New York individual trustee and designating New York law to govern.

- 1997 — One of trustor's children moved to North Carolina.

- December 30, 2002 — Trustee divided trust into equal shares for trustor's children, including a share for the benefit of North Carolina resident and her children.

- 2005-2008 — Trustee was Connecticut resident; trust investments consisted of financial assets; custodian was in Boston; tax returns, accountings, and other records were prepared and kept in New York; no distributions were made to North Carolina resident.

- February 11, 2011 — North Carolina Department of Revenue denied trustee's requests for refunds of North Carolina income taxes paid for 2005-2008.

- 2015-2018 — Business Court Division of Superior Court of Wake County, North Carolina, Court of Appeals of North Carolina, and Supreme Court of North Carolina held for trustee.[117]

c. Supreme Court Holding

Justice Sotomayor wrote the opinion for a unanimous Court in favor of the taxpayer.[118] The opinion concluded:[119]

> We hold that the presence of in-state beneficiaries alone does not empower a State to tax trust income that has not been distributed to the beneficiaries where the beneficiaries have no right to demand that income and are uncertain ever to receive it. In limiting our holding to the specific facts presented, we do not imply approval or disapproval of trust taxes that are premised on the residence of beneficiaries whose relationship to trust assets differs from that of the beneficiaries here.

Following the *Kaestner* decision, a nonresident trustee should not have to pay North Carolina income tax on the nonsource undistributed ordinary income and capital gains of a nongrantor trust even if the trust has North Carolina resident discretionary beneficiaries.

d. Implications of the Case

The *Kaestner* decision enhances tax-savings opportunities in North Carolina, Georgia, Maryland, and elsewhere and highlights the importance of continuing to take advantage of planning opportunities in California, New Jersey, New York, Oregon, Pennsylvania, and other states.[120]

B. State Court Cases Before Quill

1. Introduction

Between 1964 and 1992, state courts decided seven cases involving the state income taxation of trusts based on the residence or domicile of the testator or trustor. In six of them, the court denied its state's power to tax.

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

In *Mercantile-Safe Deposit & Trust Company v. Murphy*,[121] 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:[122]

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

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

---

[117] *Kimberley Rice Kaestner 1992 Family Trust v. N.C. Dep't of Revenue*, No. 12-CVS-8740, 2015 NCBC 36, 2015 WL 1880607 (N.C. Sup. Ct. Apr. 23, 2015), *aff'd*, 789 S.E.2d 645 (N.C. Ct. App. 2016), *aff'd*, 814 S.E.2d 43 (N.C. 2018).

[118] *N.C. Dep't of Revenue v. The Kimberley Rice Kaestner 1992 Family Trust*, 139 S. Ct. 2213 (2019).

[119] 139 S. Ct. 2213, 2221.

[120] *See* Roxanne Bland, *Trusting in Due Process,* 98 Tax Notes State 857 (Nov. 23, 2020); Henry Ordower, *Avoiding Federal and State Constitutional Limitations in Taxation,* 97 Tax Notes State 803 (Aug. 24, 2020); Richard W. Nenno, *Opportunities to Save State Income Taxes on Nongrantor Trust Expanded by U.S. Supreme Court's Kaestner Decision,* 44 Tax Mgmt. Est., Gifts & Tr. J. 283 (Nov. 14, 2019); Bridget J. Crawford, *Magical Thinking and Trusts,* 50 Seton Hall L. Rev. 289, 307-313 (219); Jonathan G. Blattmachr & Martin M. Shenkman, *State Income Taxation of Trusts: Some Lessons of Kaestner,* 29 J. Multistate Tax'n 20 (Oct. 2019); Stuart J. Kohn & Steven L. Kriz, *The State of State Taxation of Trusts and the U.S. Supreme Court Decision in Kaestner,* 44 Tax Mgmt. Est., Gifts & Tr. J. 265 (Sept. 12, 2019); Walter Pickhardt, *Taxation of Inter Vivos Trusts After Kaestner and Fielding,* 93 Tax Notes State 1065 (Sept. 9, 2019); Michael S. Canfield, *Kaestner Family Trust Opinion: Grappling With the Patchwork of State Laws,* 93 Tax Notes State 907 (Sept. 2, 2019); William P. LaPiana, *North Carolina Fiduciary Income Tax Based on Residence of Beneficiary Held Unconstitutional,* 46 Est. Plan. 35 (Sept. 2019); Turney Berry & Charles A. Redd, *U.S. Supreme Court Decides Kaestner but Teaches Little,* 158 Tr. & Est. 18, 18-20 (Aug. 2019). *See also* Jerome R. Hellerstein, Walter Hellerstein & John A. Swain, *State Taxation* ¶20.9[2][a][1] at 3-6 (3d ed. Nov. 2020).

[121] 255 N.Y.S.2d 96 (N.Y. 1964), *aff'g* 242 N.Y.S.2d 26 (App. Div. 1963).

[122] 255 N.Y.S.2d 96, 97.

ISBN 978-1-63359-383-1

3. 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*,[123] a New York intermediate appellate court considered whether New York income tax was payable on gain incurred upon the sale of Florida real property held in a trust created by the Will of a New York decedent. Although the Will appointed two nondomiciliary individual trustees and a New York corporate trustee, Florida law prohibited the corporate trustee from serving so that only the nondomiciliary trustees acted with respect to the Florida real estate. The sale proceeds of the Florida property were held by the New York corporate co-trustee in an agency account in New York. The court held on due-process grounds that New York could not tax the gain as follows:[124]

> 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.

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

4. Pennoyer v. Taxation Division Director (1983) — No Income Taxation of Resident Testamentary Trust Based Solely on Domicile of Testator

In *Pennoyer v. Taxation Division Director*[125] the New Jersey Tax Court held that the state could not tax undistributed income of a testamentary trust based primarily on the domicile of the testator — there were no New Jersey trustees, beneficiaries, or assets.[126] The court held:[127]

> 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.

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

In *Potter v. Taxation Division Director*[128] 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 domicile of the trustor. Again, the trust had no New Jersey trustees, beneficiaries, or assets.[129] The court held:[130]

> 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 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.

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

In *In re Swift*,[131] 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 trusts' income under the state and federal due process clauses. The court observed:[132]

> 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.''[133]

[123] 445 N.Y.S.2d 648 (App. Div. 1981).
[124] 445 N.Y.S.2d 648, 649 (citations omitted).
[125] 5 N.J. Tax 386 (Tax Ct. 1983).
[126] 5 N.J. Tax 386, 388.
[127] 5 N.J. Tax 386, 399.
[128] 5 N.J. Tax 399 (Tax Ct. 1983).
[129] 5 N.J. Tax 399, 401.
[130] 5 N.J. Tax 399, 405 (citation omitted).
[131] 727 S.W.2d 880 (Mo. 1987).
[132] 727 S.W.2d 880, 882.
[133] 727 S.W.2d 880, 882.

ISBN 978-1-63359-383-1

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

In *Blue v. Department of Treasury*,[134] the Michigan Court of Appeals held 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:[135]

> 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 M.C.L. 206.18; M.S.A. 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.

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

In *Westfall v. Director of Revenue*,[136] 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:[137]

> 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.

C. *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 Domicile of Testator Passes Due-Process Test*

a. *The Case*

In *District of Columbia v. Chase Manhattan Bank*,[138] 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 domiciliary 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.[139]

The court summarized the facts and its conclusion as follows:[140]

> 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 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.[141] 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.

---

[134] 462 N.W.2d 762 (Mich. Ct. App. 1990).

[135] 462 N.W.2d 762, 764–65.

[136] 812 S.W.2d 513 (Mo. 1991).

[137] 812 S.W.2d 513, 514 (internal quotation marks omitted).

[138] 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 539, 541 n.6). *See* Bradley E.S. Fogel, *What Have You Done for Me Lately? Constitutional Limitations on State Taxation of Trusts,* 32 U. Rich. L. Rev. 165, 191 (Jan. 1998).

[139] *See* 689 A.2d 539, 540–41.

[140] 689 A.2d 539, 540.

[141] 689 A.2d 539, 542 n.7.

ISBN 978-1-63359-383-1

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:[142]

> 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 under-girds our 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 roundly criticized the holding. He first acknowledged the difficulty of applying *Quill*, which dealt with a use tax, to state fiduciary income tax, stating:[143]

> 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 state courts and periodic accountings, and (2) residence of the trustor/testator.[144] He dismissed the first category, stating:[145]

> 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: (1) the classification of the trust as a Resident Trust (and the concomitant state income tax liabilities); (2) the continuing jurisdiction of the state courts; and (3) 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.[146] He concluded:[147]

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

In this case, the court made much of the ''continuing supervisory relationship which the District's courts have with respect to administration of such a trust.''[148] It should be noted, however, that, at the time of the decision, authorities indicated that courts of another state might have been responsible for handling controversies involving the trust.[149] A few years after the decision, the District of Columbia adopted a version of the Uniform Trust Code (UTC), so that this approach now is mandated by the District's own laws.[150]

---

[142] 689 A.2d 539, 547 n.11.

[143] Bradley E.S. Fogel, *What Have You Done for Me Lately? Constitutional Limitations on State Taxation of Trusts,* 32 U. Rich. L. Rev. 165, 190 (Jan. 1998) (footnotes omitted).

[144] Fogel at 192-98.

[145] Fogel at 195-96 (footnote omitted).

[146] Fogel at 196-98.

[147] Fogel at 225.

[148] *District of Columbia v. Chase Manhattan Bank*, 689 A.2d 539, 540 (D.C. 1997).

[149] *See* VII.A.2., below.

[150] *See* D.C. Code § 19-1302.02, § 19-1301.08(a). *See also* VII.A.3., below.

ISBN 978-1-63359-383-1

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*,[151] 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:[152]

> [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 noncontingent beneficiary. The court held as follows:[153]

> 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 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.

b. Implications of the Case

Professor Blackburn described *Gavin* as a "misguided holding"[154] and opined that:[155]

> *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 observed of *Gavin* that:[156]

> 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:[157]

> Probate courts long functioned as sporadic 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.

In 2017, Judge Delapena of the Minnesota Tax Court criticized *Gavin's* holding regarding the inter vivos trust quite bluntly:[158]

> *Gavin* was incorrectly decided insofar as it relies on the domicile of trust *beneficiaries* as a basis for jurisdiction to tax a trust.

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

As did the court in the *District of Columbia* case, the Supreme Court of Connecticut emphasized the protections that Connecticut gave the trustees and the beneficiaries. Again, courts in another state probably were charged with supervising trust administration,[159] and this result is required by Connecticut's version of the UTC.[160]

D. Recent State Court Cases

1. Introduction

There have been four recent taxpayer victories in the state income taxation of trusts based on the domicile or residence of the testator or trustor. They might signal a pendulum swing away from judicial approval of states' power to tax.

---

[151] 733 A.2d 782 (Conn. 1999).

[152] 733 A.2d 782, 790.

[153] 733 A.2d 782, 790.

[154] 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, 4 (Fall 2006). *See* Jerome R. Hellerstein, Walter Hellerstein & John A. Swain, *State Taxation* ¶20.09[2][a][ii] at 8-9 (3d ed. Nov. 2020).

[155] Blackburn at 53-54.

[156] Bernard E. Jacob, *An Extended Presence, Interstate Style: First Notes on a Theme From Saenz,* 30 Hofstra L. Rev. 1133, 1239 (Summer 2002).

[157] Jacob at 1240 (footnote omitted).

[158] *Fielding v. Comm'r of Revenue*, No. 8911-R, 2017 BL 194423, 2017 WL 2484593, at *17 n.85 (Minn. Tax. Ct. May 31, 2017), *aff'd*, 916 N.W.2d 323 (Minn. 2018) (emphasis in original).

[159] *See* VII.A.2., below.

[160] Conn. Gen. Stat. § 45a-499n, § 45a-499e(a). *See also* VII.A.3., below.

ISBN 978-1-63359-383-1

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 Created by Domiciliary Testator with Trustee and Administration Outside New Jersey Not Taxable on all Income*

a. The Case

New Jersey classifies a trust created by a domiciliary testator or trustor as a Resident Trust.[161] In the 2015 case of *Residuary Trust A U/W/O Kassner v. Director, Division of Taxation*,[162] 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 domiciliary who died in 1998 and therefore was a Resident Trust for New Jersey tax purposes. But, for all of 2006 — the tax year in question — the sole trustee was domiciled 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 of New Jersey, the appellate court did not find it necessary to apply constitutional principles. Instead, it based its decision on New Jersey's square corners doctrine:[163]

> 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. *Linn v. Department of Revenue (2013) — Illinois Intermediate Appellate Court Holds that Nondomiciliary Trustee of Trust Created by Domiciliary Trustor Not Taxable Under Due Process Clause*

a. The Case

Like New Jersey, Illinois classifies a trust created by a domiciliary testator or trustor as a Resident Trust.[164] In *Linn v. Department of Revenue*,[165] however, the Appellate Court of Illinois held that Illinois's imposition of income tax on the nondomiciliary trustee of a trust would violate the Due Process Clause of the U.S. Constitution even though the trust had an Illinois trustor.

In *Linn*, trustor, A. N. Pritzker, an Illinois domiciliary, created an irrevocable trust (the ''Linda Trust'') for his granddaughter, Linda Pritzker, in 1961 and named an Illinois domiciliary individual as trustee.[166] The trust designated Illinois law to govern.[167] 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.[168] In 2006 — the tax year in question, none of the beneficiaries of the Autonomy Trust 3 lived in Illinois, the trustee was a Texas domiciliary and administration took place there, no trust assets were in Illinois, and the protector was a Connecticut domiciliary.[169] 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 of its income.[170]

In considering the parties' opposing motions for summary judgment on whether imposition of tax would violate the U.S. Due Process Clause, the Appellate Court of Illinois summarized *Quill*,[171] distinguished *Gavin*,[172] and commented favorably on *Blue* and *Mercantile*.[173] As the result of its analysis, the court opined:[174]

> [W]e find the fact the Autonomy Trust 3's 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:[175]

> [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 Au-

---

[161] NJSA § 54A:1-2(o)(2)–§ 54A:1-2(o)(3).

[162] 28 N.J. Tax 541 (N.J. Super. Ct. App. Div. 2015), *aff'g* 27 N.J. Tax 68 (N.J. Tax Ct. 2013). *See* Open Weaver Banks, Amy Nogid & Leah Robinson, *It's Hip to Be Square in New Jersey,* State Tax Today, Aug. 24, 2015, at 178-8; 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.

[163] *Residuary Trust A,* 28 N.J. Tax 541, 548 (citations omitted).

[164] 35 Ill. Comp. Stat. 5/1501(a)(20)(C)-5/1501(a)(20)(D).

[165] 2 N.E.3d 1203 (Ill. App. Ct. 2013).

[166] 2 N.E.3d 1203, 1205.

[167] 2 N.E.3d 1203, 1205.

[168] 2 N.E.3d 1203, 1205.

[169] 2 N.E.3d 1203, 1205.

[170] 2 N.E.3d 1203, 1206.

[171] 2 N.E.3d 1203, 1208.

[172] 2 N.E.3d 1203, 1208–10.

[173] 2 N.E.3d 1203, 1210.

[174] 2 N.E.3d 1203, 1210.

[175] 2 N.E.3d 1203, 1211.

ISBN 978-1-63359-383-1

tonomy 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.[176]

b. Implications of the Case

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

4. Fielding v. Commissioner of Revenue (2018) — Minnesota Supreme Court Holds that Nondomiciliary Trustee of Trust Created by Domiciliary Not Taxable Under Due Process Clause

a. The Case

Minnesota classifies an inter vivos trust created or first administered in Minnesota after 1995 as a Resident Trust if the trustor was domiciled in Minnesota when the trust became irrevocable.[177] But, in *Fielding v. Commissioner of Revenue*,[178] the Minnesota Supreme Court held that Minnesota's imposition of income tax on the nondomiciliary trustee of four trusts would violate the Due Process Clause of the U.S. Constitution even though the trustor of all four trusts and the current beneficiary of one of the trusts were domiciled in Minnesota.

At the outset, the court summarized the status of the case and its holding as follows:[179]

> Four irrevocable inter vivos trusts allege that their classification as "resident trusts" under Minn. Stat. § 290.01, subd. 7b (2016), is unconstitutional as applied to them under the Due Process Clauses of the United States and Minnesota Constitutions. The Trusts filed their 2014 Minnesota income tax returns under protest, then filed amended returns requesting refunds for the difference between taxation as resident trusts and taxation as non-resident trusts. After the Trusts' income tax refund requests were denied by the Commissioner of Revenue, the Trusts appealed to the Minnesota Tax Court. The Tax Court ruled in favor of the Trusts, holding that the statutory definition of "resident trusts," violates the Due Process Clauses of the Minnesota and United States Constitutions as applied to the Trusts for the tax year at issue. Because we conclude that the Trusts lack sufficient relevant contacts with Minnesota during the applicable tax year to be permissibly taxed, consistent with due process, on all sources of income as residents, we affirm the decision of the Tax Court.

The court described the significance of the controversy in the following way:[180]

> The dispute between the Trust and the Commissioner implicates the extent of the Trusts' tax liability to Minnesota. If the Trusts are residents, Minnesota can tax the Trusts' worldwide income. If the Trusts are not residents, Minnesota's tax authority is restricted.

The first area of contention between the parties was whether consideration was limited to the sole factor contained in the statute (i.e., whether the trustor was a domiciliary) or whether nonstatutory factors could be evaluated as well, with the trustee advocating the former view.

Siding with the Minnesota Commissioner of Revenue, the court decided:[181]

> [I]n the context of a due process challenge to the State's taxation of a taxpayer as a resident, we will examine all relevant contacts between the taxpayer and the State, including the relationship between the income attributed to the state and the benefits the taxpayer received from its connections with the state.

The Commissioner made these contentions:[182]

> The Commissioner contends that she can constitutionally tax the Trusts' worldwide income based on several contacts between Minnesota and the Trusts, asserting that the Trusts "owe their very existence" to Minnesota. Specifically, the grantor, Reid MacDonald, was a Minnesota resident when the Trusts were created, was domiciled in Minnesota when the Trusts became irrevocable, and was still domiciled in Minnesota in 2014. The Trusts were created in Minnesota, with the assistance of a Minnesota law firm, which drafted, and until 2014 retained, the trust documents. The Trusts held stock in FFI, a Minnesota S corporation. The Trust documents provide that questions of law arising under the Trust documents are determined in accordance with Minnesota law. Finally, one beneficiary, Vandever MacDonald, has been a Minnesota resident at least through the tax year at issue.

The trustee countered with these assertions:[183]

> The Trusts, on the other hand, note that no Trustee has been a Minnesota resident, the Trusts have not been administered in Minnesota, the records of the Trusts' assets and income have been maintained outside of Minnesota, some of the Trusts' income is derived from investments with no direct connection to Minnesota, and three of the four trust beneficiaries reside outside of Minnesota.

---

[176] 2 N.E.3d 1203, 1211.

[177] Minn. Stat. § 290.01 Subd. 7b(a).

[178] 916 N.W.2d 323 (Minn. 2018), *aff'g* No. 8911-R, 2017 BL 194423, 2017 WL 2484593 (Minn. Tax Ct. May 31, 2017). *See* Richard W. Nenno, *Opportunities to Save State Income Taxes on Nongrantor Trusts Expanded by U.S. Supreme Court's Kaestner Decision,* 44 Tax Mgmt. Est., Gifts & Tr. J. 283 (Nov. 14, 2019); Turney P. Berry & Charles A. Redd, *U.S. Supreme Court Decides Kaestner but Teaches Little,* 158 Tr. & Est. 18, 20-21 (Aug. 2019); William P. LaPiana, *State Income Tax of Trust Based on Residence of Grantor Violates Due Process,* 45 Est. Plan. 42 (Nov. 2018); Andrea Muse, *Court Holds Trust Is Not Resident, Lacks Sufficient Contacts,* 89 State Tax Notes 389 (July 23, 2018).

[179] *Fielding*, 916 N.W.2d 323, 325 (citation omitted).

[180] 916 N.W.2d 323, 328 (citation omitted).

[181] 916 N.W.2d 323, 329.

[182] 916 N.W.2d 323, 330.

[183] 916 N.W.2d 323, 330.

ISBN 978-1-63359-383-1

The court concluded that the Commissioner's arguments were either irrelevant or too attenuated for three reasons.[184]

The court first noted that:[185]

> We conclude that the contacts on which the Commissioner relies are either irrelevant or too attenuated to establish that Minnesota's tax on the Trusts' income from all sources complies with due process requirements. We reach this conclusion for the following three reasons.
>
> First, the grantor's connection to Minnesota — the Minnesota residency of Reid MacDonald in 2009, when the Trusts were established; in 2011, when the Trusts were made irrevocable; and in 2014, when the Trusts sold the FFI stock — are not relevant to the relationship between the Trusts' income that Minnesota seeks to tax and the protection and benefits Minnesota provided to the Trusts' activities that generated that income. The relevant connections are Minnesota's connection to the trustee, not the connection to the grantor who established the trust years earlier.
>
> A trust is its own legal entity, with a legal existence that is separate from the grantor or the beneficiary. Here, grantor Reid MacDonald is not the taxpayer, the Trusts are. Moreover, regardless of the grantor's personal connection with Minnesota, after 2011 he no longer had control over the Trusts' assets. For similar reasons, the Minnesota residency of beneficiary Vandever MacDonald does not establish the necessary minimum connection to justify taxing the Trusts' income.
>
> Nor do we find the grantor's decision to use a Minnesota law firm to draft the trust documents to be relevant. The parties stipulated that the law firm represented the grantor. Other than retaining the original signed trust documents, nothing in the record establishes that the law firm represented the Trusts or the Trustees in connection with the activities that led to the income that the State seeks to tax, let alone during the tax year at issue. We are unwilling to attribute legal significance to the storage of the original signed trust documents in Minnesota, when this act may have been nothing more than a service or convenience extended to the firm's client — the grantor.

The court then said that:[186]

> Second, the Trusts did not own any physical property in Minnesota that might serve as a basis for taxation as residents. The Commissioner urges us to hold that the Trusts may be taxed as residents due to their connections to FFI, a Minnesota S corporation, and it is undisputed that the Trusts held interests in intangible property, FFI stock. Although FFI was incorporated in Minnesota and held physical property within the state, the intangible property that generated the Trusts' income was stock in FFI and funds held in investment accounts. These intangible assets were held outside of Minnesota, and thus do not serve as a relevant or legally significant connection with the State.

Finally, the court observed that:[187]

> Third, we do not find the contacts with Minnesota that pre-date 2014, the tax year at issue, by the grantor, the Trusts, or the beneficiaries, to be relevant. We have evaluated a taxpayer's contacts with Minnesota, for due process purposes, in the tax year at issue. Other courts have also held that the relevant facts for evaluating the sufficiency of a taxpayer's contacts are drawn from the tax year at issue.
>
> There is good reason to focus on the taxpayer's contacts in the tax year at issue. The direct link between the activities that generated the income in the year at issue and the protections provided by the State in that same year establishes the necessary rational relationship that justifies the tax. In contrast, allowing the State to look to historical contacts unrelated to the tax year at issue risks leaving taxpayers unaware of whether or when their contacts with Minnesota may justify the imposition of a tax.

The court then continued:[188]

> [W]e are left to consider the extremely tenuous contacts between the Trusts (or their Trustees) and Minnesota during tax year 2014. The Trustees had almost no contact with Minnesota during the applicable tax year. All trust administration activities by the Trustees occurred in states other than Minnesota. Boone never traveled to Minnesota during her time as a Trustee. Fielding traveled to Minnesota for a weekend in the fall of 2014 to attend a wedding, but he never traveled to Minnesota for any purposes related to the Trusts. This level of contact is clearly not enough to establish residency for taxation purposes.
>
> We acknowledge that "questions of law" that may arise under the trust agreements are determined by the laws of Minnesota. Standing alone, however, this choice-of-law provision is not enough to permissibly tax the Trusts as residents. Our laws protect residents and non-residents alike. We will not demand that every party who chooses to look to Minnesota law — not necessarily to invoke the jurisdiction of Minnesota's courts — must pay resident income tax for the privilege. Of note here, unlike cases in other states that considered testamentary trusts, the inter vivos trusts at issue here have not been probated in Minnesota's courts and have no existing relationship to the courts distinct from that of the trustee and trust assets.

The court concluded:[189]

> [E]ven when the additional contacts the Commissioner cites are considered in combination, the State

---

[184] 916 N.W.2d 323, 330.
[185] 916 N.W.2d 323, 330–31 (citations and footnote omitted).
[186] 916 N.W.2d 323, 331–32 (citation and footnote omitted).
[187] 916 N.W.2d 323, 332 (citations omitted).
[188] 916 N.W.2d 323, 332–33 (citation omitted).
[189] 916 N.W.2d 323, 334 (footnote omitted).

ISBN 978-1-63359-383-1

> lacks sufficient contacts with the Trusts to support taxation of the Trusts' entire income as residents consistent with due process. The State cannot fairly ask the Trusts to pay taxes as residents in return for the existence of Minnesota law and the physical storage of trust documents in Minnesota. Attributing all income, regardless of source, to Minnesota for tax purposes would not bear a rational relationship with the limited benefits received by the Trusts from Minnesota during the tax year at issue. We therefore hold that Minn. Stat. § 290.01, subd.7b(a)(2), is unconstitutional as applied to the Trusts.

Having disposed of the case under the Due Process Clause, the court found it unnecessary to address Commerce Clause arguments.[190]

b. Implications of the Case

Fielding is another taxpayer victory under the Due Process Clause. A commentator has observed:[191]

> The common theme in both *Fielding* and *Kaestner* is that, for a state statute defining or treating a trust as a ''resident'' for income tax purposes to be upheld, the required connection between the trust and the state must be current and direct (a connection between the state and the settlor or a beneficiary isn't enough) and must involve a trust's purposefully availing itself of the legal benefits and protections flowing from operating in the state.

On June 28, 2019, the U.S. Supreme Court denied the Minnesota Department of Revenue's petition for certiorari.[192] This is an unfortunate development for two reasons. First, it would have been helpful to have guidance on the validity of taxing nonresident or nondomiciliary trustees of trusts created by domiciliary or resident testators or trustors because this approach appears in the statutes of over half the states. Second, it would have been helpful to know if courts are confined to statutory factors or whether they may consider nonstatutory factors in their due process analysis. The Minnesota Department of Revenue estimated that the *Fielding* decision will cost the state $33.4 million of annual revenue (20% of estimated annual collections) as well as $66.8 million (plus interest) of retroactive revenue.[193]

[190] 916 N.W.2d 323, 334 n.11.

[191] Charles A. Redd, *Charting a New Course for Estate Planners in 2019,* 158 Tr. & Est. 10, 13 (Jan. 2019). *See* Jerome R. Hellerstein, Walter Hellerstein & John A. Swain, *State Taxation* ¶20.09[2][a][ii] at 11-12 (3d ed. Nov. 2020).

[192] *Bauerly v. Fielding*, 139 S. Ct. 2773 (2019).

[193] Aaron Davis, *State Projects Shortfall After Losing Trust Taxation Case,* 93 Tax Notes State 867 (Aug. 26, 2019).

5. 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

Pennsylvania classifies a trust created by a resident testator or trustor as a Resident Trust.[194] Nevertheless, in *McNeil v. Commonwealth*,[195] the Pennsylvania Commonwealth Court held that Pennsylvania's imposition of personal income tax on nonresident trustees of two trusts violated the Commerce Clause of the U.S. 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.[196]

Concerning the U.S. Commerce Clause, the court summarized the governing principles from *Complete Auto Transit, Inc. v. Brady*[197] as follows:[198]

> 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:[199]

> 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:[200]

> [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

[194] 72 P.S. § 7301(s).

[195] 67 A.3d 185 Pa. Commw. Ct. 2013). *See* Clark R. Calhoun, Alexandra Sampson & Kendall Houghton, *No Taxation Without Nondiscrimination,* 81 State Tax Notes 113 (July 11, 2016); Mark E. Wilensky, *Trusts Prevail on Commerce Clause Challenge to Pennsylvania's Taxation of Trust Income,* 54 Tax Mgmt. Memo. 491 (Dec. 30, 2013).

[196] 67 A.3d 185, 190.

[197] 430 U.S. 274 (1977).

[198] *McNeil*, 67 A.3d 185, 192 (citations omitted) (emphasis in original).

[199] 67 A.3d 185, 192 (citation omitted). For a summary of *Quill*, see III.A.7., above.

[200] 67 A.3d 185, 195.

ISBN 978-1-63359-383-1

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:[201]

> 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:[202]

> [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:[203]

> 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:[204]

> 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 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,[205] the court did not have to decide whether it would violate the Due Process or the Equal Protection Clause of the U.S. Constitution or the Uniformity Clause of the Pennsylvania Constitution.[206]

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, but *McNeil* should encourage more trusts to make the attempt. The Commonwealth did not appeal.

As covered in III.A.8., above, the U.S. Supreme Court dispensed with the physical-presence test under the dormant Commerce Clause in 2018. Soon after, the Commonwealth Court of Pennsylvania disavowed *McNeil's* physical-presence test in applying Pennsylvania Personal Income Tax to a nonresident partner of a partnership that disposed of Pennsylvania real property:[207]

> [W]e reject Taxpayers' contention that the taxpayer must have a physical presence in the taxing state in order to satisfy the first prong of the *Complete Auto* test. Because we relied on the *Quill* physical presence test in *McNeil Trust*, we reject Taxpayers' reliance on that decision as well.

The absence of the substantial-nexus requirement would not have changed the outcome in *McNeil* because the Commonwealth failed to meet two of the other *Complete Auto* criteria.

E. *Constitutional Analysis of Taxation Based on Domicile or Residence of Testator/Trustor*

A careful analysis of the constitutional limitations on the income taxation of trusts based solely on the domicile or resi-

[201] 67 A.3d 185, 195 (citations and internal quotation marks omitted).
[202] 67 A.3d 185, 196–97 (citation and internal quotation marks omitted).
[203] 67 A.3d 185, 197 (citations and internal quotation marks omitted).
[204] 67 A.3d 185, 197–98 (citations omitted).
[205] 67 A.3d 185, 198.
[206] 67 A.3d 185, 198 n.17.
[207] *Andrews v. Commonwealth*, 196 A.3d 1090, 1098 n.13 Pa. Commw. Ct. 2018).

ISBN 978-1-63359-383-1

dence of the testator or trustor necessarily is impaired by the fact that the U.S. Supreme Court has never actually addressed the issue. *Brooke* and *Safe Deposit and Trust* involved personal property ad valorem taxes based on beneficiaries' domiciles or residences; *Quill* and *Wayfair* considered state 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 connection 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.

Nonetheless, notwithstanding a 2015 decision to the contrary, given that two courts have held that the due process requirements are met by the domicile or residence 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 lived at death.[208]

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 or residence of the trustor at the time the trust was created.[209]

More significantly, the Commerce Clause should preclude state income taxation of a trust based solely on the domicile or residence 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 U.S. Supreme Court stated, in *Complete Auto Transit, Inc. v. Brady*,[210] that a valid tax must: (1) be 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 or residence of the trustor was an insufficient basis for state income taxation of the trust income. Even if a state attempts to apportion its tax fairly, it seems that it cannot meet all four requirements of *Complete Auto Transit, Inc.*, and that its tax effort must fail under the Commerce Clause. In the author's view, the Pennsylvania Commonwealth Court correctly applied the Commerce Clause in *McNeil v. Commonwealth*.

A 2015 decision of the U.S. Supreme Court has a bearing on Commerce Clause analysis.

In *Comptroller of the Treasury of Maryland v. Wynne*,[211] 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:[212]

> 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:[213]

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

Like *Quill* via *Wynne*, *Wayfair* should extend to fiduciary income taxes as well as to corporate taxes.[214]

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

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

[209] *Accord* Stanley R. Kaminski, *Due Process Tax Nexus and the Expatriate Inter Vivos Trust,* 39 Est. Plan. 34 (Mar. 2012).

[210] 430 U.S. 247, 279 (1977).

[211] 575 U.S. 542, 135 S. Ct. 1787 (2015). *But see Steiner v. Utah Tax Comm'n*, 449 P.3d 189, 197 (Utah 2019) (''Utah's tax code thus satisfies the internal consistency test''). *See* Jennifer McLoughlin, *State Supreme Court Strikes Taxpayers' Dormant Commerce Clause Claims,* 93 Tax Notes State 886 (Aug. 26, 2019). For commentary on *Wynne*, see Jennifer Carr, *New York Can't Ignore Wynne Forever,* 91 State Tax Notes 571 (Feb. 18, 2019); Blaise M. Sonnier & Nancy B. Nichols, *An Analysis of Recent Cases Applying Wynne's Internal Consistency Test,* 128 J. Tax'n 25 (June 2018); Christopher Brown, *Wynne It's Time for Change: How States and Their Political Subdivisions Must Amend Their Tax Systems to Comply with the Dormant Commerce Clause,* 70 Tax Law. 947 (Summer 2017) (focusing on Philadelphia City Wage Tax); *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). In *Wynne v. Comptroller of Md.*, 228 A.3d 1129 (Md. 2020), the Maryland Court of Appeals held that Maryland's reduction of the interest rate payable on refunds resulting from the U.S. Supreme Court's *Wynne* decision did not violate the Commerce Clause. *See* Andrea Muse, *Maryland Court of Appeals Upholds Lower Interest for Wynne Refunds,* 96 Tax Notes State 1368 (June 15, 2020). For the status of the *Wynne* litigation, see Jennifer Carr, *Wynne Litigation: Where Are We Now?* 97 Tax Notes State 543 (Aug. 3, 2020); Michael I. Lurie & Deandré R. Morrow, *The Wynne Soap Opera: Will It Be Renewed for a Third Season?* 97 Tax Notes State 289 (July 20, 2020).

[212] *Wynne*, 135 S. Ct. 1787, 1795.

[213] 135 S. Ct. 1787, 1797.

[214] Jaye Calhoun & William J. Kolarik, II, *Implications of the Supreme Court's Historic Decision in Wayfair,* 89 State Tax Notes 125, 135 (July 9, 2018) (''The Wayfair sufficiency test appears to apply when determining whether substantial nexus exists for *all* SALT regimes, including income, franchise, gross receipts, and property tax'') (emphasis in original). *See Smith v. Robinson*, 265 So.3d 740, 754 (La. 2018) (''Act 109 is unconstitutional, as it is in violation of the dormant Commerce Clause of the United States Constitution''). *See also* Andrea Muse, *Court Holds Limitation on Credit Unconstitutional,* 90 State Tax Notes 1112 (Dec. 17, 2018).

ISBN 978-1-63359-383-1

of the U.S. Constitution as well as under the Due Process Clause of the Fourteenth Amendment, though neither clause might preclude such taxation with respect to testamentary trusts.

F. Taxation of Trust Administered in State

1. U.S. Supreme Court Cases

In *North Carolina Department of Revenue v. The Kimberley Rice Kaestner 1992 Family Trust*, the U.S. Supreme Court observed in 2019 that:[215]

> The Court's cases also suggest that a tax based on the site of trust administration is constitutional. See *Hanson v. Denckla*, 357 U.S. 235, 251, 78 S. Ct. 1228, 2 L.Ed.2d 1283 (1958); *Curry v. McCanless*, 307 U.S. 357, 370, 59 S. Ct. 900, 83 L.Ed. 1339 (1939).

2. Wisconsin Cases

a. Wisconsin Department of Taxation v. Pabst (1961)

In *Wisconsin Department of Taxation v. Pabst*,[216] 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:[217]

> 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 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.

b. Pabst v. Wisconsin Department of Taxation (1963)

In *Pabst v. Wisconsin Department of Taxation*,[218] 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:[219]

> 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 (1961, unabridged) 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:[220]

> 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 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.

3. Comment

Practitioners should be on the lookout for guidelines that states use in assessing ''administration'' for purposes of their tax system.[221]

G. Taxation of Domiciliary or Resident Trustee or Fiduciary

1. U.S. Supreme Court Cases

North Carolina Department of Revenue v. The Kimberley Rice Kaestner 1992 Family Trust (2019)

In *North Carolina Department of Revenue v. The Kimberley Rice Kaestner 1992 Family Trust*,[222] relying on *Greenough v. Tax Assessors of Newport*,[223] the U.S. Supreme Court confirmed in 2019 that a state may tax a resident trustee of an otherwise Nonresident Trust without violating the Due Process Clause.

2. California Case

McCulloch v. Franchise Tax Board (1964)

In *McCulloch v. Franchise Tax Board*,[224] the Supreme Court of California held that California could tax the co-trustee/beneficiary on accumulated income distributed to him from a

---

[215] *N.C. Dep't of Revenue v. The Kimberley Rice Kaestner 1992 Family Trust*, 139 S. Ct. 2213, 2220 (2019) *See* III.A.9., above.
[216] 112 N.W.2d 161 (Wis. 1961).
[217] 112 N.W.2d 161, 165.
[218] 120 N.W.2d 77 (Wis. 1963).
[219] 120 N.W.2d 77, 81 (citation omitted).
[220] 120 N.W.2d 77, 85.
[221] *See* VIII.D., below.
[222] 139 S. Ct. 2213, 2220 (2019). *See* III.A.9., above.
[223] 331 U.S. 486 (1947). *See* III.A.5., above.
[224] 390 P.2d 412 (Cal. 1964).

ISBN 978-1-63359-383-1

Missouri trust because the co-trustee/beneficiary was a California resident. The court said:[225]

> 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.

H. Taxation of Trustee of Trust Having Domiciliary or Resident Beneficiary

1. U.S. Supreme Court Cases

In *Brooke v. City of Norfolk*,[226] *Safe Deposit and Trust Company v. Virginia*,[227] and *North Carolina Department of Revenue v. The Kimberley Rice Kaestner 1992 Family Trust*,[228] the U.S. Supreme Court held that a state cannot tax a nonresident trustee of a trust that had domiciliary or resident beneficiaries. But, in *Guaranty Trust Company v. Virginia*,[229] the Court confirmed that a state can tax resident or domiciliary beneficiaries on income that they received from a Nonresident Trust.

2. California Cases

a. Whatever precedential value the following cases might have had was eliminated by the U.S. Supreme Court's *Kaestner* decision.[230]

b. In *McCulloch v. Franchise Tax Board*,[231] the Supreme Court of California held that California could tax a California resident beneficiary on accumulated income distributed to him from a Missouri trust.[232]

c. In *In the Matter of the Appeal of The First National Bank of Chicago*,[233] the California State Board of Equalization ruled that California could tax six trusts being administered in Illinois because all beneficiaries of the trusts were California residents. It said:[234]

> 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*,[235] the California State Board of Equalization, following *McCulloch* and *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.

3. The Kaestner Case

The Court held in 2019 in *North Carolina Department of Revenue v. The Kimberley Rice Kaestner 1992 Family Trust* that:[236]

> We hold that the presence of in-state beneficiaries alone does not empower a State to tax trust income that has not been distributed to the beneficiaries where the beneficiaries have no right to demand that income and are uncertain ever to receive it.

Following *Kaestner*, the Hellerstein treatise explained why *McCulloch's* precedential value is questionable:[237]

> The California court failed to note or explain [in *McCulloch*] the apparent conflict between its ruling and the U.S. Supreme Court's decision in *Safe Deposit & Trust Co.* Moreover, the California court's decision is difficult, if not impossible, to reconcile with *Kaetner Trust.*

[225] 390 P.2d 412, 421.
[226] 277 U.S. 27 (1928). *See* III.A.2., above.
[227] 280 U.S. 83 (1929). *See* III.A.3., above.
[228] 139 S. Ct. 2213 (2019). *See* III.A.9., above.
[229] 305 U.S. 19 (1938). *See* III.A.4., above.
[230] *See* III.A.9., above.
[231] 390 P.2d 412.
[232] 390 P.2d 412, 421.
[233] Cal. Admin. Decision 64-SBE-054, 1964 WL 1459 (Cal. State Bd. Eq. June 23, 1964).
[234] Cal. Admin. Decision 64-SBE-054, 1964 WL 1459, at *3 (citation omitted).
[235] Cal. Admin. Decision 70-SBE-007, 1970 WL 2442 (Cal. State Bd. Eq. Feb. 18, 1970).
[236] 139 S.Ct. 2213, 2221 (2019). *See* III.A.9., above.
[237] Jerome R. Hellerstein, Walter Hellerstein & John A. Swain, *State Taxation* ¶20.09[2][a][ii] at 11 (3d ed. Nov. 2020) (footnote omitted).

ISBN 978-1-63359-383-1

IV. Specific State Considerations

A. *New York (New York State Personal Income Tax; New York City Personal Income Tax)*

1. Introduction

This discussion of particular states necessarily begins with New York. The Empire State has generated and continues to generate much of the pertinent case law and rulings. Moreover, those authorities are relevant in as many as 26 other states — Alabama, Arkansas, Connecticut, Delaware, the District of Columbia, Idaho, Illinois, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Missouri, Montana, Nebraska, New Jersey, Ohio, Oklahoma, Pennsylvania, Rhode Island, Utah, Vermont, Virginia, West Virginia, and Wisconsin — because they all tax trust income in a comparable manner. For 2014 (the latest year for which numbers are available), 59,685 resident fiduciaries paid over $342,000,000 of New York income tax.[238]

2. History

New York long has defined ''Resident Trust'' as a trust established by a New York domiciliary testator or trustor. Following the *Mercantile-Safe Deposit & Trust Company v. Murphy*[239] and *Taylor v. State Tax Commissioner*[240] decisions, the New York State Department of Taxation and Finance adopted a regulation in 1992 confirming their holdings (i.e., that the trustee of a trust created by a New York testator or trustor is not taxable if the trust has no New York trustee, asset, or source income),[241] 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[242] and the Department of Taxation and Finance announced that trustees of such trusts did not have to file tax returns.[243] The Exempt Resident Trust exemption was codified in 2003, effective January 1, 1996.[244]

In 2010, Governor Patterson unsuccessfully attempted to repeal the exemption for Exempt Resident Trusts.[245] 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.[246] That reporting requirement was made statutory in 2014.[247]

The 2014-2015 New York budget bill[248] 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[249] and imposes reporting requirements on the trustees of such trusts.[250] Second, the bill classifies incomplete gift nongrantor trusts as grantor trusts for New York State and New York City income-tax purposes.[251]

3. Current Rules

a. New York State

(1) General

In New York State, a trustee of a ''Resident Trust'' must file a state return if it must file a federal income tax return, had New York taxable income, or was subject to a separate tax on a lump-sum distribution, whereas the trustee of a ''Nonresident Trust'' must file a return if it had New York-source income and New York adjusted gross income, was subject to a separate tax on a lump-sum distribution, or incurred a net operating loss in certain circumstances.[252]

New York State treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[253] and the Empire State permits trustees of nongrantor trusts to take a distribution deduction.[254] In 2020, 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% (the 8.82% rate applied starting with such income over

---

[238] N.Y. State Dep't. of Tax'n and Fin., Office of Tax Policy Analysis, *Analysis of 2014 Personal Income Tax Returns*, Tbl. 57 (Feb. 2017) www.tax.ny.gov/research/stats/stat_pit/personal_income_tax_returns/analysis_of_2014_personal_income_tax_returns.htm.

[239] 255 N.Y.S.2d 96 (N.Y. 1964), *aff'g* 242 N.Y.S.2d 26 (N.Y. App. Div. 1963). *See* III.B.2., above.

[240] 445 N.Y.S.2d 648 (N.Y. App. Div. 1981). *See* III.B.3., above.

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

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

[243] N.Y. TSB-M-96(1)I (N.Y. Dep't Tax'n Fin. July 29, 1996).

[244] N.Y. Tax Law § 605(b)(3)(D)(i).

[245] 2009 N.Y. S.B. 6610, Pt. G.

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

[247] N.Y. Tax Law § 658(f)(2).

[248] 2014 N.Y. Laws 59, Pt. I (Mar. 31, 2014). *See* N.Y. TSB-M-15(1)I (N.Y. Dep't Tax'n Fin. Feb. 12, 2015).

[249] 2014 N.Y. Laws 59, Pt I, § 1, § 6 (Mar. 31, 2014).

[250] 2014 N.Y. Laws 59, Pt I, § 4 (Mar. 31, 2014).

[251] 2014 N.Y. Laws 59, Pt. I, § 2, § 7 (Mar. 31, 2014). *See* VIII.J., below.

[252] Instructions to 2020 N.Y. Form IT-205 at 2. *See* N.Y. Tax Law § 651(a)(2)–651(a)(3), § 651(e).

[253] *See* N.Y. Tax Law § 611(a), § 612(a); instructions to 2020 N.Y. Form IT-205 at 6.

[254] *See* N.Y. Tax Law § 618; N.Y. Comp. Codes R. & Regs. tit. 20, § 118.1; instructions to 2020 N.Y. Form IT-205 at 6.

ISBN 978-1-63359-383-1

$1,077,550),[255] and the current rate schedule applies through 2024.[256]

New York State defines "Resident Trust" as a trust that is created by a New York State testator or trustor as follows:[257]

> (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 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.[258]

The statute describes when a trust is deemed to be "revocable" or "irrevocable":[259]

> 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."[260]

New York State taxes all New York taxable income of Resident Trusts[261] but only New York-source income of Nonresident Trusts.[262] In New York State, trustees must make estimated tax payments for trusts.[263]

(2) Exempt Resident Trust Exemption

Importantly, as mentioned above, the New York Tax Law was amended in 2003 to codify an exemption for an Exempt Resident Trust.[264] Hence, a Resident Trust is not subject to tax if it has no New York State trustee, asset, or source income as follows:[265]

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

Regarding (I) above, note the use of "domicile." In this connection, the Technical Services Division of the State of New York Department of Taxation and Finance has issued guidance on how to determine the domicile of a corporate trustee and the circumstances in which advisors, protectors, and committee members will be treated as domiciliary trustees.[266]

Regarding (II) above the New York tax law provides:[267]

> (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.

Thus, if a trust only has non-New York trustees and intangible assets (e.g., stocks and bonds), the trust will meet the exemption.

Practice Tip: 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.[268]

Regarding (III) above, the New York State Department of Taxation and Finance takes the position that a single dollar of source income prevents a trust from satisfying the Exempt Resident Trust exemption.[269]

Practice Tip: 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.[270]

One might read the Exempt Resident Trust provision to say that a trust that has New York source income but no New York

---

[255] N.Y. Tax Law § 601(c)(1)(B)(iii); instructions to 2020 N.Y. Form IT-205 at 10.

[256] N.Y. Tax Law § 601(c)(1)(B)(iv)–601(c)(1)(B)(vii). *See* N.Y. TSB-M-19(4)I (N.Y. Dep't Tax'n Fin. Sept. 3, 2019), www.tax.ny.gov.

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

[258] *See* N.Y. Tax Law § 605(b)(1)(B). *See also* Robert Kantowitz, *A Tale of Two States,* 98 Tax Notes State 161 (Oct. 12, 2020).

[259] N.Y. Tax Law § 605(b)(3), flush language at end. *See* N.Y. Comp. Codes R. & Regs. tit. 20, § 105.23(a); instructions to 2020 N.Y. Form IT-205 at 2.

[260] N.Y. Tax Law § 605(b)(4). *See* instructions to 2020 N.Y. Form IT-205 at 2.

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

[262] N.Y. Tax Law § 631, § 633; instructions to 2020 N.Y. Form IT-205 at 2. *See* N.Y. Tax Bull. TB-IT-615 (Dec. 15, 2011), www.tax.ny.gov.

[263] N.Y. Tax Law § 685(c)(6); instructions to 2020 N.Y. Form IT-205 at 4.

[264] N.Y. Tax Law § 605(b)(3)(D)(i), effective January 1, 1996.

[265] N.Y. Tax Law § 605(b)(3)(D)(i). *See* N.Y. Comp. Codes R. & Regs. tit. 20, § 105.23(c); instructions to 2020 N.Y. Form IT-205 at 2.

[266] N.Y. TSB-A-04(7)I, 2004 N.Y. Tax Lexis 259 (N.Y. Dep't Tax'n Fin. Nov. 12, 2004). *See* IV.A.4.d., below.

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

[268] *See* IV.A.5., below.

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

[270] *See* IV.A.5., below.

ISBN 978-1-63359-383-1

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.[271] 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:[272]

> [U]nder the policy described in TSB-M-96(I), Resident Trusts, a resident trust that was not subject to tax because it met the conditions described in section 605(b)(3)(D) of the Tax Law was not required to file a return. . . .
>
> 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 even to trustees of Exempt Resident Trusts that satisfied § 605(b)(3)(D)(i)'s requirements before 2010:[273]

> 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:[274]

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

(3) Throwback Tax

As noted above, the 2014-2015 New York budget bill imposes a throwback tax on distributions of accumulated income to New York resident beneficiaries from Exempt Resident Trusts. The provision in question provides that the income on which such a beneficiary is taxed includes:[275]

> 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 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.[276] The bill also imposes reporting requirements on trustees making accumulation distributions.[277]

Although the result might not have been intended, accumulation distributions do not include capital gains because the taxable amount is based on undistributed net income under the first sentence of § 667(a).[278] 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. It should be noted that the U.S. Supreme Court did not endorse the throwback-tax structure in

[271] *See Residuary Tr. A U/W/O Kassner Dir., Div. of Tax'n,* 28 N.J. Tax 541, 548 (N.J. Super. Ct. App. Div. 2015), *aff'g* 27 N.J. Tax 68 (N.J. Tax Ct. 2013). *See* III.D.2., above. *Accord Hill v. Dir., N.J. Div. of Tax'n*, 29 N.J. Tax 318 (N.J. Super. Ct. App. Div. 2016).

[272] N.Y. TSB-M-10(5)I (N.Y. Dep't Tax'n Fin. July 23, 2010), www.tax.ny-.gov. *See* instructions to 2020 N.Y. Form IT-205 at 3.

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

[274] N.Y. Tax Law § 658(f)(2).

[275] N.Y. Tax Law § 612(b)(40).

[276] 2014 N.Y. Laws 59, Pt. I, § 9 (Mar. 31, 2014).

[277] N.Y. Tax Law § 658(f)(1).

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

ISBN 978-1-63359-383-1

its 2019 *North Carolina Department of Revenue v. The Kimberley Rice Kaestner 1992 Family Trust* decision.[279]

(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.[280] The statutory language is:[281]

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

The provision does not apply to income of such trusts that are liquidated before June 1, 2014.[282] The validity of this provision is questionable unless or until *Mercantile-Safe Deposit and Trust Company v. Murphy*[283] 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.[284]

New York City treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[285] and the City permits trustees of nongrantor trusts to take a distribution deduction.[286] In 2020, the City taxed the City taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 3.876% (the 3.876% rate applied starting with such income over $50,000),[287] and the current rate schedule is not scheduled to change until 2024.[288]

Like New York State, New York City defines "Resident Trust" as a trust that is created by a testator or trustor domiciled in New York City as follows:[289]

> (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 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."[290]

New York City taxes all City taxable income of Resident Trusts; it does not tax Nonresident Trusts.[291] In New York City, trustees must make estimated tax payments for trusts.[292]

Also like New York State, New York City does not tax trustees of Exempt Resident Trusts but requires them to file informational returns.[293]

> (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

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

[280] 2014 N.Y. Laws 59, Pt. I, § 9 (Mar. 31, 2014).

[281] N.Y. Tax Law § 612(b)(41).

[282] 2014 N.Y. Laws 59, Pt. I, § 9 (Mar. 31, 2014).

[283] 255 N.Y.S.2d 96 (N.Y. 1964), *aff'g* 242 N.Y.S.2d 26 (N.Y. App. Div. 1963). *See* III.B.2., above.

[284] N.Y. Tax Law § 1306(a), § 1306(e); instructions to 2020 N.Y. Form IT-205 at 16.

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

[286] *See* N.Y. Tax Law § 1303.

[287] N.Y. Tax Law § 1304(a)(3)(A), § 1304-B(a)(1)(ii); N.Y.C. Admin. Code § 11-1701(a)(3)(A), § 11-1704.1; instructions to 2020 N.Y. Form IT-205 at 1, 18. *See* N.Y. TSB-M-10(7)I (N.Y. Dep't Tax'n Fin. Aug. 17, 2010), www.tax.ny.gov.

[288] N.Y. Tax Law § 1304(b)(3); N.Y.C. Admin. Code § 11-1701(b)(3). *See* N.Y. TSB-M-15(2)I (N.Y. Dep't Tax'n Fin. Feb. 13, 2015), www.tax.ny.gov.

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

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

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

[292] *See* N.Y. Tax Law § 1301(b).

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

ISBN 978-1-63359-383-1

> this city if one or more of the trustees are domiciled in the city of New York.
>
> (iii) Provided further, that for the purposes of item (I) of clause (i) of this subparagraph, a trustee which is a banking corporation as defined in subdivision (a) of section 11-640 of this title and which is domiciled outside the city of New York at the time it becomes a trustee of the trust shall be deemed to continue to be a trustee domiciled outside the city of 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[294] and the incomplete-gift-non-grantor-trust rules[295] 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 2020, then the trustee was subject to tax at rates up to 12.696%, with the top rate beginning with taxable income over $1,077,550.[296]

d. CRTs

A charitable-remainder trust (CRT) is exempt from federal income tax.[297] It therefore is exempt from New York State and City income tax under the following statute:[298]

> (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 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 Domicile of Trustee

This 2010 decision of the New York State Division of Tax Appeals illustrates the importance of paying attention to detail.[299] In 1992, the trustor, who lived in New York City, created an irrevocable nongrantor trust in which he named his attorney, also a New York City domiciliary, as trustee. The trust initially was subject to New York State and City income tax because of the trustor's and the trustee's New York City domiciles. In 1995, the trustee moved to Florida but continued to file tax returns using his law firm's Manhattan address and to pay State and City tax. Subsequently, it was discovered that the trustee should have ceased paying tax upon his move to Florida. The New York State Division of Taxation granted refunds for the open years — 2001-2003, but the administrative law judge upheld the Division of Taxation's refusal to pay refunds for the closed years — 1996-2000.[300] The amount of tax was not disclosed. Although the trustee and the accountant might have faced liability for the tax erroneously paid for the closed years, the author has been informed that the beneficiaries were notified of the issue but that they opted not to pursue their claims.

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

This 2008 decision of the New York State Division of Tax Appeals considered the taxation of two trusts that were funded at the expiration of the initial 10-year term of a grantor-retained income trust (GRIT).[301] The trustor was a New York domiciliary in 1990 when he created the GRIT, but he lived in Connecticut at the end of the initial term in 2000. Because the trust had source income, the establishment of the trustor's domicile determined whether the trusts were taxed on all income or on source income only. Several million dollars was involved. The administrative law judge concluded:[302]

> [S]ince the transfers were not effectuated until July 30, 2000, the ten-year anniversary of the Peterffy Trust, the Amauris and Niavius Trusts could not properly be taxed as resident trusts by the State of New York because, pursuant to Tax Law § 605(b)(3), Thomas Peterffy was a Connecticut and not a New York domiciliary at the time the stock was transferred to these trusts. As such, since the Timber Hill, Inc., stock was not transferred to the Amauris Trust and the Niavius Trust until July 30, 2000, at a time that the grantor of the Peterffy Trust was a Connecticut domiciliary, it is hereby determined that the Amauris Trust and the Niavius Trust were not resident trusts as defined by Tax Law § 605(b)(3)(C).

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

In 2004, the New York Technical Services Division considered whether proposed actions by a committee acting under five irrevocable trusts entered into by John D. Rockefeller, Jr.,

[294] N.Y.C. Admin. Code § 11-1712(b)(36).
[295] N.Y.C. Admin. Code § 11-1712(b)(37).
[296] N.Y. Tax Law § 601(c)(1)(B)(iii), § 1304(a)(3)(A), § 1304-B(a)(1)(ii).
[297] § 664(c)(1).
[298] N.Y. Tax Law § 601(h). *See* instructions to 2020 N.Y. Form IT-205 at 3.
[299] *In the Matter of the Joseph Lee Rice III Family 1992 Trust*, DTA No. 822892, 2010 N.Y. Tax Lexis 268 (N.Y. Div. Tax. App. Nov. 4, 2010). *See N.C. Dep't of Revenue v. The Kimberley Rice Kaestner 1992 Family Trust*, 139 S. Ct. 2213 (2019) (imposition of North Carolina income tax on accumulated income of portion of same trust having nonresident trustor and trustee based on resident discretionary beneficiaries violated Due Process Clause). *See* III.A.9., above.
[300] *See* N.Y. Tax Law § 697(d).
[301] *In the Matter of the Petition of the Amauris Trust*, DTA No. 821369, 2008 WL 2954180 (N.Y. Div. Tax. App. July 24, 2008). See also *In the Matter of the Petition of the Niavius Trust*, DTA No. 821497 (N.Y. Div. Tax. App. July 24, 2008).
[302] *Amauris*, DTA No. 821369, 2008 WL 2954180, at *21.

ISBN 978-1-63359-383-1

and Chase National Bank in 1934 would enable the trustees to eliminate New York State and City income tax as follows:[303]

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

First, the five-member committee, which directed the trustee on investment and distribution matters, proposed to replace the New York corporate trustee with its Delaware affiliate. The ruling said that the domicile of the proposed successor trustee should be determined as follows:[304]

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

However, the ruling declined to decide this issue for the following reason:[305]

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

Next, the two members of the committee who lived in New York proposed to resign. The ruling observed:[306]

> An advisor to a trustee has been interpreted by the courts to include not only a person who has been designated by particular terminology in the trust instrument but also any other individual who, by the terms of the trust instrument, has been given power to direct or control a trustee in the performance of some part or all of that trustee's functions and duties, or who has been invested with a form of veto power over particular actions of a trustee through the medium or device of requiring that those actions be taken only with the consent and approval of such advisor.
>
> It is well settled under New York law that a grantor of a trust may limit a trustee's powers. In *Matter of Rubin*, the court addressed the status of advisors. The court held that the designation of an advisor is a valid limitation on a trustee's powers, and noted that the courts have generally considered an advisor to be a fiduciary, somewhat in the nature of a co-trustee. Another term that may be employed, said the court, is quasi-trustee or special trustee. The court's statement "since the relationship between the fiduciary and the advisor is that of a co-trustee, with the advisor having the controlling power, the fiduciary is justified in complying with the directives and will not generally be held liable for any losses," indicates a tacit acceptance of the characterization of the advisor as a trustee. However, an advisor that does not have any powers under the terms of the trust instrument to direct or control a trustee in the performance of some part or all of that trustee's functions and duties, and has not been invested with a form of veto power over particular actions of a trustee through the medium or device of requiring that those actions be taken only with the consent and approval of the advisor, will not be considered a co-trustee.
>
> Under the facts in this case, the Committee has been granted broad powers over the assets of the Trusts. For example, the Committee may direct the Trustee to take or refrain from taking any action which the Committee deems it advisable for the Trustee to take or refrain from taking. All of the powers of the Trustee under the Trust Agreements are subject to the directions of the Committee. Since the Committee is an advisor having the controlling power over the Trustee, following *Rubin*, supra, the members of the Committee are considered to be co-trustees of the Trusts. Therefore, for purposes of the first condition under Section 605(b)(3)(D)(i) of the Tax Law and section 105.23(c) of the Regulations, the individuals comprising the Committee are considered to be trustees of the Trusts.
>
> However, the determination of whether Petitioner or any other investment management firms or former Committee members that may be retained by the Proposed Committee to provide investment advice or management services would also be treated as co-trustees of the Trusts for purposes of section 605(b)(3)(D)(i) of the Tax Law and section 105.23(c) of the Regulations is a factual matter that is not susceptible of determination in this Advisory Opinion.

Regarding New York State income tax, the ruling concluded:[307]

> In conclusion, Petitioner states that all real and tangible property included in the corpus of the Trusts, is located outside New York and all the income and gains of the Trusts are derived or connected from sources outside of New York State, determined as if the Trusts were a nonresident. Pursuant to section 605(b)(3)(D)(ii) of the Tax Law, any intangible property included in the corpus of the Trusts is located in New York State if any of the trustees are domiciled in New York State. Therefore, the determination of whether the Trusts will be exempt from New York State personal income tax for purposes of section 605(b)(3)(D) of the Tax Law and section 105.23(c) of the Regulations will depend on whether the Proposed Successor Trustee, any member of the Proposed Com-

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

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

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

[306] N.Y. TSB-A-04(7)I, 2004 N.Y. Tax Lexis 259, at *21-23 (citations omitted).

[307] N.Y. TSB-A-04(7)I, 2004 N.Y. Tax Lexis 259, at *23-25.

ISBN 978-1-63359-383-1

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

Regarding New York City income tax, the ruling concluded:[308]

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

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

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

The New York State Department of Taxation and Finance 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.[309] The ruling concluded that:[310]

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

A trustee considering exercising a decanting power with the hope of escaping tax by changing the creator of the trust should keep this Advisory Opinion in mind because:[311]

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

f. Cases and Rulings Involving Exempt Resident Trust Exemption

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

In this 1994 ruling,[312] a New York City domiciliary established an irrevocable complex inter vivos trust in 1976. Although the sole individual trustee initially lived in New York City, he moved to Connecticut in 1985. During the years in question, the corpus consisted solely of intangible personal property (some of which was held by a New York financial institution), and the trust earned no source income.

Regarding New York State tax, the ruling said:[313]

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

Regarding New York City tax, the ruling concluded:[314]

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

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

[308] N.Y. TSB-A-04(7)I, 2004 N.Y. Tax Lexis 259, at *25.
[309] N.Y. TSB-A-03(6)I 2003 WL 22970581 (N.Y. Dep't Tax'n Fin. Nov. 21, 2003), www.tax.ny.gov.
[310] N.Y. TSB-A-03(6)I, 2003 WL 22970581, at *5 (citation omitted).
[311] N.Y. Est. Powers & Trusts Law § 10-6.6(d).
[312] N.Y. TSB-A-94(7)I 1994 WL 275392 (N.Y. Dep't Tax'n Fin. Apr. 8, 1994), www.tax.ny.gov.
[313] N.Y. TSB-A-94(7)I, 1994 WL 275392, at *3.
[314] N.Y. TSB-A-94(7)I, 1994 WL 275392, at *3.

ISBN 978-1-63359-383-1

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

The issue in this 1996 Technical Services Bulletin was whether the trustees of a trust created by a New York City domiciliary in 1961 had to pay New York State and City income tax on a large capital gain.[315] Initially, the two individual trustees were New York residents, but, by 1988, both trustees were nonresidents. Regarding New York State income tax, the ruling said:[316]

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

Regarding New York City income tax, it concluded:[317]

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

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

In this 2000 ruling,[318] a New York City domiciliary created a Delaware LLC of which she was the managing member. She kept a 1% interest and contributed a 99% interest to a trust for the benefit of New York beneficiaries but appointed a nonresident individual as trustee.

The ruling identified the pertinent issues as follows:[319]

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

It found that the trustee was not taxable for the following reasons:[320]

> Issue 3 . . . In this case, the three conditions contained in section 105.23(c) of the Personal Income Tax Regulations have been met. First, the trustee is domiciled outside of New York State. Second, the corpus of the Trust consists of intangible assets. The situs of the intangible assets of a trust are deemed to be at the domicile of the trustee. Therefore, the situs of the corpus of the Trust is deemed to be outside of New York State. Third, none of the assets of the Trust are employed in a business carried on in New York State and all income and gains of the Trust were derived from sources outside of New York State, determined as if the Trust were a nonresident.
>
> Accordingly, the Trust is a New York resident trust. However, for the taxable years that the three conditions contained in section 105.23(c) of the Personal Income Tax Regulations are met, no New York State personal income tax is imposed on such Trust for those years. Further, no New York City personal income tax authorized under Article 30 of the Tax Law is imposed on the Trust for those taxable years.
>
> Issue 4
>
> The domicile of the Trustee of the Trust does affect the taxable status of the Trust. If the Trustee is domiciled in New York State, the Trust would not meet the three conditions contained in section 105.23(c) of the Personal Income Tax Regulations, and the Trust would be subject to New York State personal income tax. In addition, if the Trustee is a resident of the City of New York, the Trust would be subject to the New York City personal income tax authorized under Article 30 of the Tax Law. The domicile of the beneficiary does not affect the taxable status of the trust.

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

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

This 2004 ruling, summarized above,[321] recognized that the trusts under consideration would qualify as Exempt Resi-

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

[316] N.Y. TSB-A-96(4)I, 1996 WL 667910, at *3.

[317] N.Y. TSB-A-96(4)I, 1996 WL 667910, at *3.

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

[319] N.Y. TSB-A-00(2)I, 2000 WL 567678, at *1.

[320] N.Y. TSB-A-00(2)I, 2000 WL 567678, at *5-6.

[321] N.Y. TSB-A-04(7)I, 2004 N.Y. Tax Lexis 259 (N.Y. Dep't Tax'n Fin.

ISBN 978-1-63359-383-1

dent Trusts if the corporate trustee and the committee members were nondomiciliaries.

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

This 2006 decision[322] involved a trust that a New York City domiciliary created in 1973 naming individual trustees. In 1981, the last New York domiciliary trustee resigned and was replaced by a nondomiciliary trustee as provided in the trust instrument but without a court proceeding. Nevertheless, the trustees continued to file returns and to pay tax. In 2004, the trustees filed amended returns seeking refunds for 2000 (about $100,000), 2001 (about $6,000), and 2002 (about $100,000), which were denied by the Division of Taxation.

On appeal, the Division of Tax Appeals identified the issue as follows:[323]

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

The Division of Tax Appeals reversed the determination of the Division of Taxation and granted the refunds for the following reasons:[324]

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

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

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

This 2010 decision of the Division of Tax Appeals, summarized above,[325] recognized that a Resident Trust ceased to be taxable as soon as the sole domiciliary individual trustee became a Florida domiciliary.

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

This 2010 Technical Services Bulletin addressed the tax-payment requirements of the surviving nondomiciliary trustee of a New York Resident Trust due to the death of the New York domiciliary individual co-trustee on August 1, 2008.[326] The ruling concluded:[327]

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

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

This 2011 Technical Services Bulletin considered the New York income-tax consequences for Resident Trusts caused by changes of domiciles of the grantors and trustees.[328] It concluded:[329]

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

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

TSB-A-20(2)I, issued in 2020, recited these facts:[330]

> The Trust is an irrevocable, non-grantor trust that was established by (Grantor) for the benefit of the Grantor's descendants, some of whom are currently domiciliaries of New York. The Grantor was a New York

Nov. 12, 2004), www.tax.ny.gov. See IV.A.4.d., above.

[322] *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).

[323] *Heffer*, DTA No. 820351, 2006 WL 1806492, at *1.

[324] *Heffer*, DTA No. 820351, 2006 WL 1806492, at *5.

[325] *In the Matter of the Joseph Lee Rice III Family 1992 Trust*, DTA No. 822892, 2010 N.Y. Tax Lexis 268 (N.Y. Div. Tax App. 2010). *See* IV.A.4.b., above.

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

[327] N.Y. TSB-A-10(4)I, 2010 WL 2557532, at *2.

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

[329] N.Y. TSB-A-11(4)I, 2011 WL 7113861, at *2.

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

ISBN 978-1-63359-383-1

> State domiciliary at the time the Trust was created and funded on December 7, 2016. Petitioner is the sole trustee and is a domiciliary of the State of New Jersey. As an irrevocable non-grantor trust, the Trust is treated as a separate taxpayer for federal income purposes.

It noted that ''[a]ll the income of the trust has been retained, and no distributions have been made to the trust beneficiaries.''[331]

According to the advisory, the trust held the following investments:[332]

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

The advisory noted:[333]

> In order for a resident trust to qualify for the exemption in Tax Law § 605(b)(3)(D), three conditions must be met: (1) all trustees must be domiciled outside of New York State; (2) the entire corpus of the trust must be located outside of New York State; and (3) all of the trust's income or gain must be sourced outside New York State. For the purpose of sourcing the trust corpus, intangible property shall be deemed ''located in New York if one or more of the trustees are domiciled in the state.

The determination concluded:[334]

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

Regarding possible constitutional issues, the determination observed:[335]

> While Petitioner suggests that, notwithstanding the fact that the Trust earned income that is sourced to New York, the imposition of tax on the Trust would violate due process guarantees of the United States Constitution, administrative agencies must presume statutes to be constitutional and therefore have no authority to avoid statutory requirements on constitutional grounds.

It should be noted that New York's approach is different from that of states such as New Jersey[336] and Minnesota,[337] where there is authority to tax such a trust on source income only. Given that the Department of Taxation and Finance could not consider constitutional issues, it is possible that federal district court might be available to adjudicate similar controversies.[338]

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

This case illustrates the importance of thinking about the state income taxation of trusts at the outset rather than relying on a refund request. In *Matter of Michael A. Goldstein No. 1 Trust v. Tax Appeals Tribunal of the State of New York*,[339] the trustees filed New York income tax returns for 1995, 1996, and 1997. As the result of an IRS audit, the trustees' taxable income was decreased. The trustees filed amended returns requesting New York income-tax refunds in July 2006 that were issued in December of that year.

The New York State Department of Taxation and Finance paid interest from July 2006 rather than from the dates of filing of the original returns based on then N.Y. Tax Law § 688.[340] A New York intermediate appellate court confirmed that determination.[341]

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

5. Source Income

a. Introduction

In New York, trustees of Nonresident Trusts are taxed on source income[342] and a single dollar of source income apparently will prevent a Resident Trust from meeting the Exempt

[331] N.Y. TSB-A-20(2)I, 2020 WL 2615558, at *1.
[332] N.Y. TSB-A-20(2)I, 2020 WL 2615558, at *1.
[333] N.Y. TSB-A-20(2)I, 2020 WL 2615558, at *2.
[334] N.Y. TSB-A-20(2)I, 2020 WL 2615558, at *2.
[335] N.Y. TSB-A-20(2)I, 2020 WL 2615558, at *2.

[336] *See Residuary Trust A U/W/O Kassner*, 28 N.J. Tax 541 (Super. Ct. App. Div. 2015) *See also* III.D.2., above.
[337] *See Fielding v. Comm'r of Revenue*, 916 N.W.2d 323 (Minn. 2018). *See also* III.D.4., above.
[338] *See* VI.K.4., below.
[339] 957 N.Y.S.2d 433 (N.Y. App. Div. 2012).
[340] N.Y. Tax Law § 688.
[341] *Goldstein*, 957 N.Y.S.2d 433, 436.
[342] N.Y. Tax Law § 633, § 631. *See* TSB-M-18(2)I (N.Y. Dep't Tax'n Fin. Apr. 6, 2018), www.tax.ny.gov.

ISBN 978-1-63359-383-1

Resident Trust exemption.[343] The New York State Department of Taxation and Finance has announced that source income includes income from:[344]

> • real or tangible personal property located in New York State, (including certain gains or losses from the sale or exchange of an interest in an entity that owns real property in New York State, see TSB-M-09(5)I) *Amendment to the Definition of New York Source Income of a Nonresident Individual*; . . .
>
> • a business, trade, profession, or occupation carried on in New York State;
>
> • your distributive share of New York State partnership income or gain;
>
> • your share of New York State estate or trust income or gain; . . .
>
> • any gain from the sale, transfer, or other disposition of shares of stock in a cooperative housing corporation in connection with the grant or transfer of a proprietary leasehold, when the real property comprising the units of the cooperative housing corporation is located in New York State;
>
> • any income you received related to a business, trade, profession, or occupation previously carried on in New York State, including but not limited to covenants not to compete and termination agreements (see TSB-M-10(9)I), *Income Received by a Nonresident Related to a Business, Trade, Profession, or Occupation Previously Carried on Within New York State*; and
>
> • a New York S corporation in which you are a shareholder. . . .

The agency has said that the following items do not constitute source income:[345]

> • your income from annuities and pensions that meet the New York State definition of an annuity, unless the annuity is employed or used as an asset of a business, trade, profession, or occupation carried on in New York State;
>
> • your interest, dividends, or gains from the sale or exchange of intangible personal property, unless they are part of the income you received from carrying on a business, trade, profession, or occupation in New York State; . . .
>
> • your income as a shareholder of a corporation that is a New York C corporation; . . . .

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

The trustee of a New York Nonresident Trust or of a Resident Trust that holds tangible personal property, real property, or shares of stock in a cooperative housing corporation might consider transferring the property into an FLP or LLC with the hope of converting it into intangible personal property that will not produce source income. In this regard, New York State treats the gain incurred upon the sale of interests in certain entities that hold New York real property as source income.[346] Specifically, real property located in New York includes an interest in an entity (i.e., a partnership, limited liability corporation, S corporation, or non-publicly traded C corporation with 100 or fewer shareholders) that owns real property or shares of stock in a cooperative housing corporation in New York having a fair market value that equals or exceeds 50% of all the assets of the entity on the date of sale or exchange of the taxpayer's interest in the entity.[347] 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.[348] The gain or loss derived from New York sources from the taxpayer's sale or exchange of an interest in an entity is the total gain or loss for federal income-tax purposes from that sale or exchange multiplied by a fraction, the numerator of which is the fair market value of the real property or shares of stock in a cooperative housing corporation located in New York on the date of sale or exchange and the denominator of which is the fair market value of all the assets of the entity on the date of sale or exchange.[349] The New York State Department of Taxation and Finance has issued Technical Services Bulletins that illustrate the operation of the provision and describes its application to trusts at the end.[350]

c. *In re Ittleson (2005) — An Example of Source Income*

This 2005 case,[351] which did not involve a trust, illustrates source income. In 1986, a married couple living in New York

---

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

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

[345] N.Y. Tax Bull. TB-IT-615 at 1-2.

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

[347] N.Y. Tax Law § 631(b)(1)(A)(1).

[348] N.Y. Tax Law § 631(b)(1)(A)(1).

[349] N.Y. Tax Law § 631(b)(1)(A)(1).

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

[351] *In re Ittleson*, N.Y. DTA 819283, 2005 WL 2108132 (N.Y. Div. Tax App. Aug. 25, 2005). *See Burton v. N.Y.S. Dep't of Tax'n & Fin.*, 37 N.E.3d 718 (N.Y. 2015) (proceeds of nondomiciliary's deemed sale of S Corporation stock was New York source income); *In re Lewis*, N.Y. DTA 827791, 2019 WL 2610775 (N.Y. Div. Tax App. June 20, 2019) ("a nonresident individual's gain received on the sale of the stock he owned in an electing subchapter S New York domestic corporation was required to be included in that individual's New York source income, to the extent recognized for federal income tax purposes and in accordance with the S corporation's business allocation percentage"); *In re Gleason*, N.Y. DTA 823829, 2014 WL 1273575 (N.Y. Div. Tax App. Mar. 18, 2014) (Connecticut resident's income from exercise of nonstatutory stock options was New York-source income); *In re Linde*, N.Y. DTA 823300, 2012 WL 1980651 (N.Y. Div. Tax. App. Mar. 24, 2012) (all income realized from nonresident partnership's sale of New York real property allocated to New York); N.Y. TSB-A-15(5)I (N.Y. Dep't Tax'n Fin. May 29, 2015), www.tax.ny.gov (nondomiciliary taxable on portion of gain from redemption of S corporation stock attributable to New York real property); N.Y. TSB-A-07(1)I, 2007 WL 1610039 (N.Y. Dep't Tax'n Fin. Feb. 7, 2007), www.tax.ny.gov (sale of interest in Georgia partnership not New York-source income). *See* Andrea Muse, *ALJ Upholds Retroactive Tax on Deemed Asset Sale*, 93 Tax Notes State

ISBN 978-1-63359-383-1

City bought a Modigliani painting for about $1.5 million and hung it in their Manhattan cooperative apartment. The owners moved to South Carolina in December of 1996, but the painting remained in the apartment, where it stayed until March of 1997 when it was turned over to Sotheby's for auction. Sotheby's sold the painting for about $8.5 million in May of 1997, producing roughly a $7 million gain. The Tax Appeals Tribunal stated the issue at the outset:[352]

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

In holding the gain to be taxable, it concluded:[353]

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

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

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[354] and because tax rates might go down in the future, beneficiaries might leave New York, and distributions might go to non-New York beneficiaries. As shown in Worksheet 3, the potential tax savings for a New York State Resident Trust and for a New York City Resident Trust that incurred a $1 million long-term capital gain in 2020 were at least $68,493 and $107,549, respectively.[355] 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.

As shown in Worksheet 4, the net tax cost of including $1 million of long-term capital gain in DNI for a New York State/New York City resident individual rather than taxing the gain in a trust that was structured as an Exempt Resident Trust in 2020 was $33,831 for a New York State Resident Trust and $72,156 for a New York City Resident Trust.[356] Domiciliaries of other states (including New York statutory residents) should consider creating trusts in New York because the state does not tax trusts created by nondomiciliaries except on source income.

B. *Northeast (Other Than New York)*

1. *Connecticut (Connecticut Income Tax)*

In Connecticut, a trustee of a Resident Trust must file a return if such trustee must file a federal return or if the trust has Connecticut taxable income; the trustee of a Nonresident Trust must file a return if the trust has Connecticut-source income.[357]

Connecticut treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[358] and the Constitution State permits trustees of nongrantor trusts to take a distribution deduction.[359] In 2020, Connecticut taxed the Connecticut taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at 6.99%,[360] and the 6.99% rate is not scheduled to change.[361] A Connecticut alternative minimum tax is sometimes payable.[362]

Connecticut defines ''Resident Trust'' as a trust that is created by a Connecticut resident testator or trustor as follows:[363]

> (C) a trust, or a portion of a trust, consisting of property transferred by will of a decedent who at the time of his death was a resident of this state, and (D) a trust, or a portion of a trust, consisting of the property of (i) a person who was a resident of this state at the time the property was transferred to the trust if the trust was then irrevocable, (ii) a person who, if the trust was revocable at the time the property was transferred to the trust, and has not subsequently become irrevocable, was a resident of this state at the time the property was transferred to the trust or (iii) a person who, if the trust was revocable when the property was transferred to the trust but the trust has subsequently become irrevocable, was a resident of this state at the time the trust became irrevocable.

Unlike New York, Connecticut bases taxation on ''residence'' rather than ''domicile'' and specifies that:[364]

> The criteria used to determine whether a decedent or grantor is a resident of this state, for Connecticut income tax purposes, are the same criteria used to determine whether an individual is a resident of this state.

---

151 (July 8, 2019).

[352] *In re Ittleson*, N.Y. DTA 819283, 2005 WL 2108132, at *1.

[353] *In re Ittleson*, N.Y. DTA 819283, 2005 WL 2108132, at *6.

[354] *See* IV.A.3.a.(3), above. Subsequent budget bills made no substantive changes in these provisions. *See* TSB-M-18(4)I (N.Y. Dep't Tax'n Fin. May 25, 2018), www.tax.ny.gov/pdf/memos/income/m18_4i.pdf.

[355] For an explanation of how these figures were derived, see I.B.3., above.

[356] For an explanation of how these figures were derived, see I.B.4., above.

[357] Instructions to 2020 Form CT-1041 at 6; Conn. Agencies Reg. § 12-740-1. *See* Billy Hamilton, *What's the Matter With Connecticut?* 84 State Tax Notes 1059 (June 12, 2017).

[358] *See* Conn. Gen. Stat. § 12-700(a), § 12-701(a)(8), § 12-701(a)(19), § 12-701(a)(20); instructions to 2020 Form CT-1041 at 7.

[359] *See* Conn. Gen. Stat. § 12-700(a), § 12-700(d), § 12-701(a)(9).

[360] Conn. Gen. Stat. § 12-700(a)(9)(E); 2020 Form CT-1041 at 2.

[361] Conn. Gen. Stat. § 12-700(a)(9)(E).

[362] Instructions to 2020 Form CT-1041 at 5.

[363] Conn. Gen. Stat. § 12-701(a)(4)(C)–§ 12-701(a)(4)(D). *See* Conn. Agencies Reg. § 12-701(a)(4)-1; instructions to 2020 Form CT-1041 at 5.

[364] Instructions to 2020 Form CT-1041 at 5.

ISBN 978-1-63359-383-1

For Connecticut purposes, an individual is a resident if the individual is domiciled in the state or if the individual has a permanent place of abode and spends more than 183 days there during the year.[365]

Note that the tax return instructions concede that:[366]

> The residence of the fiduciary or the beneficiary does not affect the status of a trust . . . as resident or nonresident.

A regulation offers the following guidance on when a trust is revocable or irrevocable:[367]

> (b) For purposes of subsection (a) of this section, a trust or portion of a trust is revocable if it is subject to a power in the grantor, 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.''[368]

Connecticut taxes all taxable income of Resident Trusts[369] but only Connecticut-source income of Nonresident Trusts.[370] In Connecticut, trustees must make estimated tax payments for trusts.[371]

For inter vivos trusts, Connecticut apportions tax based on the number of resident and nonresident noncontingent beneficiaries as follows:[372]

> For purposes of this chapter, if any trust or portion of a trust, other than a trust created by the will of a decedent, has one or more nonresident noncontingent beneficiaries, the Connecticut taxable income of the trust, as defined in subdivision (9) of this subsection, shall be modified as follows: The Connecticut taxable income of the trust shall be the sum of all such income derived from or connected with sources within this state and that portion of such income derived from or connected with all other sources which is derived by applying to all such income derived from or connected with all other sources a fraction the numerator of which is the number of resident noncontingent beneficiaries and the denominator of which is the total number of noncontingent beneficiaries.

The tax return instructions define ''noncontingent beneficiary'' as follows:[373]

> Noncontingent beneficiary is a beneficiary whose interest is not subject to a condition precedent and includes every individual to whom a trustee of an inter vivos trust during the taxable year: 1) is required to currently distribute income or corpus, or both; or 2) properly pays or credits income or corpus, or both; or 3) may, in the trustee's discretion, distribute income or corpus, or both. Noncontingent beneficiary includes every beneficiary to whom or to whose estate any of the trust's income for the taxable year must be distributed at a specified future date or event *and* every beneficiary who has the unrestricted lifetime or testamentary power, exercisable currently or at some future specified date or event, to withdraw any of the trust's income for the taxable year or to appoint the income to any person including the estate of the beneficiary. This also applies to a noncontingent beneficiary which is a trust or an estate. Wherever reference is made to an individual who is a noncontingent beneficiary, that reference includes a trust or estate that is a noncontingent beneficiary, but does not include a corporation that is a noncontingent beneficiary.

They also define ''contingent beneficiary'':[374]

> Contingent beneficiary is an individual (or trust or estate) who is a beneficiary, but not a noncontingent beneficiary of a resident inter vivos trust.

A 2005 Connecticut ruling[375] considered whether the donee of a power of appointment is a resident for Connecticut income-tax purposes. Like the New York ruling summarized above, it concluded:[376]

> The residency status of an appointive trust created by the exercise of a power of appointment that is not a general power of appointment is to be determined by the residency of the donor of the power of appointment. The residency status of an appointive trust created by the exercise of a general power of appointment is to be determined by the residency of the donee of the power of appointment.

A CRT generally is exempt from federal income tax.[377] It therefore usually is exempt from Connecticut income tax under the following statute:[378]

> Any person which by reason of its purposes or activities is exempt from federal income tax shall be exempt from tax imposed under this chapter.

In *Chase Manhattan Bank v. Gavin*,[379] the Connecticut Supreme Court held that the state can tax a testamentary trust solely because the testator was a resident at death and that it can

---

[365] Conn. Gen. Stat. § 12-701(a)(1). *See* instructions to 2020 Form CT-1041 at 5.

[366] Instructions to 2020 Form CT-1041 at 5.

[367] Conn. Agencies Reg. § 12-701(a)(4)-1(b). *See* instructions to 2020 Form CT-1041 at 5.

[368] Conn. Gen. Stat. § 12-701(a)(5); instructions to 2020 Form CT-1041 at 5.

[369] Conn. Gen. Stat. § 12-701(a)(9); Conn. Agencies Reg. § 12-701(a)(9)-1.

[370] Conn. Gen. Stat. § 12-713, § 12-714; Conn. Agencies Reg. § 12-711(c)-3, § 12-711(c)-4, § 12-713(a)-1, § 12-713(a)-4, § 12-714(a)-1; instructions to 2020 Form CT-1041 at 6-7. *See Allen v. Comm'r of Revenue Servs.*, 152 A.3d 488, 508 (Conn. 2016) (income derived from exercise of stock options awarded while taxpayer was Connecticut resident but later exercised when he was nonresident was Connecticut source income and taxation did not violate due process). *See also* Robert Willens, *Connecticut Properly Taxed Option Income of a Nonresident*, 05 Daily Tax Rpt. J-1 (Jan. 9, 2017).

[371] Conn. Gen. Stat. § 12-722(n); Conn. Agencies Reg. § 12-701(a)(11)-1; instructions to 2020 Form CT-1041 at 11.

[372] Conn. Gen. Stat. § 12-701(a)(4). *See* instructions to 2020 Form CT-1041 at 7.

[373] Instructions to 2020 Form CT-1041 at 5 (emphasis in original).

[374] Instructions to 2020 Form CT-1041 at 5.

[375] Ct. Ruling 2005-2, *Income Tax/Residency of Appointive Trust*, 2005 WL 578844 (Jan. 14, 2005) www.ct.gov/drs.

[376] Ct. Ruling 2005-2 at *1.

[377] § 664(c)(1).

[378] Conn. Gen. Stat. § 12-710. *See* Conn. Gen. Stat. § 12-701(18).

[379] 733 A.2d 782 (Conn. 1999). *See* III.C.3., above.

ISBN 978-1-63359-383-1

tax an inter vivos trust created by a resident if the trust's sole beneficiary was a Connecticut resident, was entitled to current income, possessed a testamentary power of appointment, and would receive all trust assets upon attaining a specified age. Nevertheless, it might be unconstitutional for Connecticut to tax Resident Trusts in these and other circumstances.[380]

As shown in Worksheet 3, the potential tax saving for a Connecticut Resident Trust on a $1 million long-term capital gain incurred in 2020 was $69,893.[381] As shown in Worksheet 4, the net tax cost of including $1 million of long-term capital gain in DNI for a Connecticut resident individual rather than taxing the gain to a trust that was structured to escape tax in 2020 was $35,729.[382]

Practice Tip: Residents of other states might consider establishing trusts in Connecticut because it does not tax trusts created by nonresidents except on source income.

2. Delaware (Delaware Personal Income Tax)

In Delaware, a trustee must file a return if it must file a federal return except as provided below.[383]

Delaware treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[384] and the First State permits trustees of nongrantor trusts to take a distribution deduction.[385] In 2020, Delaware taxed the Delaware taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 6.60% (the 6.60% rate applied starting with such income over $60,000), and the rate schedule is not scheduled to change.[386]

Delaware defines ''Resident Trust'' as a trust that is created by a Delaware domiciliary testator or trustor or that has one or more Delaware resident individual or corporate trustees as follows:[387]

> ''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 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 the individual is domiciled in the state or if the individual maintains a place of abode and spends more than 183 days in Delaware during the year.[388] A ''Nonresident Trust'' is a trust that is not a ''Resident Trust.''[389]

Delaware taxes all taxable income of Resident Trusts[390] but only Delaware-source taxable income of Nonresident Trusts.[391] In Delaware, trustees must make estimated tax payments for Resident and Nonresident Trusts whose fair market value equals or exceeds $1 million for the preceding year.[392]

Importantly, Delaware allows Resident Trusts to deduct taxable income set aside for future distribution to nonresidents as follows:[393]

> 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,[394] but Delaware makes this determination based on the residences of relevant existing beneficiaries on the last day of the tax year.[395] 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.[396]

A CRT generally is exempt from federal income tax.[397] Consequently, it usually is exempt from Delaware income tax in accordance with the following statute, which exempts:[398]

> 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 the trustee of a nongrantor trust

[380] *See* III.A.–III.E., above.
[381] For an explanation of how this figure was derived, see I.B.3., above.
[382] For an explanation of how this figure was derived, see I.B.4., above.
[383] 30 Del. C. § 1605(b)(1)(a); instructions to 2020 Del. Form 400 at 1.
[384] 30 Del. C. § 1601(9). *See* 30 30 Del. C. § 1105.
[385] 30 Del. C. § 1634. *See* 30 Del. C. § 1635(a).
[386] 30 Del. C. § 1102(a)(14); 2020 Del. Form 400 at 2.
[387] 30 Del. C. § 1601(8). *See* instruction to 2020 Del. Form 400 at 1-2.
[388] 30 Del. C. § 1103. *See* instructions to 2020 Del. Form 400 at 2.
[389] 30 Del. C. § 1601(5); instructions to 2020 Del. Form 400 at 2.
[390] 30 Del. C. § 1632, § 1635(a), § 1636.
[391] 30 Del. C. § 1632, § 1639.
[392] 30 Del. C. § 1169(a), § 1170; instructions to 2020 Del. Form 400 at 1.
[393] 30 Del. C. § 1636(a).
[394] *See, e.g.,* Md. Code Ann., Tax-Gen. § 10-207(o)(3); Mass. Gen. Laws ch. 62, § 10(a).
[395] 30 Del. C. § 1636(b).
[396] 30 Del. C. § 1605(b)(1)(a).
[397] § 664(c)(1).
[398] 30 Del. C. § 1633(2).

ISBN 978-1-63359-383-1

created by a Delaware domiciliary might take the position that the trust is not subject to Delaware income tax if it has no Delaware trustee, asset, or source income even if it has one or more Delaware resident beneficiaries.[399]

As shown in Worksheet 3, the potential tax saving for a Delaware Resident Trust on a $1 million long-term capital gain incurred in 2020 was at least $64,977.[400] As shown in Worksheet 4, the net tax cost of including $1 million of long-term capital gain in DNI for a Delaware resident individual rather than taxing the gain to a trust that was structured to escape tax in 2020 was $30,538.[401]

Practice Tip: Residents of other states should consider establishing trusts in Delaware because it will not tax trusts established by nondomiciliaries without Delaware resident beneficiaries except on source income.

3. District of Columbia (District of Columbia Income Tax)

In the District of Columbia, a trustee must file a return if a trust has $100 or more of gross income.[402]

The District of Columbia treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[403] and the District permits trustees of nongrantor trusts to take a distribution deduction.[404] In 2020, the District of Columbia taxed the District of Columbia fiduciary income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 8.95% (the 8.95% rate applied starting with such income over $1 million),[405] and the current rate schedule is not scheduled to change.[406]

The District of Columbia defines "Resident Trust" and "Nonresident Trust" as follows:[407]

> For the purposes of this subchapter, . . . trusts are: (1) Resident . . . trusts, or (2) nonresident . . . trusts. If the decedent was at the time of his death domiciled within the District, . . . any trust created by his will is a resident trust. If the decedent was not at the time of his death domiciled within the District, . . . any trust created by his will is a nonresident trust. If the creator of a trust was at the time the trust was created domiciled within the District, or if the trust consists of property of a person domiciled within the District, the trust is a resident trust. If the creator of the trust was not at the time the trust was created domiciled within the District, the trust is a nonresident trust.

In classifying a trust's tax status "[t]he residence or situs of the fiduciary shall not control the classification of . . . trusts as resident or nonresident under the provisions of § 47-1809.01."[408]

The District of Columbia taxes all taxable income of Resident Trusts,[409] but the District does not tax Nonresident Trusts. Trustees may — but are not required to — make estimated tax payments for trusts.[410]

The District of Columbia provides no specific guidance for the taxation and reporting of CRTs.

In *District of Columbia v. Chase Manhattan Bank*,[411] the District of Columbia Court of Appeals held that the District can tax the trustee of a Resident Trust solely because the testator was domiciled in the District at death,[412] but it expressly did not rule on whether the District could tax the trustee of an inter vivos trust solely because the trustor was domiciled in the District.[413] The trustee of an inter vivos nongrantor trust created by a District of Columbia domiciliary might take the position that the trust is not subject to District of Columbia income tax if it has no District trustee, asset, or source income.[414]

As shown in Worksheet 3, the potential tax saving for a District of Columbia Resident Trust on a $1 million long-term capital gain incurred in 2020 was at least $85,016.[415] As shown in Worksheet 4, the net tax cost of including $1 million of long-term capital gain in DNI for a District of Columbia resident individual rather than taxing the gain to a trust that was structured to escape tax in 2020 was $49,819.[416]

Practice Tip: Domiciliaries of other states might consider establishing trusts in the District because the District does not tax trusts created by nondomiciliaries except on source income.

4. Maine (Maine Income Tax)

In Maine, a trustee must file a return if the trust has Maine taxable income, $10,000 or more of gross income, or Maine tax liability.[417]

---

[399] *See* III.A.–III.E., above.

[400] For an explanation of how this figure was derived, see I.B.3., above.

[401] For an explanation of how this figure was derived, see I.B.4., above.

[402] D.C. Code § 47-1805.02(2)(D); instructions to 2020 D.C. Form D-41 at 1. *See* Hannah Kohanzadeh, D.C. Fiscal Policy Institute, *Taxes in the District: The Evolution of D.C. Tax Rates Since the Early 2000s* (May 2, 2018), www.dcfpi.org.

[403] Because an individual who resides in the District of Columbia computes taxable income using federal gross income, which includes all types of grantor-trust income (see D.C. Code § 47.1803.02(a)), it appears that the separate narrow definition of a grantor trust probably is not available (see D.C. Code § 47-1809.08, § 47-1809.09).

[404] D.C. Code § 47-1809.05(1)–§ 47-1809.05(2).

[405] D.C. Code § 47-1806.03(a)(10); instructions to 2020 D.C. Form D-41 at 8.

[406] D.C. Code § 47-1806.03(a)(10).

[407] D.C. Code § 47-1809.01. *See* D.C. Code § 47-1809.02; instructions to 2020 D.C. Form D-41 at 7. For District of Columbia income-tax purposes, an individual is a "resident" if the individual is domiciled in the District or if the individual maintains a place of abode there for 183 days or more during the taxable year with certain exceptions (D.C. Code § 47-1801.04(42)). Given that taxation is based on the testator's or trustor's domicile, the second test in the foregoing definition does not come into play.

[408] D.C. Code § 47-1809.02; instructions to 2020 D.C. Form D-41 at 7.

[409] D.C. Code § 47-1809.04.

[410] Instructions to 2020 D.C. Form D-41 at 1.

[411] 689 A.2d 539 (D.C. 1997). *See* III.C.2., above.

[412] 689 A.2d 539, 547.

[413] 689 A.2d 539, 547 n.11.

[414] *See* III.A.–III.E., above.

[415] For an explanation of how this figure was derived, see I.B.3., above.

[416] For an explanation of how this figure was derived, see I.B.4., above.

[417] Me. Rev. Stat. Ann. tit. 36, § 5220(3)–§ 5220(4). *See* instructions to 2020 Form 1041ME at 1. *See also Goggin v. State Tax Assessor*, 191 A.3d 341, 343 (Me. 2018) (Maine resident individual not entitled to Maine income-tax credit for New Hampshire business taxes on a New Hampshire LLC of which she is a member); *Kennebec v. Maine Revenue Services*, Maine Bd. of Tax Appeals-2017-10 (Oct. 30, 2017), www.maine.gov/boardoftaxappeals/ (income received from sale of stock used to satisfy financial obligation under divorce judgement subject to Maine income tax).

ISBN 978-1-63359-383-1

Maine treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[418] and the Pine Tree State permits trustees of nongrantor trusts to take a distribution deduction.[419] In 2020, Maine taxed the Maine taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 7.15% (the 7.15% rate applied starting with such income over $52,600),[420] and the rate schedule, adjusted for inflation, is not scheduled to change (in 2021 the 7.15% rate applies starting with such income over $53,150).[421]

Maine defines ''Resident Trust'' as follows:[422]

> ''Resident . . . trust'' shall mean: . . .
>
> B. A trust created by will of a decedent who at death was domiciled in this State; or
>
> C. A trust created by, or consisting of property of, a person domiciled in this State.

A ''Nonresident Trust'' is a trust that is not a ''Resident Trust.''[423]

Maine taxes all Maine taxable income of Resident Trusts.[424] It only taxes Maine-source taxable income of Nonresident Trusts[425] and describes situations in which income attributable to FLPs and LLCs that own tangible personal property or real property in Maine will be treated as source income.[426] In Maine, trustees must make estimated tax payments for trusts.[427]

A CRT generally is exempt from federal income tax.[428] Hence, it usually also is exempt from Maine income tax under the following statute:[429]

> An association, trust, or other unincorporated organization which by reason of its purposes or activities is exempt from federal income tax shall be exempt from the tax imposed by this Part except with respect to its unrelated business taxable income.

The instructions to the Maine fiduciary income tax return provide:[430]

> [A]ll Charitable Remainder Trusts are *not* required to file a Maine return.

Notwithstanding the express language of the statute, Maine Revenue Services historically has not attempted to tax a nongrantor trust created by a Maine testator or trustor that has no Maine trustee, beneficiary, asset, or source income. Nevertheless, the trustee of such a trust might take the position that the trust is not subject to Maine income tax even if the trust has domiciliary beneficiaries.[431]

As shown in Worksheet 3, the potential tax saving for a Maine Resident Trust on a $1 million long-term capital gain incurred in 2020 was at least $71,072.[432] As shown in Worksheet 4, the net tax cost of including $1 million of long-term capital gain in DNI for a Maine resident individual rather than taxing the gain to a trust that was structured to escape tax in 2020 was $36,958.[433]

Practice Tip: Domiciliaries of other states might consider establishing trusts in Maine because it does not tax trusts created by nondomiciliaries except on source income.

5. *Maryland (Maryland Income Tax; Maryland County Income Tax)*

In Maryland, a trustee must file a return if such trustee must file a federal return and if such trust has Maryland taxable income.[434]

Maryland treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[435] and the Old Line State permits trustees of nongrantor trusts to take a distribution deduction.[436] In 2020, Maryland imposed a state income tax on the Maryland net taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 5.75% (the 5.75% rate applied starting with such income over $250,000).[437] In 2020, Maryland also imposed a county income tax on the Maryland taxable income of nongrantor trusts at rates between 2.25% and 3.20%, depending on the locale.[438] Hence, a Maryland trust was taxed at rates up to 8.95%. The current top state and county rate schedules are not scheduled to change.[439]

---

418 *See* Me. Rev. Stat. Ann. tit. 36, § 5121; instructions to 2020 Form 1041ME at 1.

419 *See* Me. Rev. Stat. Ann. tit. 36, § 5163, § 5164.

420 Me. Rev. Stat. Ann. tit. 36, § 5111(1-F), § 5160, § 5403; instructions to 2020 Form 1041ME at 3. *See* Maine Revenue Services, *Maine Tax Alert* at 2 (Nov. 2020), www.maine.gov/revenue.

421 Me. Rev. Stat. Ann. tit. 36, § 5111(1-F). *See* Maine Revenue Services, *Maine Tax Alert* at 2 (Nov. 2020), www.maine.gov/revenue.

422 Me. Rev. Stat. Ann. tit. 36, § 5102(4)(B)–§ 5102(4)(C). *See* instructions to 2020 Form 1041ME at 1. For Maine income-tax purposes, an individual is a ''resident,'' with certain exceptions, if the individual is domiciled in Maine or if the individual maintains a permanent place of abode and spends more than 183 days in the state during the taxable year (Me. Rev. Stat. Ann. tit. 36, § 5102(5)). Given that taxation is based on the testator's or trustor's domicile, the second test in the foregoing definition does not come into play.

423 Me. Rev. Stat. Ann. tit. 36, § 5102(2). *See* instructions to 2020 Form 1041ME at 1.

424 Me. Rev. Stat. Ann. tit. 36, § 5163, § 5164.

425 Me. Rev. Stat. Ann. tit. 36, § 5175-A; Code Me. R. 18-125-806.02, 18-125-806.03. *See* Maine Revenue Services, Guidance Document, *Schedule NR Part Year Residents, Nonresidents and ''Safe Harbor Residents'' Only* (Feb. 2021), www.maine.gov/revenue.

426 Code Me. R. 18-125-806.02(D).

427 Me. Rev. Stat. Ann. tit. 36, § 5228; instructions to 2020 Form 1041ME at 2.

428 § 664(c)(1).

429 Me. Rev. Stat. Ann. tit. 36, § 5162(2).

430 Instructions to 2020 Form 1041ME at 1 (emphasis in original).

431 *See* III.A.–III.E., above.

432 For an explanation of how this figure was derived, see I.B.3., above.

433 For an explanation of how this figure was derived, see I.B.4., above.

434 Md. Code Ann., Tax-Gen. § 10-813; instructions to 2020 Md. Form 504 at 1. *See* Maryland Dep't of Revenue Admin. Release No. 16, *Fiduciaries, Including Estates and Trusts* (Sept. 2011), www.maryland.taxes.gov.

435 *See* Md. Code Ann., Tax-Gen. § 10-101(e)(2), § 10-102, § 10-201; instructions to 2020 Md. Form 504 at 2.

436 *See* Md. Code Ann., Tax-Gen. § 10-101(e)(2).

437 Md. Code Ann., Tax-Gen. § 10-105(a)(1)(viii); instructions to 2020 Md. Form 504 at 5.

438 Md. Code Ann., Tax-Gen. § 10-101(d), § 10-103, § 10-106(a)(1)(iii); instructions to 2020 Md. Form 504 at 6.

439 Md. Code Ann., Tax-Gen. § 10-101(d), § 10-103, § 10-105(a)(1), § 10-106(a)(1)(iii). To view the 2020 state income tax rates and the 2020 and 2021 county (local) income tax rates, go to https://www.marylandtaxes.gov/individual/income/tax-info/tax-rates.php.

ISBN 978-1-63359-383-1

Maryland defines "Resident Trust" as a trust that is created by a Maryland testator or trustor or that is administered in Maryland as follows:[440]

> (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 the individual is domiciled in Maryland or if the individual spends more than 6 months and maintains an abode in the state during the year.[441] The term "principally administered" is not defined. A "Nonresident Trust" is a trust that is not a "Resident Trust."[442]

Maryland taxes all Maryland taxable income of Resident Trusts[443] but only Maryland-source taxable income of Nonresident Trusts.[444] In Maryland, trustees must make estimated tax payments for trusts.[445]

The state gives trustees the following deduction for intangible personal property held in trust for nonresidents:[446]

> (o)(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) *The subtraction allowed under paragraph (2)(ii) of this subsection does not apply if there are no remaindermen of the trust in being.*

Given that the deduction for capital gain income is not allowed if not all remainder beneficiaries are nonresidents or if remainder beneficiaries are unborn, are unascertained, or have contingent interests,[447] 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 Maryland domiciliary testator or living resident trustor that has minimal ties to Maryland still must pay tax, but the trustee of a nongrantor trust created by a Maryland resident might consider taking 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 though there is no direct support for that position in Maryland law. That position would be based on the constitutional challenges in other states.[448] 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, assuming there are no other contacts with Maryland.

As shown in Worksheet 3, the potential tax saving for a Baltimore City Resident Trust on a $1 million long-term capital gain incurred in 2020 was at least $87,868.[449] As shown in Worksheet 4, the net tax cost of including $1 million of long-term capital gain in DNI for a Baltimore, Maryland, resident individual rather than taxing the gain to a trust that was structured to escape tax in 2020 was $53,558.[450]

Practice Tip: Maryland residents and nonresidents should be cautious about creating trusts in Maryland because it taxes trusts administered in the state.

6. Massachusetts (Massachusetts Income Tax)

In Massachusetts, a trustee must file a return if such trustee receives more than $100 of Massachusetts taxable income.[451]

Massachusetts treats a trust as a grantor trust if the trust is classified as a grantor trust under § 671–§ 678 (not § 679),[452] and the Bay State allows trustees of nongrantor trusts to take a distribution deduction.[453] In 2020, Massachusetts taxed most taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at 5.00% but, after a 50% deduction, taxed short-term capital gains and long-term gains

[440] Md. Code Ann., Tax-Gen. § 10-101(k)(1)(iii). *See* instructions to 2020 Md. Form 504 at 1.

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

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

[443] Md. Code Ann., Tax-Gen. § 10-601, § 10-604; instructions to 2020 Md. Form 504 at 1.

[444] Md. Code Ann., Tax-Gen. § 10-105(d), § 10-210; instructions to 2020 Md. Form 504 at 1.

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

[446] Md. Code Ann., Tax-Gen. § 10-207(o) (emphasis added). *See* instructions to 2020 Md. Form 504 at 4-5.

[447] *See* instructions to 2020 Md. Form 504 at 5.

[448] *See* III.A.–III.E., above.

[449] For an explanation of how this figure was derived, see I.B.3., above.

[450] For an explanation of how this figure was derived, see I.B.4., above.

[451] Mass. Gen. Laws ch. 62C, § 6(b); instructions to 2020 Mass. Form 2 at 5. *See* TIR 04-23, *Changes in the Tax Treatment of Certain Estates and Trusts as a Result of Chapter 262 of the Acts of 2004* (Mar. 15, 2018), www.mass.gov; Massachusetts Budget and Policy Center, *The Income Tax in Massachusetts* (Apr. 3, 2013), www.massbudget.org. *See also Lowry v. Comm'r of Revenue*, Massachusetts Administrative Decision C330919, 2020 WL 2526060 (Mass. App. Tax Bd. May 5, 2020) (Texas margin tax not creditable for Massachusetts income-tax purposes because margin tax not income tax). *See* Andrea Muse, *Accountant Denied Credit for Paid Texas Tax,* 96 Tax Notes State 807 (May 11, 2020).

[452] Mass. Gen. Laws ch. 62, § 10(e), § 10(f); instructions to 2020 Mass. Form 2 at 4. *See* Mass. Dep't of Revenue Directive 89-4, *Grantor Trust with Non-Resident Grantor* (Mar. 15, 1989), www.mass.gov/dor.

[453] Mass. Gen. Laws ch. 62, § 10(h)–§ 10(j); instructions to 2020 Mass. Form 2 at 4.

ISBN 978-1-63359-383-1

on collectibles at 12.00%.[454] The 5.00% rate is not scheduled to change.[455] Massachusetts ''taxable income'' is not derived from a comparable figure for federal purposes.

Massachusetts defines ''Resident Trust'' to include testamentary trusts created by Massachusetts residents as follows:[456]

> Trusts created under the will of a person who died a resident of Massachusetts are subject to the taxing jurisdiction of Massachusetts with respect to all of their taxable income from whatever source derived.

The Commonwealth also defines ''Resident Trust'' to include certain inter vivos trusts created by residents as follows:[457]

> To be subject to the taxing jurisdiction of Massachusetts as a ''Resident Inter Vivos Trust'' at least one trustee must be a resident of Massachusetts and in addition at least one of the following conditions must exist:
>
> a. At the time of the creation of the trust the grantor (or any one of several grantors) was a resident of Massachusetts. The ''time of the creation of the trust'' will ordinarily be the time when a declaration of trust has been made and property delivered by the grantor to the trustee.
>
> b. During any part of the year for which income is computed the grantor (or any one of several grantors) resided in Massachusetts.
>
> c. The grantor (or any one of several grantors) died a resident of Massachusetts.

In Massachusetts, an individual is a resident if the individual is domiciled in the Commonwealth or if the individual maintains a permanent place of abode and spends more than 183 days there during the year.[458]

The Supreme Judicial Court of Massachusetts has clarified the circumstances in which a corporate trustee will be a ''resident'' for these purposes:[459]

> [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.

A ''Nonresident Trust'' is a trust that is not a ''Resident Trust.''[460] Massachusetts taxes all taxable income of Resident Trusts[461] but only Massachusetts-source taxable income of Nonresident Trusts.[462] In Massachusetts, trustees must make estimated tax payments for trusts[463] and must withhold tax for nonresident grantors and beneficiaries.[464]

Importantly, Massachusetts generally taxes trustees of Resident Trusts only on income attributable to resident beneficiaries as follows:[465]

> 1. Resident Beneficiaries. To the extent that trust income is payable to, or accumulated for the benefit of resident beneficiaries, all of such income is taxable to the trust at the rate applicable to the particular class of income.
>
> 2. Non-Resident Beneficiaries. Where trust income is payable to, or accumulated for the benefit of, non-resident beneficiaries, only the net income derived from professions, trade or business carried on within Massachusetts is taxable to the trust.

But, unborn and unascertained persons as well as persons with uncertain interests are deemed to be residents:[466]

> Income received by trustees or other fiduciaries described in subsection (c) of this section which is accumulated for unborn or unascertained persons, or persons with uncertain interests shall be taxed as if accumulated for the benefit of a known inhabitant of the commonwealth.

The Massachusetts income tax does not apply to:[467]

> [T]rustees of charitable remainder annuity trusts or charitable remainder unitrusts, as defined in section six hundred and sixty-four (d) of the Code.

The instructions to the Massachusetts fiduciary income tax return impose the following filing requirements:[468]

> Trustees of split-interest trusts, e.g., . . . charitable remainder annuity trusts, and charitable remainder unitrusts, are to file a Form 2G, not Form 2.

The trustee of a trust created by a Massachusetts testator might take the position that the trust is not subject to Massa-

---

[454] Mass. Gen. Laws ch. 62, § 4; instructions to 2020 Mass. Form 1 at 2; 2020 Mass. Form 2 at 2. *See* Governor's Press Release, *Baker-Polito Administration Announces Massachusetts Income Tax Rate Dropping to 5% on January 1, 2020* (Dec. 13, 2019), www.mass.gov/news.

[455] Mass. Gen. Laws ch. 62, § 4.

[456] Mass. Reg. Code tit. 830, § 62.10.1(1)(a). *See* Mass. Gen. Laws ch. 62, § 10(c); instructions to 2020 Mass. Form 2 at 4.

[457] Mass. Reg. Code tit. 830, § 62.10.1(1)(b)(1). *See* Mass. Gen. Laws ch. 62, § 10(c); instructions to 2020 Mass. Form 2 at 4.

[458] Mass. Gen. Laws ch. 62, § 1(f).

[459] *Bank of Am., N.A. v. Comm'r of Revenue*, 54 N.E.3d 13, 21 (Mass. 2016), *aff'g* Massachusetts Administrative Decision C314617, 2015 WL 3668943 (Mass. App. Tax Bd. June 10, 2015). *See* Mass. Dep't of Revenue TIR 16-14, *Decision of the Massachusetts Supreme Judicial Court in Bank of America, N.A. v. Commissioner of Revenue* (Nov. 14, 2016), www.mass.gov.

[460] Mass. Gen. Laws ch. 62, § 10(d); Mass. Reg. Code tit. 830, § 62.10.1(1)(a), § 62.10.1(1)(b)(2); instructions to 2020 Mass. Form 2 at 4.

[461] Mass. Gen. Laws ch. 62, § 4, § 10(a) § 13, § 25. *See* Mass. Reg. Code tit. 830, § 62.10.1(1), § 62.10.1(2); instructions to 2020 Mass. Form 2 at 4.

[462] Mass. Gen. Laws ch. 62, § 4, § 5A, 10(a); Mass. Reg. Code tit. 830, § 62.5A.1, § 62.10.1(1), § 62.10.1(2); instructions to 2020 Mass. Form 2 at 5.

[463] Mass. Gen. Laws ch. 62B, § 13; instructions to 2020 Mass. Form 2 at 5-6.

[464] Mass. Gen. Laws ch. 62, § 10(g); instructions to 2020 Mass. Form 2 at 6.

[465] Mass. Reg. Code tit. 830, § 62.10.1(2)(b). *See* Mass. Gen. Laws. ch. 62, § 10(a).

[466] Mass. Gen. Laws. ch. 62, § 10(a). *See* Mass. Reg. Code tit. 830, § 62.10.1(2)(b)(3); instructions to 2020 Mass. Form 2 at 4. *See also State Tax Comm'n v. Loring*, 215 N.E.2d 751 (Mass. 1966) (income accumulated for California beneficiary with vested interest not taxable).

[467] Mass. Gen. Laws. Ch. 62, § 10(c).

[468] Instructions to 2020 Mass. Form 2 at 5.

ISBN 978-1-63359-383-1

chusetts income tax if it has no Massachusetts trustee, asset, or source income even if it has resident beneficiaries.[469] Tax can be eliminated on inter vivos trusts created by Massachusetts residents simply by appointing no Massachusetts trustee.

As shown in Worksheet 3, the potential tax saving for a Massachusetts Resident Trust on a $1 million long-term capital gain incurred in 2020 was $50,000.[470] As shown in Worksheet 4, the net tax cost of including $1 million of long-term capital gain in DNI for a Massachusetts resident individual rather than taxing the gain to a trust that was structured to escape tax in 2020 was $15,659.[471]

Practice Tip: Residents of other states might consider establishing trusts in Massachusetts because it does not tax trusts created by nonresidents except on source income. A planning opportunity might exist by reason of the disconnect between the federal and the Massachusetts grantor-trust rules.[472]

7. New Hampshire

The Granite State's income tax on interest and dividends[473] does not apply to nongrantor trusts.[474]

8. New Jersey (New Jersey Gross Income Tax)

In New Jersey, a trustee of a Resident Trust must file a return if the trust has more than $10,000 of gross income; a trustee of a Nonresident Trust must file a return if the trust has New Jersey source income and more than $10,000 of gross income from all sources.[475]

New Jersey treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[476] and the Garden State permits trustees of nongrantor trusts to take a distribution deduction.[477] In 2020, New Jersey taxed the New Jersey taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 10.75% (the 10.75% rate applied starting with such income over $1 million)[478] and the current rate schedule is not scheduled to change.[479]

New Jersey defines "Resident Trust" as a trust that is created by a New Jersey domiciliary testator or trustor as follows:[480]

A 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 this State, or

(3) A trust, or portion of a trust, consisting of the property of:

(a) 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

(b) A person domiciled in this State at the time such trust, or portion of a trust, became irrevocable, if it was revocable when such property was transferred to the trust but has subsequently become irrevocable.

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."[481]

New Jersey taxes all New Jersey gross income of Resident Trusts[482] but only New Jersey-source gross income of Nonresident Trusts.[483] In New Jersey, trustees must make estimated tax payments for trusts.[484]

As discussed above, New Jersey treats a trust as a Resident Trust if it was created by a New Jersey domiciliary testator or

---

[469] *See* III.A.–III.E., above.

[470] For an explanation of how this figure was derived, see I.B.3., above.

[471] For an explanation of how this figure was derived, see I.B.4., above.

[472] *See* II.A., above.

[473] N.H. Rev. Stat. § § 77:1 et seq.

[474] *See* N.H. Rev. Stat. § 77:10. *See* N.H. Dep't of Revenue TIR 2014-002, *Interest and Dividends Tax (Trusts and Trust Beneficiaries)* (Apr. 3, 2014), www.revenue.nh.gov; N.H. Dep't of Revenue TIR 2012-002, *New Hampshire 2012 Legislative Session in Review* (July 10, 2012), www.revenue.nh.gov. *See also* James Usseglio, *Converting to an LLC to Minimize New Hampshire Taxes,* 87 State Tax Notes 195 (Jan. 8, 2018).

[475] Instructions to 2020 Form NJ-1041 at 3. *See* NJSA § 54A:8-3.1(a)(1)(c). *See also* N.J. Div. Tax'n GIT-12, *Estates and Trusts: Understanding Income Tax* (Dec. 2019), www.state.nj.us/treasury.

[476] *See* NJSA § 54A:5-1(h); instructions to 2020 Form NJ-1041 at 3.

[477] NJSA § 54A:5-3; instructions to 2020 Form NJ-1041 at 3.

[478] NJSA § 54A:2-1(b)(7); instructions to 2020 Form NJ-1041 at 30.

[479] NJSA § 54A:2-1(b)(1)–§ 54A:2-1(b)(7).

[480] NJSA § 54A:1-2(o)(2)–§ 54A:1-2(o)(3). *See* instructions to 2020 Form NJ-1041 at 3. In a Letter Ruling, which will not be released for publication, the N.J. Division of Taxation determined that a trust created by a Delaware trustee via the exercise of a decanting power over three New Jersey resident trusts at the direction of a non-New Jersey adviser would be considered to be a nonresident trust for New Jersey tax purposes where the new trust did not meet the definition of Resident Trust. For New Jersey income-tax purposes, an individual is a "resident," with certain exceptions, if the individual is domiciled in New Jersey or if the individual maintains a permanent place of abode and spends more than 183 days in the state during the taxable year (NJSA § 54A:1-2(m)). Given that taxation is based on the testator's or trustor's domicile, the second test in the foregoing definition does not come into play. For the meaning of "domicile" for New Jersey income-tax purposes, see instructions to 2020 Form NJ-1041 at 3. *See also* Robert Kantowitz, *A Tale of Two States,* 98 Tax Notes State 161 (Oct. 12, 2020).

[481] NJSA § 54A:1-2(p); instructions to 2020 Form NJ-1041 at 4.

[482] NJSA § 54A:5-1.

[483] NJSA § 54A:2-1.1, § 54A:5-7; instructions to 2020 Form NJ-1041 at 4. *See Tina Schiller Trust for Benefit Siegelbaum v. Dir., Dep't of Treasury, Div. of Tax'n for State of N.J.*, 14 N.J. Tax 173, 181 (N.J. Super. Ct. App. Div. 1994) ("The disposition of the corporate stock here constitutes the nontaxable sale of the intangible asset"). *See also* VIII.F., below. *See Hill v. Dir., State Div. of Tax'n*, 29 N.J. Tax 318 (N.J. Super. Ct. App. Div. 2016) (Pennsylvania residents taxed on New Jersey source income distributed to them from New Jersey resident trust); *Xylem Dewatering Solutions Inc. v. Dir. Div. of Tax'n*, 30 N.J. Tax 41, 41 (2017), *aff'd sub nom.*, *John M. Paz v. Dir., Div. of Tax'n*, 31 N.J. Tax 76 (N.J. Super. Ct. App. Div. 2019) ("gain from the deemed sale of assets of a New Jersey S corporation under Internal Revenue Code § 338(h)(10) is sourced to New Jersey on the non-resident shareholders' New Jersey Non-Resident Gross Income Tax Returns" based "with reference to the Corporation Business Tax statutes"). *See also* Andrea Muse, *Appellate Court Affirms Sourcing of Gain to State,* 91 State Tax Notes 522 (Feb. 11, 2019); Robert Willens, *New Jersey Uses the 'McKesson' Decision to Its Advantage,* 99 Daily Tax Rep. J-1 (May 24, 2017); Eric Yauch, *Deemed Asset Sale Gain Should Be Sourced to New Jersey, State Tax Court Rules,* 2017 State Tax Today 70-2 (Apr. 13, 2017).

[484] NJSA § 54A:8-4(m); instructions to 2020 Form NJ-1041 at 6.

ISBN 978-1-63359-383-1

trustor.[485] But, recognizing the constitutional limits on the state's ability to tax non-New Jersey trustees, the New Jersey Tax Court held in *Pennoyer v. Taxation Division Director*[486] and *Potter v. Taxation Division Director*[487] that the state must treat a Resident Trust as a Nonresident Trust in certain circumstances. In the 2015 case of *Residuary Trust A U/W/O Kassner v. Director, Division of Taxation*,[488] a New Jersey intermediate appellate court confirmed that a Resident Trust that had a New York trustee and administration outside New Jersey would enjoy beneficial tax treatment.

The New Jersey taxing authorities honor the *Pennoyer-Potter* rule. Hence, a Resident Trust does not have to pay any New Jersey tax if it has no New Jersey trustee, asset, or source income and files an informational return as follows:[489]

> A resident . . . trust is not subject to New Jersey tax if it:
>
> - Does not have any tangible assets in New Jersey;
> - Does not have any income from New Jersey sources; and
> - Does not have any trustees . . . in New Jersey.
>
> However, the fiduciary must file Form NJ-1041 for such . . . trust, enclose a statement certifying that the . . . trust is not subject to tax, and check the box on Line 26.

Practice Tip: Because it is unclear whether advisers, protectors, and committees are encompassed within "trustee," the safe course is not to appoint New Jersey domiciliaries to participate in New Jersey trusts.

In 2009, the New Jersey Division of Taxation announced that CRTs are taxed at the trust level for the following reason:[490]

> 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.

New Jersey taxation at the trust level is undesirable when, as often is the case, a client wants to use a CRT to diversify a portfolio of low-basis securities without being taxed immediately on all capital gains.[491]

New Jersey testators and trustors should structure their trusts (including their CRTs) to qualify as Exempt Resident Trusts. Even though the Appellate Division of the New Jersey Superior Court held that a Resident Trust having a New York trustee and out-of-state administration will qualify as an Exempt Resident Trust,[492] source income might prevent a trust from meeting the exemption.[493] Therefore, 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. Similarly, given that New Jersey has not conceded that a trust with domiciliary beneficiaries escapes tax, a testator or trustor might create two trusts, one for New Jersey beneficiaries and the other for non-New Jersey beneficiaries.

As shown in Worksheet 3, the potential tax saving for a New Jersey Resident Trust on a $1 million long-term capital gain incurred in 2020 was at least $74,484.[494] As shown in Worksheet 4, the net tax cost of including $1 million of long-term capital gain in DNI for a New Jersey resident individual rather than taxing the gain to a trust that was structured to escape tax in 2020 was $40,363.[495]

Practice Tip: Domiciliaries of other states might consider establishing trusts in New Jersey because it does not tax trusts created by nondomiciliaries except on source income.

In 2016 (the latest year for which figures are available), 84,909 fiduciary returns reported owing $173.2 million of New Jersey tax.[496] Given that the rules for escaping tax were clear, one wonders how much of that tax could have been saved.

9. *Pennsylvania (Pennsylvania Personal Income Tax)*

In Pennsylvania, a trustee of a Resident Trust must file a return if the trust has Pennsylvania taxable income; a trustee of a Nonresident Trust must file a return if the trust has Pennsylvania-source taxable income or a Pennsylvania resident beneficiary.[497]

The Pennsylvania personal income tax is completely decoupled from the federal income-tax system. Accordingly, the Keystone State does *not* follow the federal grantor-trust rules for irrevocable trusts.[498] But, starting in 2020, the Commonwealth allows a decedent's personal representative and the trustee of the decedent's revocable trust to make a § 645 elec-

[485] NJSA § 54A:1-2(o)(2)–§ 54A:1-2(o)(3).
[486] 5 N.J. Tax 386 (Tax Ct. 1983). *See* III.B.4., above.
[487] 5 N.J. Tax 399 (Tax Ct. 1983). *See* III.B.5., above.
[488] 8 N.J. Tax 541 (N.J. Super. Ct. App. Div. 2015). *See* III.D.2., above.
[489] Instructions to 2020 Form NJ-1041 at 3.
[490] N.J. Div. Tax'n Tech. Bull. 64, *Charitable Remainder Trusts*, 2009 N.J. Tax Tech. Bull. Lexis 34 (N.J. Div. Tax. June 29, 2009) (emphasis in original), www.state.nj.us/treasury.
[491] *See* § 664(b).
[492] *Kassner*, 28 N.J. Tax 541. *See* III.D.2., above.
[493] Instructions to 2020 Form NJ-1041 at 4.
[494] For an explanation of how this figure was derived, see I.B.3., above.
[495] For an explanation of how this figure was derived, see I.B.4., above.
[496] N.J. Dep't of the Treasury, *Statistics of Income: 2016 Gross Income Tax Returns* (Aug. 2019), https://www.nj.gov/treasury/taxation/pdf/pubs/soi-tables2016.pdf.
[497] Instructions to 2020 Form PA-41 at 1-2. *See* 72 P.S. § 7330(a), § 7331(g); 61 Pa. Code § 117.5. *See also* Jennifer Weidler Karpchuk, *Hyatt and Kaestner: Implications for Pennsylvania,* 93 Tax Notes State 517 (Aug. 5, 2019); Pa. Dep't of Revenue, *The Tax Compendium* at 14-17 (Feb. 2019), http://www.revenue.pa.gov.
[498] *See* 72 P.S. § 7302; 61 Pa. Code § 105.1; instructions to 2020 Form PA-41 at 4.

ISBN 978-1-63359-383-1

tion.[499] In addition, trustees of nongrantor trusts are permitted to take a distribution deduction.[500] In 2020, the Commonwealth taxed the Pennsylvania net taxable income of trustees of irrevocable trusts at 3.07%,[501] and the 3.07% rate is not scheduled to change.[502]

Pennsylvania defines ''Resident Trust'' as a trust that is created or funded by a Pennsylvania resident testator or trustor as follows:[503]

> ''Resident Trust'' means:
>
> (1) A trust created by the will of a decedent who at the time of his death was a resident individual; and
>
> (2) Any trust created by, or consisting in whole or in part of property transferred to a trust by a person who at the time of such creation or transfer was a resident.

In classifying a trust for income-tax purposes, ''[t]he residence of the fiduciary and the beneficiaries of the trust shall be immaterial.''[504]

In Pennsylvania, an individual is a resident for tax purposes if the individual is domiciled in the Commonwealth or if the individual maintains a permanent place of abode and spends more than 183 days there during the taxable year.[505] A ''Nonresident Trust'' is a trust that is not a ''Resident Trust.''[506]

Pennsylvania taxes Resident Trusts on the following seven specific classes of income:

- Taxable interest income
- Taxable dividend income
- Net income or loss from the operation of a business, profession, or farm
- Net gain or loss from the sale, exchange, or disposition of property
- Net income or loss from rents, royalties, patents, or copyrights
- Estate or trust income
- Gambling and lottery winnings.[507]

Nonresident Trusts are taxed on the above classes of income attributable to Pennsylvania sources.[508] In Pennsylvania, trustees must make estimated tax payments for trusts[509] and must withhold tax on source income distributable to nonresident beneficiaries.[510]

The Commonwealth assesses a throwback tax on accumulation distributions to resident beneficiaries from Nonresident Trusts. Hence, a regulation provides:[511]

> Amounts received by a resident beneficiary from a nonresident . . . trust shall be taxable to the beneficiary in the year received to the extent that such income was not subject to tax under this article. The resident beneficiary shall be allowed a credit against the tax otherwise due under this article for his pro rata share of any income tax, wage tax or tax on or measured by gross or net earned or unearned income imposed on the . . . trust with respect to such income by another state. The credit shall not exceed the proportion of the tax otherwise due. Reference should be made to § 111.4 (relating to limitation on credit).

The Commonwealth offers a very narrow definition of Exempt Resident Trust. Thus, according to the Pennsylvania fiduciary income tax return instructions, a trust created by a resident will not be taxed in the following extremely limited circumstances:[512]

> An inter vivos trust or a testamentary trust created by a resident can become a nonresident trust if the settlor is no longer a resident or is deceased, and the trust lacks sufficient contact with Pennsylvania to establish nexus. Any one of the following conditions provides sufficient contact for a resident trust to remain a resident trust or to requalify as a resident trust:
>
> - The trust has a resident trustee;
> - Any trust administration occurs in Pennsylvania;
> - Trust assets include:
>   - Real or tangible personal property located within Pennsylvania, or
>   - Stock, securities or intangible personal property, evidenced by the documents, certificates or other instruments that are physically located, or have a business situs within Pennsylvania; or
> - The situs of the trust is Pennsylvania as provided in 20 PA. C.S. § 7708.

---

[499] 72 P.S. § 7331(g); instructions to 2020 Form PA-41 at 1, 13.

[500] 72 P.S. § 7305; 61 Pa. Code § 105.2, § 105.3, § 105.4(c), § 105.4(d); instructions to 2020 Form PA-41 at 7.

[501] 72 P.S. § 7302; 2020 Form PA-41 at 1.

[502] 72 P.S. § 7302.

[503] 72 P.S. § 7301(s). *See* 61 Pa. Code § 101.1; instructions to 2020 Form PA-41 at 5.

[504] 61 Pa. Code § 101.1.

[505] 72 P.S. § 7301(p). *See* instructions to 2020 Form PA-41 at 5.

[506] 72 P.S. § 7301(n); instructions to 2020 Form PA-41 at 4. *See In re David C. Matthew Family Tr.*, Penn. Board of Finance and Revenue Decision No. 1917374 (Feb. 10, 2020), www.bfrcases.patreasury.gov (petitioner was not resident trust in 2016 because ''Petitioner's grantor was not a Pennsylvania resident at the time Petitioner was created, and Petitioner and its grantor owned no Pennsylvania property at the time of the grantor's death or at any time during 2016'').

[507] Instructions to 2020 Form PA-41 at 6. *See* 72 P.S. § 7301(j), § 7302, § 7303, § 7305; 61 Pa. Code § 105.4(a), § 105.4(b). *See In re Lesline B. Brothers*, Penn. Board of Finance and Revenue Decision No. 1916802 (Mar. 16, 2020), www.bfrcases.patreasury.gov (tax was not due in 2014 on sale of restricted stock units because ''Petitioner has shown that Pennsylvania income tax was withheld on the RSU's at the time of issuance . . .'').

[508] 72 P.S. § 7301(k), § 7302, § 7303, § 7305; 61 Pa. Code § 101.8, § 105.4(a), § 105.4(b).

[509] 72 P.S. § 7324(a); instructions to 2020 Form PA-41 at 13-14.

[510] 72 P.S. § 7325–§ 7326; 61 Pa. Code § 115.2, § 115.9; instructions to 2020 Form PA-41 at 6-7.

[511] 61 Pa. Code § 105.5(c). For an illustrative example, see 61 Pa. Code § 105.6(6). It should be noted that the U.S. Supreme Court did not endorse the throwback-tax structure in its 2019 *N.C. Dep't of Revenue v. The Kimberley Rice Kaestner 1992 Family Trust* decision, 139 S. Ct. 2213, 2225 n.13 (2019) (''The Trust also raises no challenge to the practice known as throwback taxation, by which a State taxes accumulated income at the time it is actually distributed. *See, e.g.*, Cal. Rev. & Tax. Code § 17745(b)'').

[512] Instructions to 2020 Form PA-41 at 4.

ISBN 978-1-63359-383-1

A 2001 Pennsylvania letter ruling[513] concluded that a trust created by a Pennsylvania testator that had no Pennsylvania fiduciary, asset, or beneficiary no longer would have to pay Pennsylvania income tax if a Pennsylvania court transferred the situs of the trust to a place outside the Commonwealth and if the courts of that state assumed jurisdiction. Unfortunately, that ruling expired in 2006.[514] In the 2013 *McNeil v. Commonwealth* case,[515] though, the Pennsylvania Commonwealth Court held that Pennsylvania's imposition of personal income tax on two inter vivos trusts having no Pennsylvania trustee, asset, or source income violated the U.S. Commerce Clause even though the trustor and the discretionary beneficiaries lived in the Commonwealth. The tax return instructions contain the following caution for trustees seeking to have a Resident Trust taxed as a Nonresident Trust:[516]

> CAUTION: Do not file an amended return to change the residency status of a trust. You must file a REV-65 Petition for Refund, with the Board of Appeals.

The Board of Finance and Revenue of the Commonwealth of Pennsylvania followed *McNeil* in *In re John S. Coates 2009 Trust*[517] There, a Pennsylvania resident created a trust and appointed his wife and a financial institution trustees. The trustor and his wife became Florida residents as of October 1, 2012. In granting the trust's petition for a refund of tax paid for the final quarter of 2012, the Board concluded:[518]

> The Petitioner's only ties to Pennsylvania were the facts that the settlor, Mr. Coates, was a Pennsylvania resident at the time the trust was created, and the trustees were Pennsylvania residents. All other business concerning Petitioner occurred outside of Pennsylvania. The facts and documentation establish that the trustees were residents of Florida as of October 1, 2012. Since the one trustee is no longer a Pennsylvania resident, Petitioner has no connection to Pennsylvania. Therefore, pursuant to *McNeil*, Pennsylvania cannot assert personal income tax against Petitioner.
>
> Accordingly, this Board finds that as of October 1, 2012, Petitioner was no longer a Pennsylvania resident trust, and is entitled to a refund on tax paid from October 2012 through December 2012.

The *McNeil* decision was based, in part, on the fact that the trust had no physical presence in Pennsylvania. In the meantime, the U.S. Supreme Court eliminated the physical-presence requirement under the Commerce Clause.[519] As discussed in III.D.5.(b)., above, *McNeil* nevertheless remains a basis by which trustees can resist taxation by the Commonwealth.

[513] PIT-01-040 (July 27, 2001).

[514] 61 Pa. Code § 3.3(b). *See McNeil v. Commonwealth*, 67 A.3d 185, 191 (Pa. Commw. Ct. 2013). *See* III.D.5., above.

[515] *McNeil*, 67 A.3d 185.

[516] Instructions to 2020 Form PA-41 at 19. REV-65, *Board of Appeals Petition Form*, is available at www.revenue.pa.gov/FormsandPublications/otherforms/Documents/rev-65.pdf.

[517] *In re John S. Coates 2009 Trust*, Penn. Board of Finance and Revenue Decision No. 1608880 (Apr. 11, 2017).

[518] Coates, No. 1608880, at *2.

[519] *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080 (2018). *See* III.A.8., above.

Pennsylvania taxes CRTs at the trust level. Hence, the instructions to the Pennsylvania fiduciary income tax return provide:[520]

> Charitable Remainder Annuity Trusts (CRATs) and Charitable Remainder Unitrusts (CRUTs) 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 undistributed income may benefit any private individual in subsequent years; or
> - 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 undistributed income, and report the income to the beneficiary on the same basis as any other ordinary trust.

Pennsylvania taxation at the trust level is undesirable when, as often is the case, a client wants to use a CRT to diversify a portfolio of low-basis securities without being taxed immediately on all capital gains.[521]

Pennsylvania testators and trustors should structure their trusts (including their CRTs) to eliminate tax.

As shown in Worksheet 3, the potential tax saving for a Pennsylvania Resident Trust on a $1 million long-term capital gain incurred in 2020 was $30,700.[522] As shown in Worksheet 4, the tax saving from including $1 million of long-term capital gain in DNI for a Pennsylvania resident individual rather than taxing the gain to a trust that was structured to escape tax in 2020 was $3,421.[523]

Practice Tip: Residents of other states might consider establishing trusts in Pennsylvania because it does not tax trusts created by nonresidents except on source income.

Given that Pennsylvania does not have grantor-trust rules for irrevocable trusts, it might be possible to design a trust to be a grantor trust for federal purposes and a nontaxable nongrantor trust for Pennsylvania purposes.[524]

[520] Instructions to 2020 Form PA-41 at 3. *See* 72 P.S. § 7301(c.1).

[521] *See* § 664(b).

[522] For an explanation of how this figure was derived, see I.B.3., above.

[523] For an explanation of how this figure was derived, see I.B.4., above.

[524] *See* II.A., above.

ISBN 978-1-63359-383-1

10. Rhode Island (Rhode Island Personal Income Tax)

In Rhode Island, a trustee must file a return if such trustee must file a federal return or if the trust has Rhode Island taxable income.[525]

Rhode Island treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[526] and the Ocean State permits trustees of nongrantor trusts to take a distribution deduction.[527] In 2020, Rhode Island taxed the Rhode Island taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 5.99% (the 5.99% rate applied starting with such income over $8,300)[528] and the current rate schedule, adjusted for inflation, is not scheduled to change (the 5.99% rate applies starting with such income over $8,450 in 2021).[529]

Rhode Island defines ''Resident Trust'' as follows:[530]

(c) Resident . . . trust. A resident . . . trust means: . . .

> (2) A revocable trust which becomes irrevocable upon the occurrence of any event (including death) which terminates a person's power to revoke, but only after the event, and only if the person having the power to revoke was a Rhode Island resident individual at the time of the event.
>
> (3) A trust created by will of a decedent who at his or her death was a resident individual in this state.
>
> (4) An irrevocable trust created by or consisting of property contributed by a person who is a resident individual in this state at the time the trust was created or the property contributed (A) while the person is alive and a resident individual in this state, and (B) after the person's death if the person died a resident individual of this state.

In Rhode Island, an individual is a resident for tax purposes if the individual is domiciled in the state or if the individual maintains a permanent place of abode and spends more than 183 days there during the tax year.[531] A ''Nonresident Trust'' is a trust that is not a ''Resident Trust.''[532]

Rhode Island taxes all taxable income of Resident Trusts[533] but only Rhode Island-source taxable income of Nonresident Trusts.[534] In Rhode Island, trustees must make estimated tax payments for trusts.[535]

Importantly, Rhode Island treats a trust as a Resident Trust only to the extent that it has resident beneficiaries as follows:[536]

> (5) In subdivisions (2), (3), and (4) of this subsection the trust shall be a resident trust only to the extent that the beneficiaries are Rhode Island resident individuals, subject to such regulations as may be promulgated by the tax administrator.

The Division of Taxation of the Rhode Island Department of Revenue has issued the following regulation regarding the residency status of beneficiaries:[537]

> A. The status of a beneficiary as a ''resident individual'' or as a ''nonresident individual'' is his or her status for personal income tax purposes but determined at the close of the trust's taxable year rather than at the close of the beneficiary's taxable year.
>
> B. For those children born after the execution of the trust, children of a resident individual are deemed to be resident individuals and; likewise, children of a nonresident individual are deemed to be nonresident individuals.

That agency also issued the following regulation that guides trustees regarding the treatment of accumulated ordinary income and capital gains:[538]

> A. If income is accumulated in a discretionary trust in any year and the trustee has a discretionary power to distribute the income or the accumulated income among a group of people, any one of whom is a resident individual, the trust is deemed to be a resident trust with regard to the accumulated income pertaining to the resident beneficiary or beneficiaries.
>
> B. If income is accumulated in a trust in any year, the trust is deemed to be a resident trust for the purposes of the accumulated income to the extent that the income is accumulated for future distribution only to a person who is a (or to persons who are) resident(s) at the close of the trust's taxable year; and is deemed to be a nonresident trust to the extent that the income is accumulated for future distribution to a person(s) who is a nonresident at the close of the trust's tax year.
>
> C. Capital gains realized and deemed retained for future distribution to the remaindermen are undistributed gains and the trust is deemed to be a resident trust in the same ratio that the interests of all resident individual remaindermen bear to the interests of all remaindermen.

A CRT generally is exempt from federal income tax.[539] Consequently, it usually also is exempt from Rhode Island income tax pursuant to the following statute:[540]

> A trust or other unincorporated organization, which by reason of its purposes or activities is exempt from federal income tax, shall be exempt from the Rhode

[525] R.I. Gen. Laws § 44-30-51(a)(2); instructions to 2020 Form RI-1041 at I-1.

[526] *See* R.I. Gen. Laws § 44-30-1(a), § 44-30-2.6(a).

[527] *See* R.I. Gen. Laws § 44-30-1(a), § 44-30-2.6(a), § 44-30-16.

[528] R.I. Gen. Laws § 44-30-2.6(c)(3)(A)(II), § 44-30-2.6(c)(3)(E); 2020 Form RI-1041 Tax Rate Schedules at 1.

[529] R.I. Dep't of Revenue, Div. of Tax'n, Adv. 2020-59, *Inflation-Adjusted Amounts Set for Tax Year 2021* (Dec. 10, 2020), www.tax.ri.gov.

[530] R.I. Gen. Laws § 44-30-5(c)(2)–§ 44-30-5(c)(4). *See* instructions to 2020 Form RI-1041 at I-1.

[531] R.I. Gen. Laws § 44-30-5(a).

[532] R.I. Gen. Laws § 44-30-5(d); instructions to 2020 Form RI-1041 at I-1.

[533] R.I. Gen. Laws § 44-30-16; instructions to 2020 Form RI-1041 at I-1.

[534] R.I. Gen. Laws § 44-30-35; instructions to 2020 Form RI-1041 at I-1.

[535] R.I. Gen Laws § 44-30-55(a).

[536] R.I. Gen. Laws § 44-30-5(c)(5). *See* 280-RICR-20-55-7.7; instructions to 2020 Form RI-1041 at I-1.

[537] 280-RICR-20-55-7.6.

[538] 280-RICR-20-55-7.7. Examples are provided (280-RICR-20-55-7.8).

[539] § 664(c)(1).

[540] R.I. Gen. Laws § 44-30-1(d).

ISBN 978-1-63359-383-1

Island personal income tax, except with respect to its unrelated business taxable income.

As just mentioned, if a Rhode Island testator or trustor creates a trust that benefits no Rhode Island beneficiary, Rhode Island will not tax the trustee. No case or ruling addresses whether the trustee of a trust created by a Rhode Island testator or trustor that has minimal ties to Rhode Island still must pay tax, but the trustee of a nongrantor trust created by a Rhode Island resident might consider taking the position that the trust is not subject to Rhode Island income tax if it has no Rhode Island trustee, asset, or source income even if such trust has resident beneficiaries.[541]

As shown in Worksheet 3, the potential tax saving for a Rhode Island Resident Trust on a $1 million long-term capital gain incurred in 2020 was at least $59,765.[542] As shown in Worksheet 4, the net tax cost of including $1 million of long-term capital gain in DNI for a Rhode Island resident individual rather than taxing the gain to a trust that was structured to escape tax in 2020 was $23,287.[543]

Practice Tip: Residents of other states might consider establishing trusts in Rhode Island because the state does not tax trusts created by nonresidents except on source income.

11. Vermont (Vermont Income Tax)

In Vermont, a trustee must file a return if such trustee must file a federal return and if the trust has more than $100 of Vermont income or more than $1,000 of Vermont-source income.[544]

Vermont treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[545] and the Green Mountain State permits trustees of nongrantor trusts to take a distribution deduction.[546] In 2020, Vermont taxed the taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 8.75% (the top rate applied to such income over $9,750),[547] and the current rate schedule is not scheduled to change.[548]

Vermont defines ''Resident Trust'' as follows:[549]

(B) A trust qualifies for residency in this State if it is:

(i) a trust, or a portion of a trust, consisting of property transferred by will or by a decedent who at his or her death was domiciled in this state; or

(ii) a trust, or portion of a trust, consisting of 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 portion of a trust, became irrevocable, if it was revocable when such property was transferred to the trust but has subsequently become irrevocable.

(C) As used in subdivision (B) of this subsection, a trust or a 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.''[550]

Vermont taxes all taxable income of Resident Trusts[551] but only Vermont-source taxable income of Nonresident Trusts.[552] In Vermont, trustees are required to make estimated tax payments for trusts.[553]

Vermont taxes trustees of trusts that are ''subject to income taxation under the laws of the United States.''[554] Because a CRT generally is exempt from federal income tax,[555] it therefore usually is exempt from Vermont tax as well.

No case or ruling addresses whether the trustee of a trust created by a Vermont testator or trustor that has minimal ties to Vermont still must pay tax, but the trustee of a nongrantor trust created by a Vermont domiciliary might consider taking the position that the trust is not subject to Vermont income tax if it has no Vermont trustee, asset, or source income.[556]

As shown in Worksheet 3, the potential tax saving for a Vermont Resident Trust on a $1 million long-term capital gain incurred in 2020 was at least $86,789.[557] As shown in Worksheet 4, the net tax cost of including $1 million of long-term capital gain in DNI for a Vermont resident individual rather than taxing the gain to a trust that was structured to escape tax in 2020 was $47,379.[558]

Practice Tip: Domiciliaries of other states might consider establishing trusts in Vermont because it does not tax trusts created by nondomiciliaries except on source income.

C. South

1. Alabama (Alabama Income Tax)

In Alabama, the trustee of a Resident Trust must file a return if the trust has net income over $1,500 or if the trustee is

541 *See* III.A.–III.E., above.
542 For an explanation of how this figure was derived, see I.B.3., above.
543 For an explanation of how this figure was derived, see I.B.4., above.
544 Vt. Stat. Ann. tit. 32, § 5861(a); instructions to 2020 Vt. Form FIT-161 at 1.
545 *See* Vt. Stat. Ann. tit. 32, § 5811(21), § 5822(a).
546 *See* Vt. Stat. Ann. tit. 32, § 5811(21), § 5822(a).
547 2018 Vt. Acts & Resolves 46, § H.2. *See* 2020 Vt. Form FIT-161 at 2; Vt. Stat. Ann. tit. 32, § 5822(a)(5), § 5822(b)(2).
548 2018 Vt. Acts & Resolves 46, § H.2.
549 Vt. Stat. Ann. tit. 32, § 5811(11)(B)–§ 5811(11)(C). *See* instructions to 2020 Vt. Form FIT-161 at 2. For Vermont income-tax purposes, an individual is a ''resident'' if the individual is domiciled in Vermont or if the individual maintains a permanent place of abode and spends more than 183 days in the state during the tax year (Vt. Stat. Ann. tit. 32, § 5811(11)(A)). Given that taxation is based on the testator's or trustor's domicile the second test in the foregoing definition does not come into play.
550 Vt. Stat. Ann. tit. 32, § 5811(9).
551 Vt. Stat. Ann. tit. 32, § 5823(a); instructions to 2020 Vt. Form FIT-161 at 1.
552 Vt. Stat. Ann. tit. 32, § 5823(b); instructions to 2020 Vt. Form FIT-161 at 1.
553 Instructions to 2020 Vt. Form FIT-161 at 5.
554 Vt. Stat. Ann. tit. 32, § 5822(a).
555 § 664(c)(1).
556 *See* III.A–III.E., above.
557 For an explanation of how this figure was derived, see I.B.3., above.
558 For an explanation of how this figure was derived, see I.B.4., above.

ISBN 978-1-63359-383-1

claiming a qualifying net operating loss for the taxable year; the trustee of a Nonresident Trust must file a return if the trust generates income from Alabama sources.[559]

Alabama treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes[560] and the Cotton State permits trustees of nongrantor trusts to take a distribution deduction.[561] In 2020, Alabama taxed the Alabama taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 5.00% (the top rate applied to such income over $3,000),[562] and the current rate schedule is not scheduled to change.[563]

The definition of ''Resident Trust'' in Alabama is unclear for testamentary trusts. A statute defines ''Resident Trust'' as follows:[564]

> A trust is a resident trust for a taxable year if it is a trust which meets both a. and b.:
>
> > a. The trust is created by the will of a decedent who was an Alabama resident at death or by a person who was an Alabama resident at the time such trust became irrevocable; and
> >
> > b. For more than seven months during such taxable year, a person, as defined in this section, who either resides in or is domiciled in Alabama is either a fiduciary of the trust or a beneficiary of the trust to whom distributions currently may be made.

But, a regulation, which took effect in 2015, defines the term as follows:[565]

> A ''resident trust'' means any trust created: (1) by the will of an Alabama resident decedent or (2) by a person who was an Alabama resident at the time such trust became irrevocable and that has a fiduciary or beneficiary that either resides in or is domiciled in Alabama for more than seven (7) months during the respective taxable year.

Note that Alabama classifies a trust as a resident trust if it was created by a resident — not a domiciliary—testator or trustor. The pertinent statute provides:[566]

> Every natural person domiciled in the State of Alabama, and every other natural person who maintains a permanent place of abode within the state or spends in the aggregate more than seven months of the income year within the state, shall be presumed to be residing within the state for the purposes of determining liability for income taxes under this chapter.

The following guidance is given on when an individual or corporate trustee is domiciled in Alabama:[567]

> The fiduciary of a trust is domiciled in Alabama if the individual, or group of individuals, who carry out the fiduciary responsibilities of the trust are located in Alabama. If the trustee is a corporate fiduciary engaged in interstate trust administration, the fiduciary is treated as being domiciled in Alabama if the trustee conducts the major part of its administration of the trust in Alabama.

A ''Nonresident Trust'' is a trust that is not a ''Resident Trust.''[568]

Alabama taxes all taxable income of Resident Trusts[569] but only Alabama-source taxable income of Nonresident Trusts.[570] In Alabama, trustees are not required to make estimated tax payments for trusts.[571]

A CRT generally is exempt from Alabama income tax under the following statute:[572]

> Trusts shall be exempt from the tax imposed by this chapter if they are exempt from federal income tax under . . . 26 U.S.C.S . . . § 664 (relating to charitable remainder trusts). The foregoing exemption shall not apply, however, to any entity that is not exempt from federal income tax by reason of 26 U.S.C. § § 502 or 503, nor to any income of an otherwise exempt organization to the extent that such income constitutes ''unrelated business taxable income,'' as defined in 26 U.S.C. § 512.

No case or ruling addresses whether the trustee of a trust created by an Alabama testator or trustor that has minimal ties to Alabama still must pay tax, but, under the statute quoted above, if a nongrantor trust created by an Alabama testator or trustor does not have a resident fiduciary or current beneficiary, Alabama tax is not payable.[573] In this regard, a trust established by an Alabama testator or trustor that prohibits distributions to an Alabama resident beneficiary for a prescribed period of years should not be subject to Alabama tax (except on Alabama-source income) because the trust is not an Alabama Resident Trust and because Alabama has no throwback rule that would apply to a subsequent distribution to an Alabama resident beneficiary.

The trustee of a nongrantor trust created by an Alabama resident might consider taking the position that the trust is not subject to Alabama income tax if it has no Alabama trustee, asset, or source income even if it has one or more resident current beneficiaries.[574]

---

[559] Ala. Admin. Code r. 810-3-29-.01, 810-3-29-.07(2)(d), 810-3-29-.07(3)(b). *See* Ala. Code § 40-18-29(a); instructions to 2020 Ala. Form 41 at 1. *See also* Alabama Dep't of Revenue, *General Summary of State Taxes* at 26 (Jan. 4, 2021), www.revenue.alabama.gov.

[560] Ala. Code § 40-18-25(g); Ala. Admin. Code rs. 810-3-25-.11, 810-3-25-.14; instructions to 2020 Ala. Form 41 at 1-2.

[561] Ala. Code § 40-18-25(a); Ala. Admin. Code rs. 810-3-25-.11, 810-3-25-.12; instructions to 2020 Ala. Form 41 at 2-3.

[562] Ala. Code § 40-18-5(1)(c); instructions to 2020 Ala. Form 41 at 2.

[563] Ala. Code § 40-18-5.

[564] Ala. Code § 40-18-1(33).

[565] Ala. Admin. Code r. 810-3-29-.07(2)(b).

[566] Ala. Code § 40-18-2(b).

[567] Ala. Admin. Code r. 810-3-29-.07(2)(c).

[568] Ala. Code § 40-18-1(22); Ala. Admin. Code r. 810-3-29-.07(3)(a).

[569] Ala. Code § 40-18-2(a)(5); Ala. Admin. Code r. 810-3-25-.10.

[570] Ala. Code § 40-18-2(a)(4). *See Gasser v. Dep't of Revenue*, No. INC. 11-489, 2012 WL 5450748, at *6 (Ala. Admin. Law Div. Oct. 15, 2012) (''[T]he settlement proceeds were not derived from property owned in Alabama or . . . from business transacted in the State'').

[571] Instructions to 2020 Ala. Form 41 at 1.

[572] Ala. Code § 40-18-25.1(a).

[573] Ala. Code § 40-18-1(33).

[574] *See* III.A.–III.E., above.

ISBN 978-1-63359-383-1

As shown in Worksheet 3, the potential tax saving for an Alabama Resident Trust on a $1 million long-term capital gain incurred in 2020 was at least $38,063.[575] As shown in Worksheet 4, the net tax cost of including $1 million of long-term capital gain in DNI for an Alabama resident individual rather than taxing the gain to a trust that was structured to escape tax in 2020 was $5,546.[576]

Practice Tip: Residents of other states might consider establishing trusts in Alabama because it does not tax trusts created by nonresidents except on source income.

2. Arkansas (Arkansas Income Tax)

In Arkansas, a trustee must file a return if (1) income is currently distributable, (2) tax is payable by beneficiaries or the grantor, (3) the net income of the trust is $3,000 or more, and/or (4) a beneficiary is a nonresident.[577]

Prior to 2019, it appeared that it might be possible to structure a trust as a grantor trust for federal purposes and as a nongrantor trust for Arkansas purposes because Arkansas treated a trust as a grantor trust in the following circumstances, which were narrower than under federal law:[578]

> The grantor of a trust is treated as its ''owner'' and is generally taxed on its income if:
>
> > a) The grantor reserves the power to take back title to (that is, revoke) trust funds for himself *where* the grantor can exercise this power alone, or it can be exercised only by another who is regarded as a nonadverse party or it can be exercised by both the grantor and nonadverse party together;
> >
> > b) The trust income is distributed actually or constructively to the grantor or the grantor's spouse;
> >
> > c) The trust income is held or accumulated for future distribution to the grantor or the grantor's spouse;
> >
> > d) The trust income is applied to pay premiums on life insurance policies taken out on the life of the grantor's spouse.

Unfortunately, an Administrative Law Judge ruled to the contrary in 2020.[579] There, the taxpayers sought to escape Arkansas income tax on long-term capital gain incurred in 2017 by structuring a trust without any of the attributes quoted above.[580] The judge concluded that the above list was not exclusive and that, ''the income of the trust was properly imputed to the Taxpayers' Arkansas Individual Income Tax Return.''[581]

Effective in 2019, Arkansas treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[582] and the Natural State allows trustees of nongrantor trusts to take a distribution deduction.[583] In 2020, Arkansas taxed the net taxable income of nongrantor trusts at rates up to 6.60% (the 6.60% rate applied starting at such income over $82,000).[584] The top rate decreased to 5.90% for 2021 and later years.[585] The brackets will continue to be adjusted for inflation.[586] Fifty percent of net capital gain up to $10 million and all net capital gain over $10 million is exempt from tax.[587]

Arkansas does not define ''Resident Trust.'' It appears that it taxes trusts created by Arkansas testators and trustors if the trust has at least one Arkansas trustee. Reaching this conclusion is a two-step process. First, by negative implication, Arkansas taxes trusts created by resident testators and trustors pursuant to the following provision:[588]

> [N]o state income tax shall be due this state from a trust . . . created by a nonresident donor, trustor, or settlor, or by a nonresident testator even though administered by a resident trustee. . . .

Second, Arkansas only taxes net income attributable to resident fiduciaries as follows:[589]

> (a) The tax imposed by the Income Tax Act of 1929 shall be imposed upon resident fiduciaries, which tax shall be levied, collected, and paid annually with respect to:
>
> > (1) That part of the net income of . . . trusts which has not been distributed or become distributable to beneficiaries during the income year.

''Fiduciary'' is defined broadly and includes a ''trustee . . . or any person, whether individual or corporate, acting in a fiduciary capacity for any . . . trust. . . .''[590] This definition would extend to an adviser, protector, or committee serving in such capacity. Net income is apportioned based on the number of resident and nonresident fiduciaries.[591]

For Arkansas income-tax purposes, an individual is a ''resident'' if the individual is domiciled in Arkansas or if the

---

[575] For an explanation of how this figure was derived, see I.B.3., above.

[576] For an explanation of how this figure was derived, see I.B.4., above.

[577] Instructions to 2020 Ark. Form AR1002F at 2, 5. *See* Ark. Code Ann. § 26-51-803(a); Ark. Admin. Code § 006.05.307-26-51-803.

[578] Ark. Admin. Code § 006.05.307-4.26-51-102. The footnote provides that ''The income is not taxable to the grantor if the application of the income to any of these purposes requires the approval of an adverse party (such as a beneficiary).''.

[579] *In the Matter of* * * *, Ark. Dep't of Fin. & Admin, Office of Hearings & Appeals Opinion No. 20-755 (Aug. 7, 2020), www.ark.org/dfa.

[580] No. 20-755 at 5-6.

[581] No. 20-755 at 13.

[582] Ark, Code Ann. § 26-51-201(f).

[583] *See* Ark. Code Ann. § 26-51-201(c), § 26-51-202(d), § 26-51-406; Ark. Admin. Code § 006.05.307-9.26-51-102.

[584] Ark. Code Ann. § 26-51-201(a)(9)(A), § 26-51-201(d); 2020 Ark. Indexed Tax Brackets, www.dfa.arkansas.gov. Specified reductions are available for trustees having net income between $75,000 and $80,000 (Ark. Code Ann. § 26-51-201(a)(10)).

[585] Ark. Code Ann. § 26-51-201(a)(9)(B).

[586] Ark. Code Ann. § 26-51-201(d).

[587] Ark. Code Ann. § 26-51-815(b)(1)(C), § 26-51-815(b)(3); Schedule A to 2020 Ark. Form AR1002F at 1.

[588] Ark. Code Ann. § 26-51-201(b).

[589] Ark. Code Ann. § 26-51-203(a).

[590] Ark. Code Ann. § 26-51-102(4). *See* Ark. Admin. Code § 006.05.307-3.26-51-102(8).

[591] Ark. Code Ann. § 26-51-203(a)(1). *See* Ark. Admin. Code § 006.05.307-26-51-203.

ISBN 978-1-63359-383-1

individual maintains a permanent place of abode and spends more than six months in the state within a taxable year.[592]

A ''Nonresident Trust'' is a trust that is not a ''Resident Trust.[593]

''Net income'' is not based on a federal figure. Rather, it consists of the following categories:[594]

> (A) Gains, profits, and income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid;
>
> (B) Gains, profits, and income derived from professions, vocations, trades, business, commerce, or sales;
>
> (C) Gains, profits, and income derived from dealings in property, whether real or personal, growing out of the ownership of, use of, or interest in the property;
>
> (D) Gains, profits, and income derived from interest, rent, royalties, dividends, annuities, securities, or the transaction of any business carried on for gain or profit;
>
> (E) Gains or profits and income derived from any source whatever; and
>
> (F) Any payments of alimony and separate maintenance received pursuant to a court order.
>
> (G) Unemployment compensation benefits paid from federal unemployment funds; and
>
> (H) Unemployment insurance benefits received from unemployment compensation paid under Title IV of the Social Security Act, 42 U.S.C. § 601 et seq., except for unemployment or sickness payments made pursuant to 45 U.S.C. § 352, as it existed on January 1, 2017.

Arkansas taxes trustees on all net income of Resident Trusts[595] but only on Arkansas-source net income of Nonresident Trusts.[596] In Arkansas, trustees must make estimated tax payments for trusts.[597]

A CRT generally is exempt from federal income tax.[598] Consequently, it usually also is exempt from Arkansas income tax in accordance with the following statute:[599]

> (a) Title 26 U.S.C. § 664, as in effect on January 1, 2007, and the regulations of the Secretary of the Treasury promulgated under 26 U.S.C. § 664 and in effect on January 1, 2007, are adopted for the purpose of computing the tax liability of charitable remainder trusts and their beneficiaries under the Income Tax Act of 1929, § 26-51-101 et seq.
>
> (b) Furthermore, any other provision of the federal income tax law and regulations which are necessary for interpreting and implementing 26 U.S.C. § 664 are adopted to the extent as in effect on January 1, 2007.

Practice Tip: Arkansas resident testators and trustors should consider appointing non-Arkansas fiduciaries because the state will not tax in these circumstances.

As shown in Worksheet 3, the potential tax saving for an Arkansas Resident Trust on a $1 million long-term capital gain incurred in 2020 was at least $32,036.[600] As shown in Worksheet 4, the tax saving from including $1 million of long-term capital gain in DNI for an Arkansas resident individual rather than taxing the gain to a trust that was structured to escape tax in 2020 was $2,114.[601]

Practice Tip: Residents of other states might consider establishing trusts in Arkansas because it does not tax trusts created by nonresidents except on source income. Notwithstanding the above administrative decision, a planning opportunity might exist by reason of the disconnect between the federal and Arkansas grantor-trust rules for tax years prior to 2019.[602]

3. Florida

Florida (the Sunshine State) does not impose an income tax on individuals or fiduciaries. A provision of the Florida Constitution does allow the legislature to enact such an income tax of up to 5% (even higher if authorized by a two-thirds vote of the House and Senate),[603] but the author is not aware of ongoing efforts to adopt such a tax.

4. Georgia (Georgia Income Tax)

In Georgia, a resident or nonresident trustee must file a return if the trust has income from Georgia sources or if such trustee manages funds or property for Georgia residents.[604]

Georgia treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[605] and the Peach State permits trustees of nongrantor trusts to take a distribution deduction.[606] In 2020, Georgia taxed the Georgia taxable net income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 5.75% (the 5.75% rate applied starting at such income over $7,000).[607] The top rate decreased to 5.50% in 2021 and later years.[608]

Although Georgia does not define ''Resident Trust,'' the state taxes resident and nonresident trustees:[609]

> (A) Receiving income from business done in this state;
>
> (B) Managing funds or property located in this state; or

---

[592] Ark. Code Ann. § 26-51-102(14). *See* Ark. Code Ann. § 26-51-102(10); Ark. Admin. Code § 006.06.307-1.26-51-102(9), § 006.05.307-2.26-51-102(9).
[593] Ark. Code Ann. § 26-51-201(b), § 26-51-202.
[594] Ark. Code Ann. § 26-51-404(a)(1). *See* Ark. Code Ann. § 26-51-403.
[595] Ark. Code Ann. § 26-51-203(a).
[596] Ark. Code Ann. § 26-51-202(a).
[597] Ark. Code Ann. § 26-51-911; instructions to 2020 AR1002F at 2.
[598] § 664(c)(1).
[599] Ark. Code Ann. § 26-51-309. *See* Ark. Admin. Code. § 006.05.307-1.26-51-102.
[600] For an explanation of how this figure was derived, see I.B.3., above.
[601] For an explanation of how this figure was derived, see I.B.4., above.
[602] *See* II.A., above.
[603] Fla. Const. art. VII, § 5.
[604] Ga. Comp. R. & Reg. r. 560-7-8-.01(1)(c), 560-7-8-.01(1)(d); instructions to 2020 Ga. Form 501 at 7. *See* Ga. Code Ann. § 48-7-50(a)(3)–§ 48-7-50(a)(4).
[605] Ga. Comp. R. & Reg. r. § 560-7-3-.07(3)(a). *See* Ga. Code Ann. § 48-7-27(a);
[606] Ga. Code Ann. § 48-7-22(a)(3)(A); Ga. Comp. R. & Reg. r. 560-7-3-.07(3)(b).
[607] Ga. Code Ann. § 48-7-20(b)(1), § 48-7-20(d), § 48-7-22(a)(2); instructions to 2020 Ga. Form 501 at 7.
[608] Ga. Code Ann. § 48-7-20(b)(1), § 48-7-20(d).
[609] Ga. Code Ann. § 48-7-22(a)(1).

ISBN 978-1-63359-383-1

(C) Managing funds or property for the benefit of a resident of this state.

A ''Resident Trust'' meets the third of the above criteria; a ''Nonresident Trust'' does not.

Georgia has the following unique definition of resident individual:[610]

> (i) Every individual who is a legal resident of this state on income tax day;
>
> (ii) Every individual who, though not necessarily a legal resident of this state, nevertheless resides within this state on a more or less regular or permanent basis and not on the temporary or transitory basis of a visitor or sojourner and who so resides within this state on income tax day; and
>
> (iii) Every individual who on income tax day has been residing within this state for 183 days or part-days or longer, in the aggregate, of the immediately preceding 365 day period.

Georgia taxes all Georgia taxable net income of Resident Trusts[611] but only Georgia-source taxable net income of Nonresident Trusts.[612] In Georgia, trustees must make estimated tax payments for trusts.[613]

A CRT is exempt from Georgia income tax pursuant to the following statute:[614]

> (a) The following organizations shall be exempt from taxation imposed by Code Section 48-7-21 as indicated:
>
> (1) Subject to subsections (b) and (c) of this Code section, those organizations which are exempt from federal income taxation pursuant to Section . . . 664 . . . of the Internal Revenue Code of 1986 shall be deemed to have similar exempt status for purposes of Code Section 48-7-21. . . .

But, a CRT must pay Georgia income tax on its unrelated business taxable income as follows:[615]

> (c)(1) A tax is imposed on income of an organization exempted pursuant to paragraph (1) of subsection (a) of this Code section when the income is derived from trade or business which is not related to exempt purposes of organizations described in paragraph (1) of subsection (a) of this Code section. This income shall be referred to as unrelated business income and shall be the income which is defined in Section 512 of the Internal Revenue Code of 1986. The tax imposed on unrelated business income shall be at the rate provided in Code Section 48-7-21.

The trustee of a CRT must file a Georgia return in the following circumstances:[616]

> The commissioner [of revenue] at any time may require an organization which is exempt from taxation to file an information return stating the organization's gross income, receipts, disbursements, accumulation of income, and other data deemed necessary for the proper administration of this Code section.

Georgia's tax statute is virtually identical to North Carolina's tax statute that the U.S. Supreme Court considered in *North Carolina Department of Revenue v. The Kimberley Rice Kaestner 1992 Family Trust*.[617] Accordingly, after *Kaestner*, the Georgia Department of Revenue issued guidance regarding *Kaestner's* impact on Georgia taxpayers.[618] The guidance acknowledged that Georgia may not tax a nonresident trustee of a trust in which:[619]

> 1. The beneficiaries did not receive any income from the trust during the years in question;
>
> 2. The beneficiaries had no right to demand trust income or otherwise control, possess, or enjoy the trust assets in the tax years at issue; and
>
> 3. Not only were the beneficiaries unable to demand distributions in the tax years at issue, but it was also uncertain whether they would ever receive any income from the trust in the future.

Affected taxpayers should file refund requests for open years. In this regard, the general statute of limitations is three years after the later of the date the tax was paid or the due date of the return.[620]

The guidance continued:[621]

> Although the Department must follow the *Kaestner* decision, it is limited in scope to the facts in that case. Therefore, with respect to facts that are specifically like those in *Kaestner*, a nonresident trust fiduciary would not be subject to Georgia taxation. Otherwise, the fiduciary would be subject to taxation under O.C.G.A. § 48-7-22 and must file a return.
>
> With respect to filing a return, O.C.G.A. § 48-7-50 when read together with § 48-7-22 requires a return to be filed by a nonresident fiduciary when 48-7-22 applies provided *Kaestner* does not apply.

Notwithstanding the above pronouncement, imposition of tax might be unwarranted where the facts differ from *Kaestner* under several theories.

First, the tax return instructions distinguish between trusts having resident fiduciaries, which are taxed on all income, and

[610] Ga. Code Ann. § 48-7-1(10)(A). *See* Ga. Code Ann. § 48-7-1(6); Ga. Comp. R. & Reg. r. 560-7-3-.02(1).

[611] Ga. Code Ann. § 48-7-20(a), § 48-7-20(d), § 48-7-22(a)(1), § 48-7-22(b), § 48-7-27; Ga. Comp. R. & Reg. r. 560-7-3-.07(3)(c), 560-7-3-.07(3)(d).

[612] Ga. Code Ann. § 48-7-20(a), § 48-7-20(d), § 48-7-22(a)(1), § 48-7-22(b), § 48-7-27, 48-7-30; Ga. Comp. R. & Reg. r. 560-7-3-.07(3)(c), 560-7-3-.07(d).

[613] Ga. Code Ann. § 48-7-114(e); instructions to 2020 Ga. Form 501 at 8.

[614] Ga. Code Ann. § 48-7-25(a)(1).

[615] Ga. Code Ann. § 48-7-25(c)(1).

[616] Ga. Code Ann. § 48-7-25(b)(2)(B).

[617] 139 S. Ct. 2213 (2019). *See* III.A.9., above.

[618] Ga. Dep't of Revenue Policy Bull. IT-2019-02, *Taxation of Nonresident Trust Fiduciaries — Effect of Kaestner Decision* (Aug. 13, 2019), www.dor-.georgia.gov.

[619] Ga. Dep't of Revenue Policy Bull. IT-2019-02, *Taxation of Nonresident Trust Fiduciaries — Effect of Kaestner Decision* (Aug. 13, 2019), www.dor-.georgia.gov.

[620] *See* Ga. Code Ann. § 48-2-49(b).

[621] Ga. Dep't of Revenue Policy Bull. IT-2019-02, *Taxation of Nonresident Trust Fiduciaries — Effect of Kaestner Decision*(Aug. 13, 2019), www.dor-.georgia.gov .

ISBN 978-1-63359-383-1

trusts having nonresident fiduciaries, which are only taxed on Georgia-source income.[622] This dichotomy suggests that nonresident trustees are only taxable on source income in all circumstances.

Second, a practitioner notes an existing ambiguity in Georgia's tax framework:[623]

> Wlodychak said that O.C.G.A. section 48-7-22, which imposes the state's tax on resident and nonresident fiduciaries, seems to conflict with section 48-7-50, which imposes the requirement to file tax returns.
>
> Section 48-7-22 imposes the tax on fiduciaries ''Receiving income from business done in this state; Managing funds or property located in this state; or Managing funds or property for the benefit of a resident of this state.'' But section 48-7-50 states that an income tax return must be filed by a ''Nonresident estate or trust that has federal gross income from sources within this state.''
>
> Wlodychak said that section 48-7-50 and the associated regulation seem to imply that a return is required only if the nonresident trust has income from sources in the state. Wlodychak wondered how the tax was supposed to be paid when no return was required to be filed.

Third, some Georgia practitioners take the position that nonresident trustees are not subject to tax by analogy to a regulation that imposes tax-withholding requirements on certain payors to ''any trust that is being administered by a nonresident fiduciary if the gain from the sale will be taxed to the trust.''[624]

As shown in Worksheet 3, the potential tax saving for a Georgia Resident Trust on a $1 million long-term capital gain incurred in 2020 was at least $57,250.[625] As shown in Worksheet 4, the net tax cost of including $1 million of long-term capital gain in DNI for a Georgia resident individual rather than taxing the gain to a trust that was structured to escape tax in 2020 was $22,787.[626]

Practice Tip: Testators and trustors might consider creating trusts in Georgia if there are no Georgia resident beneficiaries.

5. Louisiana (Louisiana Income Tax)

In Louisiana, a trustee must file a return if the trust has net income of $2,500 or over, gross income of $6,000 or over, or a nonresident beneficiary.[627]

Louisiana treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[628] and the Pelican State permits trustees of nongrantor trusts to take a distribution deduction.[629] In 2020, Louisiana taxed Louisiana taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 6.00% (the 6.00% rate applied starting at such income over $50,000),[630] and the current rate schedule is not scheduled to change.[631]

Louisiana defines ''Resident Trust'' as follows:[632]

> (a) ''Resident trust'' means a trust or a portion of a trust created by last will and testament of a decedent who at his death was domiciled in this state.
>
> (b) A trust other than a trust described in Subparagraph (3)(a) shall be considered a resident trust if the trust instrument provides that the trust shall be governed by the laws of the state of Louisiana. If the trust instrument provides that the trust is governed by the laws of any state other than the state of Louisiana, then the trust shall not be considered a resident trust. If the trust instrument is silent with regard to the designation of the governing law, then the trust shall be considered a resident trust only if the trust is administered in this state.

Note that paragraph (b) appears to cover trusts created by the Wills of Louisiana nondomiciliaries as well as inter vivos trusts created by Louisiana domiciliaries and nondomiciliaries. A ''Nonresident Trust'' is a trust that is not a ''Resident Trust.''[633]

Louisiana taxes all Louisiana taxable income of Resident Trusts[634] but only Louisiana-source taxable income of Nonresident Trusts.[635] In Louisiana, trustees are not required to make estimated tax payments for trusts.[636]

Louisiana 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 Louisiana testator that has minimal ties to Louisiana still must pay tax, but the trustee of a nongrantor trust created by a Louisiana testator might take the position that the trust is not subject to Louisiana income tax if it has no Louisiana trustee, asset, or source income.[637]

As shown in Worksheet 3, the potential tax saving for a Louisiana Resident Trust on a $1 million long-term capital gain

[622] Instructions to 2020 Ga. Form 501 at 7.

[623] Andrea Muse, *Georgia Issues Guidance for Nonresident Trusts After Kaestner*, 2019 Tax Notes Today State 159-1 (Aug. 16, 2019).

[624] *See* Ga. Comp. R. & Reg. r. 560-7-8-.35(1)(d).

[625] For an explanation of how this figure was derived, see I.B.3., above.

[626] For an explanation of how this figure was derived, see I.B.4., above.

[627] La. Rev. Stat. Ann. § 47:162(A)(3)–§ 47:162(A)(5); instructions to 2020 La. Form IT-541 at 1.

[628] *See* La. Rev. Stat. Ann. § 47:187, § 47:293(1), § 47:295(A); instructions to 2020 La. Form IT-541 at 1.

[629] *See* La. Rev. Stat. Ann. § 47:300.6.

[630] La. Rev. Stat. Ann. § 47:300.1(3); instructions to 2020 La. Form IT-541 at 1.

[631] La. Rev. Stat. Ann. § 47:300.1.

[632] La. Rev. Stat. Ann. § 47:300.10(3). *See* instructions to 2020 La. Form IT-541 at 1. For Louisiana income-tax purposes, an individual is a ''resident'' if the individual is domiciled, maintains a permanent place of abode, or spends more than 6 months in the state during the taxable year (La. Rev. Stat. Ann. § 47:31(1)). Given that taxation is based on the testator's domicile, only the domicile test in the foregoing definition comes into play.

[633] La. Rev. Stat. Ann. § 47:300.10(4); instructions to 2020 La. Form IT-541 at 1.

[634] La. Rev. Stat. Ann. § 47:300.3(1), § 47:300.6.

[635] La. Rev. Stat. Ann. § 47:300.3(2), § 47:300.7. *See* La. Dep't of Revenue Info. Bull. No. 13-005, *Interest and Dividends of Nonresident Trust Beneficiaries* (Jan. 11, 2013), www.rev.state.la.us (''[I]n most instances, interest and dividends of [nonresident] trust beneficiaries will be allocated to the legal domicile of the individual taxpayer'').

[636] La. Rev. Stat. Ann. § 47:116(H).

[637] *See* III.A.–III.E., above.

ISBN 978-1-63359-383-1

incurred in 2020 was at least $46,743.[638] As shown in Worksheet 4, the net tax cost of including $1 million of long-term capital gain in DNI for a Louisiana resident individual rather than taxing the gain to a trust that was structured to escape tax in 2020 was $12,392.[639]

Practice Tip: Louisiana nondomiciliary testators and Louisiana domiciliary and nondomiciliary trustors should designate the law of a state other than Louisiana to govern their trusts because Louisiana taxes trusts that designate Louisiana law to govern or are administered in Louisiana in the absence of a designation of governing law.

6. *Mississippi (Mississippi Income Tax)*

In Mississippi, a trustee of a Resident Trust must file a return; a trustee of a Nonresident Trust must file a return if the trust has Mississippi-source income.[640]

Mississippi treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[641] and the Magnolia State permits trustees of nongrantor trusts to take a distribution deduction.[642] In 2020, Mississippi taxed the Mississippi taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 5.00% on such income over $10,000,[643] and the current rate schedule is not scheduled to change.[644]

Mississippi defines ''Resident Trust'' and ''Nonresident Trust'' as follows:[645]

> A resident trust is any trust which is administered by the trustee in Mississippi. A trust being administered outside of Mississippi shall not be considered a resident trust merely because the governing instrument or a law requires that the laws of Mississippi be followed with respect to interpretation or administration of the trust. All other trusts are non-resident trusts.

Mississippi taxes all taxable income of Resident Trusts[646] but only Mississippi-source taxable income of Nonresident Trusts.[647] In Mississippi, trustees are not required to make estimated tax payments for trusts.[648]

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

Practice Tip: Mississippi and non-Mississippi testators and trustors should be cautious about creating trusts to be administered in Mississippi because the state taxes on this basis.

As shown in Worksheet 3, the potential tax saving for a nongrantor trust on a $1 million long-term capital gain incurred in 2020 was at least $49,640.[649] As shown in Worksheet 4, the net tax cost of including $1 million of long-term capital gain in DNI for a Mississippi resident individual rather than taxing the gain to a trust that was structured to escape tax in 2020 was $15,224.[650]

7. *North Carolina (North Carolina Individual Income Tax)*

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.[651]

North Carolina treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[652] and the Tar Heel State permits trustees of nongrantor trusts to take a distribution deduction.[653] In 2020, North Carolina taxed the North Carolina taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at 5.25%,[654] and the 5.25% rate is not scheduled to change.[655]

North Carolina does not define ''Resident Trust'' or ''Nonresident Trust.'' It purports to tax trustees — resident and nonresident — on all income attributable to resident beneficiaries and on source income attributable to nonresident beneficiaries as follows:[656]

> 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 the individual is domiciled in the state or is presumed to be a resident if the individual spends more than 183 days there during the year.[657]

For the purposes of this Portfolio, ''Resident Trust'' is a trust that has resident beneficiaries and ''Nonresident Trust'' is a trust that has no such beneficiaries.[658] The tax return instructions provide the following guidelines:[659]

> If none of the federal taxable income, as adjusted, is from dividends, interest, gains, losses, other intan-

---

[638] For an explanation of how this figure was derived, see I.B.3., above.

[639] For an explanation of how this figure was derived, see I.B.4., above.

[640] Instructions to 2020 Miss. Form 81-110 at 4. *See* Miss. Code Ann. § 27-7-35.

[641] *See* instructions to 2020 Miss. Form 81-110 at 4.

[642] *See* instructions to 2020 Miss. Form 81-110 at 8.

[643] Miss. Code Ann. § 27-7-5(1)(c); instructions to 2020 Miss. Form 81-110 at 11.

[644] Miss. Code Ann. § 27-7-5(1)(c).

[645] Instructions to 2020 Miss. Form 81-110 at 3. For Mississippi income-tax purposes, an individual is a ''resident'' if the individual is domiciled in Mississippi or if the individual maintains a legal or actual residence within the state during the taxable year (Miss. Code Ann. § 27-7-3(e)). Given that taxation is based on where a trust is administered, the foregoing definition does not come into play. The term ''administered by the trustee in Mississippi'' is not defined.

[646] Miss. Code Ann. § 27-7-27(4).

[647] Miss. Code Ann. § 27-7-23(b), § 27-7-27(4).

[648] Miss. Code Ann. § 27-7-35(2).

[649] For an explanation of how this figure was derived, see I.B.3., above.

[650] For an explanation of how this figure was derived, see I.B.4., above.

[651] N.C. Admin. Code tit. 17, r. 6B.3716(b); 2020 N.C. Form D-407A at 1; N.C. Dep't of Revenue, *2020 Tax Law Changes* (Jan. 20, 2021), www.ncdor.gov; N.C. Dep't of Revenue, *Personal Taxes Bulletin* at 64-68, (Feb. 3, 2021), www.ncdor.gov.

[652] *See* N.C. Gen. Stat. § 105-153.4(a); 2020 N.C. Form D-407A at 1.

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

[654] N.C. Gen. Stat. § 105-153.7(a); 2020 N.C. Form D-407 at 1.

[655] N.C. Gen. Stat. § 105-153.7(a).

[656] N.C. Gen. Stat. § 105-160.2.

[657] N.C. Gen. Stat. § 105-153.3(15).

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

[659] 2020 N.C. Form D-407A at 2.

ISBN 978-1-63359-383-1

> gibles, or is business income from sources outside North Carolina for the benefit of a nonresident beneficiary, the total income of the estate or trust is taxable to the fiduciary and you should enter zero on Line 6. If there are nonresident beneficiaries and Line 5 includes any income from interest, dividends, gains, losses, other intangible property, or business income from sources outside North Carolina for the benefit of a nonresident beneficiary, enter the amount of such income for the benefit of nonresident beneficiaries on Line 6. The determination of the amount of federal taxable income (as adjusted) which is from intangible property or is business income from sources outside North Carolina for the benefit of a nonresident beneficiary is based on the income beneficiary's state of residence on the last day of the taxable year of the estate or trust.

In North Carolina, trustees are not required to make estimated tax payments for trusts.[660]

The U.S. Supreme Court held in the *North Carolina Department of Revenue v. The Kimberley Rice Kaestner 1992 Family Trust* decision that:[661]

> We hold that the presence of in-state beneficiaries alone does not empower a State to tax trust income that has not been distributed to the beneficiaries where the beneficiaries have no right to demand that income and are uncertain ever to receive it. In limiting our holding to the specific facts presented, we do not imply approval or disapproval of trust taxes that are premised on the residence of beneficiaries whose relationship to trust assets differs from that of the beneficiaries here.

In North Carolina, a taxpayer may request a refund until the later of three years after the due date of the return or two years after payment of the tax.[662] A taxpayer who has filed a written notice of contingent event for a year that otherwise would be barred by the foregoing statute of limitations must request a refund within six months after the contingent event concludes.[663] Regarding the *Kaestner* decision, the North Carolina Department of Revenue announced:[664]

> The contingent event related to the *Kaestner* case concluded on June 21, 2019, the date of the United States Supreme Court's decision. Therefore, taxpayers who believe that the *Kaestner* decision applies to their particular facts and circumstances and who filed a Notice of Contingent Event that met the requirements of N.C. Gen. Stat. § 105-241.6(b)(5) must file an amended return with the Department on or before December 21, 2019.

The tax return instructions give the following guidance in light of the *Kaestner* decision:[665]

> Important. On June 21, 2019, the United States Supreme Court (" Court") held that the presence of "in-state beneficiaries alone does not empower a state to tax trust income that has not been distributed to the beneficiaries where the beneficiaries have no right to demand that income and are uncertain ever to receive it." *North Carolina Department of Revenue v. The Kimberley Rice Kaestner 1992 Family Trust ("Kaestner")*, 139 S. Ct. 2213, 2221 (2019). By contrast, the Court stated that taxation of trust income based on distributions of trust income to an in-state resident, a trustee's in-state residence, or in-state trust administration does not violate the Constitution. *Id.* at 2220.
>
> Trusts with connections to the State should carefully analyze those connections to determine if the connections are sufficient for the State to tax the entity's undistributed taxable income under the Due Process Clause. If Line 5 includes undistributed income for the benefit of a resident beneficiary that meets the facts and circumstances of *Kaestner* such that the income is not taxable to North Carolina, enter the amount of such income on Line 6.

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

Practice Tip: Based on the *Kaestner* decision, North Carolina residents and nonresidents should create trusts elsewhere if there are North Carolina resident discretionary beneficiaries. Tax also might be eliminated in situations beyond that addressed by *Kaestner*.[666]

As shown in Worksheet 3, the potential tax saving for a North Carolina Resident Trust on a $1 million long-term capital gain incurred in 2020 was $52,495.[667] As shown in Worksheet 4, the net tax cost of including $1 million of long-term capital gain in DNI for a North Carolina resident individual rather than taxing the gain to a trust that was structured to escape tax in 2020 was $17,815.[668]

Practice Tip: North Carolina residents and nonresidents might consider establishing trusts in North Carolina if there are no resident beneficiaries. In this regard, North Carolina offers no guidance on how to establish the residency status of future beneficiaries.

8. Oklahoma (Oklahoma Income Tax)

In Oklahoma, a trustee of a Resident Trust must file a return to arrive at Oklahoma taxable income; the trustee of a Nonresident Trust must file a return if the trust has Oklahoma-source taxable income.[669]

---

[660] N.C. Gen. Stat. § 105-163.15(k).

[661] 139 S. Ct. 2213, 2221 (2019). *See* III.A.9., above.

[662] *See* N.C. Gen. Stat. § 105-241.6(a).

[663] N.C. Gen. Stat. § 105-241.6(b)(5)(a).

[664] N.C. Dep't of Revenue, *Important Notice: Decision in the Kaestner Case* at 1 (July 2, 2019), www.ncdor.gov. *See* N.C. Dep't of Revenue, *Important Notice: Departmental Requests for Additional Information for Requests for Refund Based on Decision in the Kaestner Case* (Jan. 2, 2020), www.ncdor.gov.

[665] 2020 N.C. Form D-407A at 2.

[666] *See* instructions to 2020 N.C. Form D-407 at 2.

[667] For an explanation of how this figure was derived, see I.B.3., above.

[668] For an explanation of how this figure was derived, see I.B.4., above.

[669] Okla. Stat. tit. 68, § 2368(G); instructions to 2020 Okla. Form 513 at 3. *See Matter of Protest of Hare*, 398 P.3d 317, 323 (Okla. 2017) ("OTC erroneously denied Hare the net capital gain deduction").

ISBN 978-1-63359-383-1

Oklahoma treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[670] and the Sooner State permits trustees to take a distribution deduction.[671] In 2020, Oklahoma taxed trustees on the Oklahoma taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 5.00% (the 5.00% rate applied starting with such income over $7,200),[672] and the current rate schedule is not scheduled to change.[673]

Oklahoma defines ''Resident Trust'' as follows:[674]

> a. A trust, or a portion of a trust, consisting of property transferred by will of a decedent domiciled in this state at death, or a trust, or a portion of a trust, consisting of the property of a person domiciled in this state if such trust is not irrevocable, and
>
> b. A trust, or portion of a trust, consisting of property of a person domiciled in this state at the time such property was transferred to the trust if such trust or portion was then irrevocable or a person domiciled in this state at the time such trust or portion became irrevocable. A trust, or portion of a trust, is irrevocable if it is not subject to a power exercisable solely by the transferor of such property, at any time, to revest title in the transferor.

In classifying a trust for income-tax purposes, ''[t]he residence of the . . . trustee has no bearing on the residence of the . . . trust.''[675] A ''Nonresident Trust'' is a trust that is not a ''Resident Trust.''[676]

Oklahoma taxes all Oklahoma taxable income of Resident Trusts[677] but only Oklahoma-source taxable income of Nonresident Trusts.[678] In Oklahoma, trustees must make estimated tax payments for trusts[679] and must withhold tax from distributions to nonresident beneficiaries in certain circumstances.[680]

A CRT generally is exempt from federal income tax.[681] As a result, it usually also is exempt from Oklahoma income tax in accordance with the following statute:[682]

> A. A person or organization exempt from federal income taxation under the provisions of the Internal Revenue Code shall also be exempt from the tax imposed by Section 2351 et seq. of this title in each year in which such person or organization satisfies the requirements of the Internal Revenue Code for exemption from federal income taxation. If the exemption applicable to any person or organization under the provisions of the Internal Revenue Code is limited or qualified in any manner, the exemption from taxes imposed by this article shall be limited or qualified in a similar manner.
>
> B. Notwithstanding the provisions of subsection A of this section, the unrelated business taxable income or other income subject to tax, as computed under the provisions of the Internal Revenue Code, of any person or organization exempt from the tax imposed by this act and subject to the tax imposed on such income by the Internal Revenue Code shall be subject to the tax which would have been imposed by this act but for the provisions of subsection A of this section.

The trustee of a nongrantor trust created by an Oklahoma testator or trustor might consider taking the position that the trust is not subject to Oklahoma income tax if it has no Oklahoma trustee, asset, or source income.[683]

As shown in Worksheet 3, the potential tax saving for an Oklahoma Resident Trust on a $1 million long-term capital gain incurred in 2020 was at least $49,808.[684] As shown in Worksheet 4, the net tax cost of including $1 million of long-term capital gain in DNI for an Oklahoma resident individual rather than taxing the gain to a trust that was structured to escape tax in 2020 was $15,324.[685]

Practice Tip: Domiciliaries of other states might consider establishing trusts in Oklahoma because it does not tax trusts created by nondomiciliaries except on source income.

9. South Carolina (South Carolina Income Tax)

In South Carolina, a trustee of a Resident Trust must file a return if the trust must file a federal return, has South Carolina taxable income, or has a nonresident beneficiary; a trustee of a Nonresident Trust must file a return if the trust has South Carolina-source income.[686]

---

[670] *See* Okla. Stat. tit. 68, § 2353(12), § 2355(C); instructions to 2020 Okla. Form 513 at 5.

[671] *See* Okla. Stat. tit. 68, § 2353(12), § 2355(G).

[672] Okla. Stat. tit. 68, § 2355(C)(1)(f), § 2355(G); instructions to 2020 Okla. Form 513 at 17. *See* Okla. Tax Commission, *Single Taxpayer or Married Filing Separate Returns* (Jan. 16, 2020), www.ok.gov/tax.

[673] Okla. Stat. tit. 68, § 2355(C)(1)(f), § 2355(G). A 4.85% top rate will apply if certain revenue targets are achieved (Okla. Stat. tit. 68, § 2355(C)(1)(f).

[674] Okla. Stat. tit. 68, § 2353(6). *See* Okla. Admin. Code § 710:50-23-1(c); instructions to 2020 Okla. Form 513 at 3. For Oklahoma income-tax purposes, an individual is a ''resident'' if the individual is domiciled in Oklahoma and is presumed to be a ''resident'' if the individual spends in the aggregate more than seven months in the state during the tax year (Okla. Stat. tit. 68, § 2353(4)). Given that taxation is based on the testator's or trustor's domicile, the second test in the foregoing definition does not come into play. Without addressing state or federal constitutional issues, an Oklahoma appellate court held in 2001 than an irrevocable trust established by an Oklahoma domiciliary continued to be taxed as a resident trust notwithstanding the trustor's move to and the trustee's residence in Nevada (*Frances M. Rosen Irrevocable Tr. v. Okla. Tax Comm'n*, 31 P.3d 406 (Okla. Ct. Civ. App. 2001). *See* VI.K.4., below.

[675] *See* Okla. Admin. Code § 710:50-23-1(c)(5). *See* instructions to 2020 Oklahoma Form 513 at 3.

[676] Okla. Admin. Code § 710:50-23-1(c)(5); Okla. Stat. tit. 68, § 2353(6)(b); instructions to 2020 Okla. Form 513 at 3.

[677] Okla. Stat. tit. 68, § 2355(G), § 2364.

[678] Okla. Stat. tit. 68, § 2362, § 2364.

[679] Okla. Admin. Code § 710:50-13-3(a)(3); instructions to 2020 Okla. Form 513 at 4.

[680] Okla. Stat. tit. 68, § 2385.30; Okla. Admin. Code § 710:50-3-54, § 710:90-3-11.

[681] § 664(c)(1).

[682] Okla. Stat. tit. 68, § 2359(A)–§ 2359(B). *See* Okla. Stat. tit. 68, § 202(e).

[683] *See* III.A.–III.E., above.

[684] For an explanation of how this figure was derived, see I.B.3., above.

[685] For an explanation of how this figure was derived, see I.B.4., above.

[686] Instructions to 2020 Form SC1041 at 1. *See* S.C. Code Ann. § 12-6-4910(6), § 12-6-4930.

ISBN 978-1-63359-383-1

South Carolina treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[687] and the Palmetto State permits trustees of nongrantor trusts to take a distribution deduction.[688] In 2020, South Carolina taxed the South Carolina taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 7.0% (the 7.0% rate applied starting with such income over $15,400,[689] and the current rate schedule, adjusted for inflation, is not scheduled to change.[690] South Carolina allows individuals, estates, and trusts to deduct 44% of net capital gains.[691]

South Carolina defines ''Resident Trust'' as a trust that is ''administered in this State,''[692] but it does not define ''administered.'' The tax return instructions stipulate that ''[a]ll other trusts are nonresident trusts, including a trust administered outside South Carolina that is required to follow the laws of South Carolina for administration of the trust.''[693]

South Carolina taxes all South Carolina taxable income of Resident Trusts[694] but only South Carolina-source taxable income of Nonresident Trusts.[695] In South Carolina, trustees must make estimated tax payments for trusts.[696]

The instructions to the South Carolina fiduciary income tax return give trustees of CRTs the following guidance:[697]

> Charitable Remainder Trusts South Carolina has adopted IRC Section 664, which outlines the basic rules for charitable remainder trusts. This means the South Carolina Income Tax treatment of these trusts is generally the same as for federal Income Tax. After preparing the required annual federal filing forms including Form 5227 (Split-Interest Trust Information Return), complete the information section on Page 1 of the SC1041. At the top of page 1, type or print the following statement:
>
> This is a charitable remainder trust as described in IRC Section 664. See attached Form 5227 for South Carolina income.
>
> To prepare Federal Form 5227 for South Carolina income, prepare a separate Federal Form 5227 taking into account the differences in federal and state taxable income. For a summary of these differences, see the instructions for Part I of the SC1041. Divide the South Carolina taxable income by the federal taxable income. Use that fraction to prorate the beneficiaries' South Carolina fiduciary adjustment. Indicate the proration on each SC1041 K-1 form. Attach copies of all federal forms filed in the year to the South Carolina forms.

Practice Tip: South Carolina and non-South Carolina testators and trustors should be cautious about establishing trusts in South Carolina because the state taxes based on the place of administration.

As shown in Worksheet 3, the potential tax saving for a South Carolina Resident Trust on a $1 million long-term capital gain incurred in 2020 was at least $38,670.[698] As shown in Worksheet 4, the net tax cost of including $1 million of long-term capital gain in DNI for a South Carolina resident individual rather than taxing the gain to a trust that was structured to escape tax in 2020 was $3,683.[699]

10. Tennessee (Hall Income Tax)

In Tennessee, a trustee must file a Hall Income Tax return if the trust receives $1,250 or more of taxable interest and dividend income for resident beneficiaries.[700]

Tennessee follows the federal grantor-trust rules for irrevocable trusts,[701] but the Volunteer State does not permit trustees of nongrantor trusts to take a distribution deduction.[702] In 2020, Tennessee taxed taxable interest and dividend income (capital gains were not taxed) received by a trustee for the benefit of Tennessee residents at 1.00%,[703] and, on January 1, 2021, the rate decreased to 0% for 2021 and later years.[704]

Tennessee does not define ''Resident Trust.'' For purposes of this Portfolio, under Tennessee law, a ''Resident Trust'' is a trust administered by a Tennessee resident trustee for the benefit of Tennessee resident beneficiaries. This definition comes from two sources. First, Tennessee assesses a tax on certain interest and dividend income as follows:[705]

> An income tax shall be levied and collected annually on incomes derived by way of dividends from stocks or by way of interest on bonds of each . . . trust . . . in the state of Tennessee who received, or to whom accrued, or to whom was credited during any year income from the sources enumerated in this section, except as otherwise provided in this chapter.

Second, the above tax applies to trustees, as follows:[706]

> Trustees, . . . who receive income taxable under this chapter for the benefit of residents of Tennessee shall

---

687 *See* S.C. Code Ann. § 12-6-510(A).

688 *See* S.C. Code Ann. § 12-6-510(A), § 12-6-1130.

689 S.C. Code Ann. § 12-6-510(A), § 12-6-520; instructions to 2020 Form SC1041 at 3.

690 S.C. Code Ann. § 12-6-510(A).

691 S.C. Code Ann. § 12-6-1150.

692 S.C. Code Ann. § 12-6-30(5). *See* instructions to 2020 Form SC1041 at 1. For South Carolina income-tax purposes, an individual is a ''resident'' if the individual is domiciled in the state (S.C. Code Ann. § 12-6-20(2)). Given that trust taxation is based on the place of administration, the foregoing definition does not come into play.

693 Instructions to 2020 Form SC1041 at 1. *See* S.C. Code Ann. § 12-6-30(5).

694 S.C. Code Ann. § 12-6-510(A), § 12-6-610.

695 S.C. Code Ann. § 12-6-510(A), § 12-6-570, § 12-6-620, § 12-6-1720; instructions to 2020 Form SC1041 at 1. *See* Maura Ashton & Rick Handel, *South Carolina's Taxation of the Sale of a Partnership Interest*, 89 State Tax Notes 565 (Aug. 6, 2018).

696 S.C. Code Ann. § 12-6-3910; 2020 Form SC1041 at 1.

697 Instructions to 2020 Form SC1041 at 2.

698 For an explanation of how this figure was derived, see I.B.3., above.

699 For an explanation of how this figure was derived, see I.B.4., above.

700 Instructions to 2020 Tenn. Form INC 250 at 1. *See* Tenn. Code Ann. § 67-2-107, § 67-2-110.

701 Tenn. Code Ann. § 67-2-110(a). *See* instructions to 2020 Tenn. Form INC 250 at 1.

702 *See* Tenn. Code Ann. § 67-2-102; instructions to 2020 Tenn. Form INC 250 at 1.

703 Tenn. Code Ann. § 67-2-102(4), § 67-2-110; instructions to 2020 Tenn. Form INC 250 at 2.

704 Tenn. Code Ann. § 67-2-102(5). *See* Tenn. Dep't of Revenue Notice #17-09, *Hall Income Tax Notice: Phasing Out of Tax* (May 2017), www.tn.gov/revenue.

705 Tenn. Code Ann. § 67-2-102.

706 Tenn. Code Ann. § 67-2-110(a). *See* instructions to 2020 Tenn. Form INC

ISBN 978-1-63359-383-1

be required to make returns under this chapter and to pay the tax levied by this chapter.

For Tennessee income-tax purposes, an individual is a ''resident'' if the individual is domiciled in Tennessee and is presumed to be a ''resident'' if the individual maintains a place of residence in the state for more than six months during the taxable year.[707] For purposes of this Portfolio, a ''Nonresident Trust'' is a trust that is not a ''Resident Trust.''[708]

Tennessee taxes all taxable interest and dividend income of Resident Trusts,[709] and it taxes Tennessee resident beneficiaries on all taxable interest and dividend income that they receive from Nonresident Trusts.[710] In Tennessee, trustees are not required to make estimated tax payments for trusts.[711]

A Tennessee statute sets the following rules for CRTS:[712]

> [A] trustee of a charitable remainder trust, as defined in Internal Revenue Code § 664, codified in 26 U.S.C. § 664, shall not be required to make returns under this chapter nor to pay the tax, but shall report to each resident beneficiary the amount of taxable income distributed to such resident beneficiary, who shall be liable for the tax under this chapter.

Given that Tennessee's approach to taxation is so similar to North Carolina's framework, the U.S. Supreme Court's decision in *North Carolina Department of Revenue v. The Kimberley Rice Kaestner_1992 Family Trust*[713] supports the view that Tennessee may not tax nonresident trustees on Tennessee taxable interest and dividends in discretionary trusts that have resident beneficiaries in the state.

Practice Tip: Tennessee residents and nonresidents might consider creating trusts in Tennessee if there are no Tennessee resident beneficiaries.

11. Texas

Texas (the Lone Star State) does not impose an income tax on individuals or fiduciaries. A provision of the Texas Constitution, as amended in 2019, prohibits the enactment of such a tax as follows: ''[t]he legislature may not impose a tax on the net incomes of individuals, including an individual's share of partnership and unincorporated association income.''[714] The Texas margin tax[715] is not creditable for Massachusetts income-tax purposes because the margin tax is not an income tax.[716]

12. Virginia (Virginia Income Tax)

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 return if the trust has Virginia source income and if such trustee must file a federal return.[717]

Virginia treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[718] and the Old Dominion permits trustees of nongrantor trusts to take a distribution deduction.[719] In 2020, Virginia taxed the Virginia taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 5.75% (the 5.75% rate applied starting with such income over $17,000),[720] and the current rate schedule is not scheduled to change.[721]

Virginia defines ''Resident Trust'' as follows:[722]

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

An additional test — taxation based on administration in Virginia — was repealed as of July 1, 2019.[723]

According to a regulation, a trust is administered in Virginia in the following circumstances:[724]

> 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.

Trustees of trusts that were taxable based on this criterion should have filed part-year returns for 2019.

Note that an individual is a resident of Virginia if the individual is domiciled in the Commonwealth or if the individual spends more than 183 days and has a place of abode there during the year.[725] A ''Nonresident Trust'' is a trust that is not a ''Resident Trust.''[726]

In P.D. 16-62,[727] the Virginia Department of Taxation considered whether a Virginia resident's exercise of a nonge-

---

250 at 1.

[707] Tenn. Code Ann. § 67-2-101(5).

[708] *See* Tenn. Code Ann. § 67-2-102, § 67-2-110(a).

[709] Tenn. Code Ann. § 67-2-102; instructions to 2020 Tenn. Form INC 250 at 1. *See* Tenn. Ltr. Rul. 14-09 (Oct. 6, 2014), www.tn.gov/revenue (cash distributions from LLC are dividends subject to tax).

[710] Tenn. Code Ann. § 67-2-102, § 67-2-111.

[711] *See* 2020 Tenn. Form INC 250.

[712] Tenn. Code Ann. § 67-2-110(a). *See* instructions to 2020 Tenn. Form INC 250 at 1.

[713] 139 S. Ct. 2213 (2019). *See* III.A.9., above.

[714] Tex. Const. art. 8, § 24-a.

[715] Tex. Tax Code § 71.0001–§ 171.909.

[716] *Lowry v. Comm'r of Revenue*, Mass. Admin. Dec. C330919, 2020 WL 2526060 (Mass. App. Tax Bd. May 5, 2020), www.mass.gov/orgs/appellate-tax-board. *See* Andrea Muse, *Accountant Denied Credit for Paid Texas Tax*, 96 Tax Notes State 807 (May 11, 2020).

[717] Instructions to 2020 Va. Form 770 at 1. *See* Va. Code Ann. § 58.1-381; 23 Va. Admin. Code § 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).

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

[719] *See* Va. Code Ann. § 58.1-361.

[720] Va. Code Ann. § 58.1-320, § 58.1-360; instructions to 2020 Va. Form 770 at 9.

[721] Va. Code Ann. § 58.1-320.

[722] Va. Code Ann. § 58.1-302. *See* 23 Va. Admin. Code § 10-115-10; instructions to 2020 Va. Form 770 at 1. *See also* P.D. 08-160, 2008 WL 4184911, at *1 (Va. Dep't Tax'n Aug. 29, 2008), www.policylibrary.tax.virginia.gov (''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'n June 30, 1999), www.policylibrary.tax.virginia.gov (''The Taxpayer's estate/trust is a nonresident estate/trust''); P.D. 92-147, 1992 WL 238833, at *1 (Va. Dep't Tax'n Aug. 19, 1992), www.policylibrary.tax.virginia.gov (''The trust does not possess any of the elements which would entitle Virginia to treat the Trust as a resident trust'').

[723] Va. Code Ann. § 58.1-302, prior to amendment by 2019 Va. Laws 23, § 1.

[724] 23 Va. Admin. Code § 10-115-10.

[725] Va. Code Ann. § 58.1-302.

[726] Va. Code Ann. § 58.1-302; 23 Va. Admin. Code § 10-115-10; instructions to 2020 Va. Form 770 at 1.

[727] P.D. 16-62, 2016 WL 2940441 (Va. Dep't Tax'n Apr. 20, 2016), www-

ISBN 978-1-63359-383-1

neral 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[728] but only Virginia-source taxable income of Nonresident Trusts.[729] In Virginia, trustees must make estimated tax payments for trusts.[730]

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

- If the trust was created or funded by a trustor who was domiciled in Virginia
- If the trust was created by the Will of a testator who was domiciled in Virginia
- If the trust is administered in Virginia (until July 1, 2019).[731]

But, based on three early U.S. Supreme Court decisions — *Brooke v. City of Norfolk*,[732] *Safe Deposit and Trust Company v. Virginia*,[733] and *Guaranty Trust Company v. Virginia*[734] 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. 93-189.[735] 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 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 provided similar guidance for the second category in P.D. 99-110.[736] 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.

As noted above, prior to July 1, 2019, Virginia law included a trust administered in Virginia as a Resident Trust. The Virginia Department of Taxation offered comparable guidance for trusts administered in Virginia five times:

- P.D. 02-101[737] — 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

.tax.virginia.gov (citation omitted).

[728] Va. Code Ann. § 58.1-360, § 58.1-361; 23 Va. Admin. Code § 10-115-40. *See* P.D. 15-230, 2015 WL 9459890, at *1 (Va. Dep't Tax'n Dec. 11, 2015), www.tax.virginia.gov (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'n Oct. 19, 2015), www.tax.virginia.gov (appeal of assessment barred by statute of limitations).

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

[730] Va. Code Ann. § 58.1-490(M), § 58.1-491; 23 Va. Admin. Code § 10-115-140, § 10-115-145, § 10-115-150; instructions to 2020 Va. Form 770 at 2.

[731] Va. Code Ann. § 58.1-302.

[732] 277 U.S. 27 (1928). *See* III.A.2., above.

[733] 280 U.S. 83 (1929). *See* III.A.3., above.

[734] 305 U.S. 19 (1938). *See* III.A.4., above.

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

[736] P.D. 99-110, 1999 WL 760767 (Va. Dep't Tax'n May 13, 1999), www.tax.virginia.gov. *But see* P.D. 97-147, 1997 WL 336789, at *2 (Va. Dep't Tax'n Mar. 27, 1997), www.policylibrary.tax.virginia.gov ("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'n Aug. 23, 1991), www.policylibrary.tax.virginia.gov ("the two trusts in question are subject to the Virginia fiduciary income tax as Virginia resident trusts").

[737] P.D. 02-101 (Va. Dep't Tax'n June 24, 2002), www.tax.virginia.gov. *But see* P.D. 97-121, 1997 WL 335111 (Va. Dep't Tax'n Mar. 7, 1997), www.tax.virginia.gov. ("[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'n Nov. 18, 1997), www.policylibrary.tax.virginia.gov ("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").

ISBN 978-1-63359-383-1

resident or residents would not make the Trust a ''resident trust'' for Virginia income tax purposes.

• P.D. 07-164[738] — 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:

> 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[739] — 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[740] — 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 co-trustee 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 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[741] — The Commissioner ruled that the residuary trust under the Will of a Pennsylvania decedent having three co-trustees, 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-trustee 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 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 sources with certain adjustments.

The instructions to the Virginia fiduciary income tax return give trustees of CRTs the following guidance:[742]

> 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. The trustee of a nongrantor trust created by a Virginia domiciliary 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.[743]

As shown in Worksheet 3, the potential tax saving for a Virginia Resident Trust on a $1 million long-term capital gain

---

[738] P.D. 07-164, 2007 WL 3233154 (Va. Dep't Tax'n Oct. 7, 2007), www.tax.virginia.gov.

[739] P.D. 13-18, 2013 WL 2481146 (Va. Dep't Tax'n Feb. 5, 2013), www.tax.virginia.gov.

[740] P.D. 14-49, 2014 WL 1496457 (Va. Dep't Tax'n Apr. 2, 2014), www.tax.virginia.gov.

[741] P.D. 15-156, 2015 WL 5253741 (Va. Dep't Tax'n Aug. 12, 2015), www.tax.virginia.gov (citations omitted).

[742] Instructions to 2020 Va. Form 770 at 1. *See* P.D. 02-145, 2002 Va. Tax Lexis 145 (Va. Dep't Tax'n Nov. 20, 2002), www.tax.virginia.gov.

[743] *See* III.A.–III.E., above.

ISBN 978-1-63359-383-1

incurred in 2020 was at least $57,237.[744] As shown in Worksheet 4, the net tax cost of including $1 million of long-term capital gain in DNI for a Virginia resident individual rather than taxing the gain to a trust that was structured to escape tax in 2020 was $22,809.[745]

Practice Tip: Given that Virginia no longer taxes trusts administered in the Commonwealth, domiciliaries of other states might consider establishing trusts in Virginia because it does not tax trusts created by nondomiciliaries except on source income.

D. Midwest

1. Illinois (Illinois Income Tax)

In Illinois, a trustee must file a return if the trust has net income or loss for Illinois tax purposes, if such trustee is trustee of a Resident Trust and must file a federal return, or if such trustee is trustee of a Nonresident Trust that has Illinois source income.[746]

Illinois treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[747] and the Prairie State allows trustees of nongrantor trusts to take a distribution deduction.[748] Illinois imposes a 4.95% net income tax and a 1.50% net replacement tax.[749] The state therefore taxed the net income of nongrantor trusts at 6.45% in 2020.[750] Given that the voters defeated a 2020 ballot initiative to amend the Illinois Constitution to implement a graduated income-tax system,[751] the 6.45% rate applies in 2021 and later years.[752]

Illinois defines ''Resident Trust'' as follows:[753]

> (C) A trust created by a will of a decedent who at his death was domiciled in this State; and
>
> (D) An irrevocable trust, the grantor of which was domiciled in this State at the time such trust became irrevocable. For purpose of this subparagraph, a trust shall be considered irrevocable to the extent that the grantor is not treated as the owner thereof under Sections 671 through 678 of the Internal Revenue Code.

A ''Nonresident Trust'' is a trust that is not a ''Resident Trust.''[754]

Whereas Illinois taxes all net income of Resident Trusts,[755] it taxes only Illinois-source net income of Nonresident Trusts.[756] In Illinois, trustees are not required to make estimated tax payments for trusts.[757]

A 2000 determination of the Office of Administrative Hearings of the Illinois Department of Revenue ruled that the taxation of a trust created by an Illinois resident decedent would not violate the U.S. Due Process Clause[758] or Commerce Clause[759] even though the trust had no Illinois trustee, asset, source income, or beneficiary. In a 2007 release, the Illinois Department of Revenue concluded that Illinois could continue to tax an inter vivos trust created by a domiciliary trustor notwithstanding a change of situs to the State of Washington,[760] and, in 2008, that agency concluded that Illinois could continue to tax an inter vivos trust created by a domiciliary trustor notwithstanding the trustors move to another state.[761] In the 2013 *Linn v. Department of Revenue* decision, though, the Appellate Court of Illinois granted an Illinois income-tax refund to the trustee of a trust created by an Illinois trustor for a year in which the trust had no connections to Illinois pursuant to the federal Due Process Clause.[762]

In 2012, the Illinois Department of Revenue announced that CRTs are not taxed at the trust level for the following reason (although a CRT may have to file an Illinois return):[763]

> 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),

---

744 For an explanation of how this figure was derived, see I.B.3. above.

745 For an explanation of how this figure was derived, see I.B.4. above.

746 Instructions to 2020 IL-1041 at 2. *See* 35 ILCS 5/502(a), 5/502(b)(3); Ill. Dep't of Revenue Info. Bulletin FY 2021-14, *What's New for Illinois Income Taxes* (Feb. 2021), www.tax.illinois.gov; *See also* Andy Daglas, *Fixing the Ongoing Illinois Budget Crisis*, 95 Tax Notes State 547 (Feb. 17, 2020).

747 *See* 35 ILCS 5/203(a). *See also* Ill. Info. Ltr. IT 12-0025-GIL, 2012 WL 5285008 (Ill. Dep't Rev. Sept. 10, 2012) www.tax.illinois.gov (''Net Income for Illinois income tax purposes is a taxpayer's federal adjusted gross income'').

748 *See* 35 ILCS 5/203(c)(1).

749 35 ILCS 5/201(a), 5/201(b)(5.4), 5/201(c), 5/201(d); 2020 IL-1041 at 3; instructions to 2020 IL-1041 at 13. *See Republic Bancorp Co. v. Beard*, 107 N.E.3d 423, 432 (Ill. Ct. App. June 8, 2018) (''It exempts only certain types of trusts, such as grantor trusts, from the replacement tax''). For the history of the personal property replacement tax, see Brian Hamer, *A State's Tax Grab*, 87 State Tax Notes 1089 (Mar. 19, 2018).

750 35 ILCS 5/201(a), 5/201(b)(5.4).

751 Ill. Senate Joint Resolution No. 1 (Nov. 3, 2020), ilga.gov/legislation. *See* Paul Jones, *California, Alaska, and Illinois Voters Reject Tax Increases*, 98 Tax Notes State 634 (Nov. 9, 2020).

752 35 ILCS 5/201(a), 5/201(b)(5.4).

753 35 ILCS 5/1501(a)(20)(C)–35 ILCS 5/1501(a)(20)(D) (footnote omitted). *See* Ill. Admin. Code tit. 86, § 100.3020(a)(3)–§ 100.3020(a)(4); instructions to 2020 IL-1041 at 5-6. For Illinois income-tax purposes, an individual is a ''resident'' if the individual is in Illinois for other than a temporary or transitory purpose during the taxable year or if the individual is domiciled in the state (35 ILCS 5/1501(a)(20)(A); instructions to 2020 IL-1041 at 5). Given that taxation is based on the testator's or trustor's domicile, the first test in the foregoing definition does not come into play. *See* Paul Bogdanski, David P. Dorner & Jeremy P. Gove, *So You Moved Out of Illinois! Are You Sure?* 96 Tax Notes State 1565 (June 29, 2020); Mark J. Perry, Badger Institute, *Leaving Illinois for Wisconsin*, 93 Tax Notes State 733 (June 2019), www.badgerinstitute.org.

754 *See* 35 ILCS 5/1501(a)(14); instructions to 2020 IL-1041 at 6.

755 35 ILCS 5/301(a); Ill. Admin. Code tit. 86, § 100.3000; instructions to 2020 IL-1041 at 6-7.

756 35 ILCS 5/301(c); Ill. Admin. Code tit. 86, § 100.3000; instructions to 2020 IL-1041 at 6-7.

757 35 ILCS 5/803(a); instructions to 2020 IL-1041 at 2.

758 *Carmichael v. Ill. Dep't of Revenue*, IT 00-7, 2000 Ill. Tax Lexis 337, at 22 (Ill. Dep't Rev. Feb. 1, 2000), www.tax.illinois.gov.

759 *Carmichael*, IT 00-7, 2000 Ill. Tax Lexis 337, at *24-25.

760 Ill. Info. Ltr. IT 07-0026-GIL, 2007 WL 2467609 (Ill. Dep't Rev. July 26, 2007), www.tax.illinois.gov.

761 Ill. Info. Ltr. IT 08-0004-GIL, *Residency/Nonresidency*, 2008 WL 459830 (Ill. Dep't Rev. Jan. 23, 2008), www.tax.illinois.gov.

762 *Linn v. Dep't of Revenue*, 2 N.E.3d 1203, 1211 (Ill. App. Ct. 2013). *See* III.D.3., above.

763 Ill. Info. Ltr. IT 12-0008-GIL, *Trusts*, 2012 WL 1257370 (Ill. Dep't Rev. Mar. 23, 2012), www.tax.illinois.gov.

ISBN 978-1-63359-383-1

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).

Although Illinois rulings concluded that trustees of trusts created by Illinois testators and trustors that had minimal ties to Illinois still had to pay tax,[764] *Linn v. Department of Revenue*[765] and later cases decided under similar statutes of other states[766] give trustees of inter vivos trusts created by Illinois testators and trustors a basis for taking the position that tax is not due under such circumstances.

As shown in Worksheet 3, the potential tax saving for an Illinois Resident Trust on a $1 million long-term capital gain incurred in 2020 was $64,500.[767] As shown in Worksheet 4, the net tax cost of including $1 million of long-term capital gain in DNI for an Illinois resident individual rather than taxing the gain to a trust that was structured to escape tax in 2020 was $15,379.[768]

Practice Tip: Domiciliaries of other states might consider establishing trusts in Illinois because it does not tax trusts created by nondomiciliaries except on source income.

Trustees of inter vivos trusts should keep in mind that, for Illinois purposes, a trust is not ''irrevocable'' as long as it is treated as a grantor trust under § 671–§ 678, not § 679.[769] As a result, such a trust will not be an Illinois Resident Trust if the trustor ceases to be an Illinois domiciliary before the trust ceases to be a grantor trust under those provisions. But, a trust will be an Illinois Resident Trust if a trustor creates a grantor trust while a nondomiciliary if the trust ceases to be a grantor trust after the trustor moves to Illinois.

2. *Indiana (Indiana Income Tax)*

In Indiana, a trustee of a Resident Trust must file a return if the trust has more than $600 of gross income; a trustee of a Nonresident Trust must file a return if the trust has more than $600 of gross income from Indiana sources.[770]

Indiana treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes;[771] the Hoosier State authorizes trustees of nongrantor trusts to take a distribution deduction.[772] In 2020, Indiana taxed the state adjusted gross income of nongrantor trusts at 3.23%,[773] and the same rate applies in 2021 and future years.[774]

Indiana defines ''Resident Trust'' as ''any trust which has a situs within this state,''[775] and ''[t]he residence of a . . . trust is the place where it is administered,'' which is determined by where the trustee is located and where the trust records are kept.[776]

In Indiana, an individual is a resident for tax purposes if the individual is domiciled in the state or if the individual maintains a permanent place of residence and spends more than 183 days there during the taxable year.[777] Given that taxation is based on where a trustee is located, it's unclear whether the foregoing definition comes into play. A ''Nonresident Trust'' is a trust that is not a ''Resident Trust.''[778]

Although Indiana taxes trustees on all adjusted gross income of Resident Trusts,[779] it taxes Nonresident Trusts only on their Indiana-source adjusted gross income.[780] In Indiana, trustees are not required to make estimated tax payments for trusts[781] but must withhold tax from distributions for nonresident beneficiaries.[782]

Regarding CRTs, a commentator has opined:[783]

> Because a qualified charitable remainder trust is exempt from federal income tax, its federal adjusted gross income is zero dollars. As a result, a charitable remainder trust is effectively exempt from income tax in Indiana so long as its federal tax exemption is preserved.

Practice Tip: Indiana and non-Indiana testators and trustors should be cautious about creating trusts in the state because Indiana taxes trusts on this basis.

As shown in Worksheet 3, the potential tax saving for an Indiana Resident Trust on a $1 million long-term capital gain incurred in 2020 was $32,297.[784] As shown in Worksheet 4, the tax saving from including $1 million of long-term capital gain in DNI for an Indiana resident individual rather than taxing the gain to a trust that was structured to escape tax in 2020 was $1,853.[785]

---

764 Ill. Info. Ltr. IT 08-0004-GIL, *Residency/Nonresidency*, 2008 WL 459830 (Ill. Dep't Rev. Jan. 23, 2008), www.tax.illinois.gov; Ill. Info. Ltr. IT 07-0026-GIL, 2007 WL 2467601 (Ill. Dep't Rev. July 26, 2007), www.tax.illinois.gov; *Carmichael*, IT 00-7, 2000 Ill. Tax Lexis 337.

765 2 N.E.3d 1203, 1211.

766 *See* III.A.–III.E., above.

767 For an explanation of how this figure was derived, see I.B.3., above.

768 For an explanation of how this figure was derived, see I.B.4., above.

769 35 ILCS 5/1501(a)(20)(D); Ill. Admin. Code tit. 86, § 100.3020(a)(4); instructions to 2020 IL-1041 at 2.

770 Ind. Code § 6-3-4-1(5), § 6-3-4-1(7), § 6-3-4-2(c); instructions to 2020 Ind. Form IT-41 at 1.

771 *See* Ind. Code § 6-3-1-3.5(f); Ind. Admin. Code tit. 45, r. 3.1-1-1; instructions to 2020 Ind. Form IT-41 at 1.

772 *See* Ind. Code § 6-3-1-3.5(f), § 6-3-1-14; instructions to 2020 Ind. Form IT-41 at 1.

773 Ind. Code § -3-2-1(a)(3), § 6-3-1-3.5(f), § 6-3-1-14; instructions to 2020 Ind. Form IT-41 at 4; 2020 Ind. Form IT-41 at 1.

774 Ind. Code § 6-3-2-1(a)(3).

775 Ind. Code § 6-3-1-12(d). *See* Ind. Admin. Code tit. 45, r. 3.1-1-21(d).

776 Ind. Admin. Code tit. 45, r. 3.1-1-12. *See* instructions to 2020 Ind. Form IT-41 at 1. *See also* Ind. Dep't of Revenue, Rev. Rul. 2013-04 IT, *Adjusted Gross Income Tax Withholding* (March 31, 2015), www.in.gov/dor (''the term 'administered' is undefined'').

777 Ind. Code § 6-3-1-12(a)–§ 6-3-1-12(b).

778 Ind. Code § 6-3-1-13; Ind. Admin. Code tit. 45, r. 3.1-1-12.

779 Ind. Code § 6-3-2-1(a); Ind. Admin. Code tit. 45, r. 3.1-1-12.

780 Ind. Code § 6-3-2-1(a); Ind. Admin. Code tit. 45, r. 3.1-1-12, r. 3.1-1-25; instructions to 2020 Ind. Form IT-41 at 1. *See* Ind. Dep't of Revenue Info. Bltn. #39, *Guidelines for Reporting Income From Indiana Sources by Nonresident Individuals* (Aug. 2015), www.in.gov/dor.

781 Ind. Code § 6-3-4-4.1; instructions to 2020 Ind. Form IT-41 at 4.

782 Ind. Code § 6-3-4-12; instructions to 2020 Ind. Form IT-41 at 2.

783 Ted R. Batson, Jr., *Net Income With Make-Up Charitable Remainder Unitrusts and the Trustee's Power to Adjust Under Indiana's Uniform Principal and Income Act*, 45 Ind. L. Rev. 841, 862 (2012) (footnote omitted).

784 For an explanation of how this figure was derived, see I.B.3., above.

785 For an explanation of how this figure was derived, see I.B.4., above.

ISBN 978-1-63359-383-1

3. *Iowa (Iowa Personal Net Income Tax)*

In Iowa, a trustee must file a return if the trust has Iowa taxable income of $600 or more.[786]

Iowa treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[787] and the Hawkeye State permits trustees of nongrantor trusts to take a distribution deduction.[788] In 2020, Iowa taxed the taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 8.53% (the 8.53% rate applied starting with such income over $74,970),[789] and the current rate schedule is unchanged for 2021, except that the threshold at which the top rate applies is $75,420.[790] The top rate will decrease to 6.50% for 2023 and later years if specified revenue targets are met.[791] An alternative minimum tax, equal to 75% of the maximum regular individual income tax rate times the trust's income, is assessed to the extent it exceeds the regular income tax for the tax year.[792]

Whereas Iowa does not define ''Resident Trust,'' it taxes testamentary trusts and inter vivos trusts based on the following factors:[793]

> 89.3(1) Testamentary trusts. The situs of a testamentary trust for tax purposes is the state of the decedent's residence at the time of death until the jurisdiction of the court in which the trust proceedings are pending is terminated. In the event of termination and the trust remains open, the situs of the trust is governed by the same rules as pertain to the situs of inter vivos trusts.
>
> 89.3(2) Inter vivos trusts. If an inter vivos trust is created by order of court or makes an accounting to the court, its situs is the state where the court having jurisdiction is located until the jurisdiction is terminated. The situs of an inter vivos trust which is subject to the grantor trust rules under 26 U.S.C. Sections 671 to § 679 is the state of the grantor's residence, or the state of residence of the person other than the grantor deemed the owner, to the extent the income of the trust is governed by the grantor trust rules.
>
> If an inter vivos trust (other than a trust subject to the grantor trust rules in 26 U.S.C. Sections 671 to § 679) is not required to make an accounting to and is not subject to the control of a court, its situs depends on the relevant facts of each case. The relevant facts include, but are not limited to: the residence of the trustees or a majority of them; the location of the principal office where the trust is administered; and the location of the evidence of the intangible assets of the trust (such as stocks, bonds, bank accounts, etc.). The residence of the grantor of a trust, not subject to the grantor trust rules under 26 U.S.C. Sections 671 to § 679, is not a controlling factor as to the situs of the trust, unless the person is also a trustee. A statement in the trust instrument that the law of a certain jurisdiction shall govern the administration of the trust is not a controlling factor in determining situs. The residence of the beneficiaries of a trust is also not relevant in determining situs.

For purposes of this Portfolio, a ''Resident Trust'' is a trust that meets the above factors. A ''Nonresident Trust'' is a trust that is not a ''Resident Trust.''[794] For Iowa income-tax purposes, an individual is a resident if the individual is domiciled in or maintains a permanent place of abode in the state.[795]

Iowa taxes all taxable income of Resident Trusts[796] but only Iowa-source taxable income of Nonresident Trusts.[797] In Iowa, trustees must make estimated tax payments for trusts.[798]

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

Practice Tip: Given that it is not clear when Iowa will and will not tax a nongrantor trust, Iowa and non-Iowa testators and trustors should plan their trusts so as to avoid as many of the factors quoted above as possible.

As shown in Worksheet 3, the potential tax saving for an Iowa Resident Trust on a $1 million long-term capital gain incurred in 2020 was at least $83,261.[799] As shown in Worksheet 4, the net tax cost of including $1 million of long-term capital gain in DNI for an Iowa resident individual rather than taxing the gain to a trust that was structured to escape tax in 2020 was $48,960.[800]

4. *Kansas (Kansas Income Tax)*

In Kansas, the trustee of a Resident Trust must file a return if the trust has Kansas taxable income or if withholding tax is due for nonresident beneficiaries; the trustee of a Nonresident Trust must file a return if the trust has Kansas-source taxable income.[801]

---

[786] Iowa Code § 422.14; Iowa Admin. Code r. 701-89.4(6)(a); instructions to 2020 Iowa Form IA 1041 at 1. *See In the Matter of Thomas Colbert*, Iowa Declaratory Order No. 16IDR063-066, 2017 WL 6501978, at *9 (Iowa Dep't Inspections & Appeals June 13, 2017) (''[I]ncome the non-trustee beneficiaries received during the 2007 tax year from the sale of farmland by the Colbert Trust did not qualify for the Iowa capital gain deduction''). *See also* Iowa Dep't of Revenue Policy Letter #16201075, *Iowa Capital Gains Deduction — Material Participation of a Trust* (Oct. 28, 2016), tax.iowa.gov.

[787] Iowa Admin. Code r. 701-89.3(1)–701-89.3(2); 2020 Iowa Form IA 1041 at 1. *See* Iowa Dep't of Inspections & Appeals, Div. of Administrative Hearings, *In the Matter of Geib*, DIA No. 191DR0088 at 2 (Sept. 13, 2019), dia.iowa.gov. (''Net income'' means the adjusted gross income before the net operating loss deduction as properly computed for federal income tax purposes under the Internal Revenue Code with the adjustments provided for pursuant to the Iowa Code'').

[788] *See* Iowa Code § 422.4(16), § 422.6.

[789] Instructions to 2020 Iowa Form IA 1041 at 4; Iowa Code § 422.5A(9). *See* Iowa Dep't of Revenue Release, *IDR Announces 2020 Interest Rates, Standard Deductions, and Income Tax Brackets* (Oct. 17, 2019), tax.iowa.gov.

[790] Iowa Dep't of Revenue Release, *IDR Announces 2021 Interest Rates, Deductions, Income Tax Brackets* (Oct. 14, 2020), tax.iowa.gov.

[791] *See* Iowa Code § 422.5A(9).

[792] Iowa Code § 422.5.

[793] Iowa Admin. Code r. 701-89.3(1)–701-89.3(2).

[794] *See* Iowa Admin. Code r. 701-89.3(1)–701-89.3(2).

[795] Iowa Code § 422.4(15).

[796] Iowa Code § 422.4(16), § 422.5(1).

[797] Iowa Code § 422.5(1), § 422.8.

[798] Iowa Code § 422.16(11); Iowa Code § 422.4(14).

[799] For an explanation of how this figure was derived, see I.B.3., above.

[800] For an explanation of how this figure was derived, see I.B.4., above.

[801] Instructions to 2020 Kan. Form K-41 at 2. *See* Kan. Stat. Ann. § 79-3220(c).

ISBN 978-1-63359-383-1

Kansas treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[802] and the Sunflower State permits trustees of nongrantor trusts to take a distribution deduction.[803] In 2020, Kansas taxed the Kansas taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 5.70% (the 5.70% rate applied starting with such income over $30,000),[804] and the current rate schedule is not scheduled to change.[805]

Kansas defines ''Resident Trust'' and ''Nonresident Trust'' as follows:[806]

> ''Resident trust'' means a trust which is administered in this state. A trust shall not be deemed to be administered in this state solely because it is subject to the jurisdiction of a district court within this state. ''Nonresident trust'' means a trust other than a resident trust.

Kansas taxes all Kansas taxable income of Resident Trusts[807] but only Kansas-source taxable income of Nonresident Trusts.[808] In Kansas, trustees are not required to make estimated tax payments for trusts but must withhold tax from distributions to nonresident beneficiaries in certain circumstances.[809]

A CRT generally is exempt from federal income tax.[810] Therefore, it usually also is exempt from Kansas income tax pursuant to the following statute:[811]

> (a) A person or organization exempt from federal income taxation under the provisions of the federal internal revenue code shall also be exempt from the tax imposed by this act in each year in which such person or organization satisfies the requirements of the federal internal revenue code for exemption from federal income taxation. If the exemption applicable to any person or organization under the provisions of the federal internal revenue code is limited or qualified in any manner, the exemption from taxes imposed by this article shall be limited or qualified in a similar manner.
>
> (b) Notwithstanding the provisions of subsection (a) of this section, the unrelated business taxable income, as computed under the provisions of the federal internal revenue code, of any person or organization otherwise exempt from the tax imposed by this act and subject to the tax imposed on unrelated business income by the federal internal revenue code shall be subject to the tax which would have been imposed by this act but for the provisions of subsection (a) of this section.

Practice Tip: Kansas and non-Kansas testators and trustors should be cautious about creating trusts to be administered in Kansas because the state taxes on this basis.

As shown in Worksheet 3, the potential tax saving for a Kansas Resident Trust on a $1 million long-term capital gain incurred in 2020 was at least $56,537.[812] As shown in Worksheet 4, the net tax cost of including $1 million of long-term capital gain in DNI for a Kansas resident individual rather than taxing the gain to a trust that was structured to escape tax in 2020 was $22,122.[813]

5. *Kentucky (Kentucky Income Tax)*

In Kentucky, a trustee of a Resident Trust must file a return if the trust has gross income of $100 or more; a trustee of a Nonresident Trust must file a return if the trust has Kentucky-source gross income of $100 or more.[814]

Kentucky treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[815] and the Bluegrass State permits trustees of nongrantor trusts to take a distribution deduction.[816] In 2020, Kentucky taxed the net income (including accumulated ordinary income and capital gains) of nongrantor trusts at 5.00%[817] and the same rate applies for 2021 and for later years.[818]

Kentucky does not define ''Resident Trust.'' In practice, a ''Resident Trust'' is a trust that has a resident fiduciary and a ''Nonresident Trust'' is a trust that does not have a resident fiduciary.[819] In Kentucky, an individual is a resident for tax purposes if the individual is domiciled in the state or if the individual maintains a place of abode and spends more than 183 days there during the taxable year.[820]

Kentucky taxes all net income of Resident Trusts[821] but only Kentucky-source net income of Nonresident Trusts.[822] In Kentucky, trustees must make estimated tax payments for trusts.[823]

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

---

[802] *See* Kan. Stat. Ann. § 79-32,116, § 79-32,117.

[803] *See* Kan. Stat. Ann. § 79-32,134.

[804] Kan. Stat. Ann. § 79-32,110(a)(2)(F), § 79-32-110(d); 2020 Kan. Form K-41 at 4.

[805] Kan. Stat. Ann. § 79-32,110(a)(2)(F), § 79-32-110(d).

[806] Kan. Stat. Ann. § 79-32,109(d). *See* instructions to 2020 Kan. Form K-41 at 2. For Kansas income-tax purposes, an individual is a ''resident'' if the individual is domiciled in Kansas and is presumed to be a ''resident'' if the individual spends more than six months in the state within a tax year (Kan. Stat. Ann. § 79-32,109(b)).

[807] Kan. Stat. Ann. § 79-32,110(d), § 79-32,134.

[808] Kan. Stat. Ann. § 79-32,136, § 79-32,137; instructions to 2020 Kan. Form K-41 at 2.

[809] Kan. Stat. Ann. § 79-32,101(e); instructions to 2020 Kan. Form K-41 at 2.

[810] § 664(c)(1).

[811] Kan. Stat. Ann. § 79-32,113(a)–§ 79-32,113(b). *See* Kan. Stat. Ann. § 79-32,109(a); § 7701(a)(1).

[812] For an explanation of how this figure was derived, see I.B.3., above.

[813] For an explanation of how this figure was derived, see I.B.4., above.

[814] Instructions to 2020 Ky. Form 741 at 1. *See* Ky. Rev. Stat. Ann. § 141.030(2), § 141.190. *See* Ky. Rev. Proc. KY-RP-19-03, *Administration of Guidance* (July 26, 2019), revenue.ky.gov. *See also* Andrea Muse, *More Focus on Publication of DOR Rulings with Proposed Bill*, 99 Tax Notes State 647 (Feb. 8, 2021); Andrea Muse, *Questions Persist on Publication of DOR Guidance*, 99 Tax Notes State 646 (Feb. 8, 2021).

[815] *See* Ky. Rev. Stat. Ann. § 141.010(13) Ky. Rev. Stat. Ann. § 141.020(1); instructions to 2020 Ky. Form 741 at 1.

[816] *See* Ky. Rev. Stat. Ann. § 141.010(18) § 141.030(1); 103 Ky. Admin. Regs. 19:010(1).

[817] Ky. Rev. Stat. Ann. § 141.020(2)(a), § 141.030(1); 103 Ky. Admin. Regs. 19:010(1)–19:010(2); instructions to 2020 Ky. Form 741 at 2.

[818] Ky. Rev. Stat. Ann. § 141.020(2)(a).

[819] *See* Ky. Rev. Stat. Ann. § 141.030(1).

[820] Ky. Rev. Stat. Ann. § 141.010(25).

[821] Ky. Rev. Stat. Ann. § 141.020(1), § 141.030(1); 103 Ky. Admin. Regs. 19:010(4). *See* KY-TAM-19-01, *Internal Revenue Code § 67(e) Trust and Estate Administration Expenses* (Mar. 28, 2019), revenue.ky.gov.

[822] Ky. Rev. Stat. Ann. § 141.020(4), § 141.030(1); 103 Ky. Admin. Regs. 19:010(6).

[823] Instructions to 2020 Ky. Form 741 at 3. *See* Ky. Rev. Stat. Ann.

ISBN 978-1-63359-383-1

Practice Tip: Kentucky and non-Kentucky testators and trustors should be cautious about appointing Kentucky resident trustees because the state taxes on this basis.

As shown in Worksheet 3, the potential tax saving for a Kentucky Resident Trust on a $1 million long-term capital gain incurred in 2020 was at least $50,000.[824] As shown in Worksheet 4, the net tax cost of including $1 million of long-term capital gain in DNI for a Kentucky resident individual rather than taxing the gain to a trust that was structured to escape tax in 2020 was $15,747.[825]

6. Michigan (Michigan Income Tax)

In Michigan, a trustee of a Resident Trust must file a return if the trustee must file a federal return or if the trust has Michigan taxable income; a trustee of a Nonresident Trust must file a return if the trust has more than $300 of Michigan-source taxable income in the case of a trust that distributes income currently or $100 of such income in the case of all other trusts.[826]

Michigan treats a trust as a grantor trust if the trust is classified as a grantor trust under § 671–§ 679,[827] and the Great Lakes State authorizes trustees of nongrantor trusts to take a distribution deduction.[828] In 2020, Michigan taxed the Michigan taxable income of nongrantor trusts at 4.25%,[829] and the 4.25% rate is not scheduled to change before 2023.[830]

Michigan defines ''Resident Trust'' as follows:[831]

> Any trust created by will of a decedent who at his death was domiciled in this state and any trust created by, or consisting of property of, a person domiciled in this state, at the time the trust becomes irrevocable.

A ''Nonresident Trust'' is a trust that is not a ''Resident Trust.''[832]

Michigan taxes all taxable income of Resident Trusts,[833] except for income allocable to other states,[834] but taxes only Michigan-source income of Nonresident Trusts.[835] In Michigan, trustees must make estimated tax payments for trusts.[836]

Reflecting the *Blue v. Department of Treasury*[837] decision, Michigan recognizes an exception for an Exempt Resident Trust. Hence, Michigan fiduciary income tax return instructions expand upon the circumstances in which Michigan will not tax trust income as follows:[838]

> Michigan cannot impose an income tax on income accumulated by a trust that became irrevocable by the death of the settlor (while a Michigan resident) when *all* of the following conditions are met:
>
> - The trustee is not a Michigan resident.
> - The assets of the trust are neither held, located, nor administered in Michigan.
> - The beneficiaries are all nonresidents.

A CRT generally is exempt from federal income tax.[839] As a result, it usually also is exempt from Michigan income tax pursuant to the following statute:[840]

> (1) A person who is exempt from federal income tax pursuant to the provisions of the internal revenue code shall be exempt from the tax imposed by this part except the unrelated taxable business income of an exempt person as determined under the internal revenue code.
>
> (2) Nothing in this section shall exempt a person from the withholding and information return provisions of this part.

The instructions to the Michigan fiduciary income tax return provide the following exception to the tax return filing requirements:[841]

> Tax-exempt trusts unless the trust has unrelated business income attributable to Michigan.

Note: Estates or trusts with a charitable purpose or charitable beneficiaries should contact the Michigan Department of Attorney General, Charitable Trust Section at 517-373-1152 regarding filing requirements.

The trustee of a nongrantor trust created by a Michigan domiciliary might consider taking the position that the trust is not subject to Michigan income tax if it has no Michigan trustee, asset, or source income even if some beneficiaries live in the state.[842]

---

§ 141.305.

[824] For an explanation of how this figure was derived, see I.B.3., above.

[825] For an explanation of how this figure was derived, see I.B.4., above.

[826] Instructions to 2020 MI-1041 at 2. *See* Mich. Comp. Laws § 206.315(1). *See also* Mich. Dep't of Treasury, Rev. Admin. Bull. 2016-20, *Issuance of Bulletins, Letter Rulings, and Other Guidance for Taxpayers* (Oct. 5, 2016), www.michigan.gov/documents/treasury. *See* Mich. Dep't of Treasury, Rev. Admin. Bull. 2020-22, *Part 1: Income Tax—Tax Exempt Status of Income From United States Obligations for Individuals and Fiduciaries* (Dec. 15, 2020), www.michigan.gov/taxes; Michigan Dep't of Treasury, Admin. Bull. 2015-15, *Taxability of Income to Estates, Trusts or Beneficiaries* (Aug. 2015), www.michigan.gov/. *See also* Lynn A. Gandhi, *Michigan's Taxation of Estates, Trusts, and Beneficiaries*, 78 State Tax Notes 609 (Nov. 23, 2015).

[827] Mich. Comp. Laws § 206.51(6). The tax return instructions erroneously refer to § 671–§ 678 (instructions to 2020 MI-1041 at 2).

[828] *See* Mich. Comp. Laws § 206.36(1).

[829] Mich. Comp. Laws § 206.16, § 206.51(1)(b); 2020 MI-1041 at 1.

[830] *See* Mich. Comp. Laws § 206.51(1)(c).

[831] Mich. Comp. Laws § 206.18(1)(c). *See* instructions to 2020 MI-1041 at 3. For Michigan income-tax purposes, an individual is a ''resident'' if the individual is domiciled in Michigan or if the individual spends more than 183 days in the state during the taxable year (Mich. Comp. Laws § 206.18(1)(a); Mich. Admin. Code R. 206.5). Given that trust taxation is based on the testator's or trustor's domicile, the second test in the foregoing definition does not come into play.

[832] Mich. Comp. Laws § 206.14(3); instructions to 2020 MI-1041 at 2.

[833] Mich. Comp. Laws § 206.36(1), § 206.51(1), § 206.110(1).

[834] Mich. Comp. Laws § 206.111–§ 206.115.

[835] Mich. Comp. Laws § 206.51(7), § 206.57(7)–§ 206.110(4). *See* instructions to 2020 MI-1041 at 2.

[836] Mich. Comp. Laws § 206.16, § 206.301(1); instructions to 2020 MI-1041 at 3.

[837] 462 N.W.2d 762 (Mich. Ct. App. 1990). *See* III.B.7., above.

[838] Instructions to 2020 MI-1041 at 2 (emphasis in original).

[839] § 664(c)(1).

[840] Mich. Comp. Laws § 206.201. *See* Mich. Comp. Laws § 206.16.

[841] Instructions to 2020 MI-1041 at 2.

[842] *See* III.A.–III.E., above.

ISBN 978-1-63359-383-1

As shown in Worksheet 3, the potential tax saving for a Michigan Resident Trust on a $1 million long-term capital gain incurred in 2020 was $42,496.[843] As shown in Worksheet 4, the net tax cost of including $1 million of long-term capital gain in DNI for a Michigan resident individual rather than taxing the gain to a trust that was structured to escape tax in 2020 was $8,177.[844]

Practice Tip: Domiciliaries of other states might consider establishing trusts in Michigan because it does not tax trusts created by nondomiciliaries except on source income.

7. Minnesota (Minnesota Income Tax)

In Minnesota, a trustee must file a return if the trust has $600 or more of gross income assignable to Minnesota or if the trust has a nonresident alien beneficiary.[845]

Minnesota treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes under § 671–§ 679;[846] the North Star State permits trustees of nongrantor trusts to take a distribution deduction.[847] In 2020, Minnesota taxed the Minnesota taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 9.85% (the 9.85% rate applied starting with $136,735 of such income).[848] In 2021, Minnesota taxes such income using the same rate schedule and the 9.85% rate applies starting at $138,100 of such income.[849]

In Minnesota, the definition of ''Resident Trust'' depends on when the trust became irrevocable or was first administered in the state. For a trust that became irrevocable or was first administered in Minnesota *after* 1995, ''Resident Trust'' is defined as follows:[850]

> (a) Resident trust means a trust, except a grantor type trust, which either (1) was created by a will of a decedent who at death was domiciled in this state or (2) is an irrevocable trust, the grantor of which was domiciled in this state at the time the trust became irrevocable. For the purpose of this subdivision, a trust is considered irrevocable to the extent the grantor is not treated as the owner thereof under sections 671 to 678 of the Internal Revenue Code. The term ''grantor type trust'' means a trust where the income or gains of the trust are taxable to the grantor or others treated as substantial owners under sections 671 to 678 of the Internal Revenue Code. This paragraph applies to trusts, except grantor type trusts, that became irrevocable after December 31, 1995, or are first administered in Minnesota after December 31, 1995.

For a trust that became irrevocable or was first administered in Minnesota *before* 1996, ''Resident Trust'' is defined as follows:[851]

> (b) This paragraph applies to trusts, except grantor type trusts, that are not governed under paragraph (a). A trust, except a grantor type trust, is a resident trust only if two or more of the following conditions are satisfied:
>
> (1) a majority of the discretionary decisions of the trustees relative to the investment of trust assets are made in Minnesota;
>
> (2) a majority of the discretionary decisions of the trustees relative to the distributions of trust income and principal are made in Minnesota;
>
> (3) the official books and records of the trust, consisting of the original minutes of trustee meetings and the original trust instruments, are located in Minnesota.
>
> (c) For purposes of paragraph (b), if the trustees delegate decisions and actions to an agent or custodian, the actions and decisions of the agent or custodian must not be taken into account in determining whether the trust is administered in Minnesota, if:
>
> (1) the delegation was permitted under the trust agreement;
>
> (2) the trustees retain the power to revoke the delegation on reasonable notice; and
>
> (3) the trustees monitor and evaluate the performance of the agent or custodian on a regular basis as is reasonably determined by the trustees.

Whereas Minnesota taxes all Minnesota taxable income of Resident Trusts,[852] it taxes Nonresident Trusts only on such income from Minnesota sources.[853] In Minnesota, trustees must make estimated tax payments for trusts.[854]

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

Practice Tip: Trustees paying tax by reason of administration in Minnesota should consider changing the place of administration with the hope of escaping Minnesota tax.

843 For an explanation of how this figure was derived, see I.B.3., above.

844 For an explanation of how this figure was derived, see I.B.4., above.

845 Instructions to 2020 Minn. Form M2 at 1. *See* Minn. Stat. § 289A.08 Subd. 2(a). *See also* Minn. Dep't of Revenue, Tax Research Div., *Minnesota Tax Handbook* at 1 (Jan. 2021), www.revenue.state.mn.us.

846 *See* Minn. Stat. § 290.01 Subd. 29, § 290.014 Subd. 1.

847 *See* Minn. Stat. § 290.03(3).

848 Minn. Stat. § 290.06 Subd. 2c, 2d; instructions to 2020 Minn. Form M2 at 18. Minnesota Dep't of Revenue News Release, *Tax Year 2020 Inflation-Adjusted Amounts in Minnesota Statutes* (Dec. 13, 2019), www.revenue.state.mn.us.

849 Minn. Stat. § 290.06 Subd. 2c, 2d; Minnesota Dep't of Revenue News Release, *Minnesota Income Tax Brackets, Standard Deduction and Dependent Exemption Amount for 2021* (Dec. 14, 2020), www.revenue.state.mn.us.

850 Minn. Stat. § 290.01 Subd. 7b(a). *See* instructions to 2020 Minn. Form M2 at 1-2. For Minnesota income-tax purposes, an individual is a ''resident,'' with certain exceptions, if the individual is domiciled in Minnesota or if the individual maintains a place of abode and spends more than half the tax year in the state (Minn. Stat. § 290.01 Subd. 7; Minn. R. § 8001.0300-1). Given that trust taxation is based on the testator's or trustor's domicile, the second test in the foregoing definition does not come into play. *See* Minn. Dep't of Revenue, Income Tax Fact Sheet 1, *Residency* (Jan. 2021), www.revenue.state.mn.us. In *Fielding v. Comm'r of Revenue* (916 N.W.2d 323 (Minn. 2018)) the Supreme Court of Minnesota held that imposition of tax on the trustee of four inter vivos trusts would violate the Due Process Clause of the U.S. Constitution in the circumstances presented. *See* III.D.4., above.

851 Minn. Stat. § 290.01 Subd. 7b(b)-7b(c). *See* instructions to 2020 Minn. Form M2 at 2.

852 Minn. Stat. § 290.01 Subd. § 29, 290.06 Subd. 2c, 290.014 Subd. 3.

853 Minn. Stat. § 290.014 Subd. 3, § 290.17, § 290.191, § 290.20. *See* Minn. Dep't of Revenue, Income Tax Fact Sheet 3, *Nonresidents* (Jan. 2021), www.revenue.state.mn.us.

854 Minn. Stat. § 289A.25 Subd. 1; instructions to 2020 Minn. Form M2 at 2.

ISBN 978-1-63359-383-1

In addition, based on *Fielding v. Commissioner of Revenue*[855] and cases decided under similar statutes of other states,[856] trustees of testamentary and irrevocable inter vivos trusts created by Minnesota domiciliaries might take the position that Minnesota cannot tax if a trust has no Minnesota trustee, asset, or source income. The Minnesota Department of Revenue has announced that requests to treat Resident Trusts as Nonresident Trusts based on *Fielding* may be filed electronically and has given the following guidance:[857]

> Trust must file Schedule M2RT if both of these apply:
>
> - The trust meets the statutory definition of a resident trust
> - The trust may not have sufficient minimum connections to Minnesota for due process purposes
>
> These trusts must check both the Statutory Resident and Due Process Nonresident checkboxes on Form M2, Minnesota Income Tax for Estates and Trusts. They must also include Schedule M2RT.

Schedule M2RT is in Worksheet 2. As shown in Worksheet 3, the potential tax saving for a Minnesota Resident Trust on a $1 million long-term capital gain incurred in 2020 was at least $94,648.[858] As shown in Worksheet 4, the net tax cost of including $1 million of long-term capital gain in DNI for a Minnesota resident individual rather than taxing the gain to a trust that was structured to escape tax in 2020 was $58,793.[859]

Practice Tip: Domiciliaries of other states might consider establishing trusts in Minnesota because it no longer taxes new trusts created by nondomiciliaries except on source income.

Trustees of inter vivos trusts should keep in mind that, for Minnesota purposes, a trust is not ''irrevocable'' as long as it is treated as a grantor trust under § 671–§ 678.[860] As a result, such a trust will not be a Minnesota Resident Trust if the trustor ceases to be a Minnesota domiciliary before the trust ceases to be a grantor trust. But, a trust will be a Minnesota Resident Trust if a trustor creates a grantor trust while a nondomiciliary if the trust ceases to be a grantor trust after the trustor moves to Minnesota.

8. *Missouri (Missouri Income Tax)*

In Missouri, a trustee of a Resident Trust must file a return if such trustee must file a federal Form 1041; a trustee of a Nonresident Trust must file a return if the trust has any Missouri-source taxable income or Missouri-source gross income of $600 or more.[861]

Missouri treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[862] and the Show-Me State permits trustees of nongrantor trusts to take a distribution deduction.[863] In 2020, Missouri taxed the Missouri taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 5.40% (the 5.40% rate applied starting with such income over $8,584),[864] and the top rate will decrease in 2021 and later years if specified revenue targets are met.[865]

Missouri defines ''Resident Trust'' as follows:[866]

> (2) A trust that:
>
> (a) Was created by will of a decedent who at his or her death was domiciled in this state; and
>
> (b) Has at least one income beneficiary who, on the last day of the taxable year, was a resident of this state; or
>
> (3) A trust that:
>
> (a) Was created by, or consisting of property of, a person domiciled in this state on the date the trust or portion of the trust became irrevocable; and
>
> (b) Has at least one income beneficiary who, on the last day of the taxable year, was a resident of this state.

For Missouri income-tax purposes, an individual is a ''Resident'' if the individual is domiciled in Missouri (with limited exceptions) or if the individual maintains a permanent place of abode and spends more than 183 days in the state during the tax year.[867] A ''Nonresident Trust'' is a trust that is not a ''Resident Trust.''[868]

Missouri taxes all Missouri taxable income of Resident Trusts[869] but only taxes Missouri-source taxable income of Nonresident Trusts.[870] In Missouri, trustees are not required to make estimated tax payments for trusts.[871]

A CRT generally is exempt from federal income tax.[872] Consequently, it usually also is exempt from Missouri income tax under the following statute:[873]

> A trust or other unincorporated organization which by reason of its purposes and activities is exempt from federal income tax shall be exempt from the tax imposed by sections 143.011 to 143.996. The preceding sentence shall not apply to unrelated business taxable income and other income on which Chapter 1 of the Internal Revenue Code imposes the federal income tax or any other tax measured by income.

The trustee of a CRT does not file a federal fiduciary income-tax return — Form 1041. Instead, such a trustee files a

---

[855] 916 N.W.2d 323 (Minn. 2018). *See* III.D.4., above.
[856] *See* III.A.–III.E., above.
[857] *See* Minn. Dep't of Revenue, *Law Change FAQs for Tax Year 2020* (Oct. 2020), www.revenue.state.mn.us.
[858] For an explanation of how this figure was derived, see I.B.3., above.
[859] For an explanation of how this figure was derived, see I.B.4., above.
[860] Minn. Stat. § 290.01 Subd. 7b(a)(2); instructions to 2020 Minn. Form M2 at 1.
[861] Mo. Rev. Stat. § 143.481; instructions to 2020 Form MO-1041 at 4.
[862] *See* Mo. Rev. Stat. § 143.121.
[863] *See* Mo. Rev. Stat. § 143.341.
[864] Mo. Rev. Stat. § 143.011(1)–§ 143.011(4), § 143.061; instructions to 2020 Form MO-1041 at 11. *See* Missouri Dep't of Revenue, *2020 Tax Chart* (Feb. 2021), www.dor.mo.gov.
[865] Mo. Rev. Stat. § 143.011(2).
[866] Mo. Rev. Stat. § 143.331(2)–§ 143.331(3). *See* instructions to 2020 Form MO-1041 at 4.
[867] Mo. Rev. Stat. § 143.101(1).
[868] Mo. Rev. Stat. § 143.371.
[869] Mo. Rev. Stat. § 143.311, § 143.341.
[870] Mo. Rev. Stat. § 143.311, § 143.381.
[871] Mo. Rev. Stat. § 143.521.
[872] § 664(c)(1).
[873] Mo. Rev. Stat. § 143.321.

ISBN 978-1-63359-383-1

Split-Interest Trust Information Return—Form 5227. Given that a trustee must file a Missouri return only if such trustee must file a federal Form 1041,[874] the trustee of a CRT arguably does not have to file a Missouri return. But, the prudent course is for such a trustee to file a Missouri fiduciary income tax return — Form MO-1041.

No case or ruling addresses whether the trustee of a trust created by a Missouri domiciliary testator or trustor that has minimal ties to Missouri still must pay tax under the statute quoted above.[875] But, the trustee of a nongrantor trust created by a Missouri domiciliary might consider taking the position that the trust is not subject to Missouri income tax if it has no Missouri trustee, asset, or source income.[876] The addition of the requirement that a trust have a current resident income beneficiary should not bolster Missouri's ability to tax.[877]

As shown in Worksheet 3, the potential tax saving for the trustee of a Missouri Resident Trust on a $1 million long-term capital gain incurred in 2020 was at least $53,810.[878] As shown in Worksheet 4, the net tax cost of including $1 million of long-term capital gain in DNI for a Missouri resident individual rather than taxing the gain to a trust that was structured to escape tax in 2020 was $19,025.[879]

Practice Tip: Domiciliaries of other states might consider establishing trusts in Missouri because it does not tax trusts created by nondomiciliaries except on source income.

9. Nebraska (Nebraska Income Tax)

In Nebraska, a trustee of a Resident Trust (other than a simple trust in certain circumstances) must file a return if such trustee must file a federal return; a trustee of a Nonresident Trust must file a return if such trustee must file a federal return and if the trust has Nebraska-source income.[880]

Nebraska treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[881] and the Cornhusker State permits trustees of nongrantor trusts to take a distribution deduction.[882] In 2020, Nebraska taxed the Nebraska taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 6.84% (the 6.84% rate applied starting with such income over $16,580),[883] and the current rate schedule, adjusted for inflation, is not scheduled to change.[884] Nebraska defines ''Resident Trust'' as follows:[885]

> Resident . . . trust shall mean . . . (b) a trust or portion of a trust consisting of property transferred by the will of a decedent who at his or her death was domiciled in this state, or (c) a trust or portion of a trust consisting of the property of an individual domiciled in this state at the time such individual may no longer exercise the power to revest title to such property in himself or herself. . . .

A trust becomes irrevocable when the person whose property constitutes such trust can no longer revest title in himself or herself.[886]

A ''Nonresident Trust'' is a trust that is not a ''Resident Trust.''[887]

The following criteria are not germane in determining the residency status of a trust:

- The designation of Nebraska or another state's law to resolve trust questions
- The residence of the trustee
- The residence of a beneficiary
- The situs of the trust.[888]

Nebraska taxes all Nebraska taxable income of Resident Trusts[889] but only Nebraska-source taxable income of Nonresident Trusts.[890] Whereas Nebraska trustees are not required to make estimated tax payments for trusts,[891] they must withhold tax from distributions to nonresident beneficiaries in certain circumstances.[892]

A CRT generally is exempt from federal income tax.[893] As a result, it usually also is exempt from Nebraska income tax in accordance with the following regulation:[894]

> A trust which, by reason of its purposes or activities, is exempt from federal income tax, is also exempt from Nebraska income tax except as to unrelated business taxable income.

---

[874] Mo. Rev. Stat. § 143.481(3), § 143.481(5); instructions to 2020 Form MO-1041 at 4.

[875] *See Westfall v. Dir. of Revenue*, 812 S.W.2d 513 (Mo. 1991); *In re Swift*, 727 S.W.2d 880 (Mo. 1987). *See also* III.B.8., and III.B.6., respectively, above. Following *Swift* and *Westfall*, Missouri revised the definition of ''Resident Trust'' to be as shown above.

[876] *See* III.A.–III.E., above.

[877] *See* III.A.9., above.

[878] For an explanation of how this figure was derived, see I.B.3., above.

[879] For an explanation of how this figure was derived, see I.B.4., above.

[880] Instructions to 2020 Neb. Form 1041N at 6. *See* Neb. Rev. Stat. § 77-2717(2); Neb. Admin. R. & Regs. 316-23-009.

[881] *See* Neb. Rev. Stat. § 77-2761(3)–§ 77-2761(4), § 77-2715(2)(b). The tax return instructions erroneously refer to § 671–§ 678 (instructions to 2020 Neb. Form 1041N at 7).

[882] *See* Neb. Rev. Stat. § 77-2717(1)(a)(ii).

[883] Neb. Rev. Stat. § 77-2715.03(2), § 77-2715.03(3)(b)(ii), § 77-2717(1)(a)(ii); instructions to 2020 Neb. Form 1041N at 8. For Nebraska income-tax rates from 1993 to 2021, see *Nebraska Tax Rate Chronologies* (Rev. Jan. 2021), www.revenue.nebraska.gov.

[884] Neb. Rev. Stat. § 77-2715.03(2), § 77-2715.03(3)(b)(ii).

[885] Neb. Rev. Stat. § 77-2714.01(6). *See* Neb. Admin. R. & Regs. 316-23-001; instructions to 2020 Neb. Form 1041N at 7. For the meaning of ''domicile,'' see Neb. Admin. Code 316-23-002.02. For income-tax purposes an individual is a ''resident'' if the individual is domiciled in Nebraska or if the individual maintains a permanent place of abode and spends more than six months during the tax year in Nebraska (Neb. Rev. Stat. § 77-2714.01(7)). Given that taxation is based on the testator's or trustor's domicile, the second test in the foregoing definition does not come into play. *See* Nebraska Dep't of Revenue Information Guide, *Determining Residency Status for Nebraska Individual Income Tax Filing* (May 2019), www.revenue.nebraska.gov.

[886] Neb. Admin. R. & Regs. 316-23-001.02.

[887] Neb. Rev. Stat. § 77-2714.01(3); Neb. Admin. R. & Regs. 316-23-002.

[888] Neb. Admin. R. & Regs. 316-23-001.05, 316-23-002.03, 316-23-002.04; instructions to 2020 Neb. Form 1041N at 7.

[889] Neb. Rev. Stat. § 77-2717(1)(a)(ii); Neb. Admin. R. & Regs. 316-23-004.01.

[890] Neb. Rev. Stat. § 77-2717(1)(b); Neb. Admin. R. & Regs. 316-23-004.02.

[891] Instructions to 2020 Neb. Form 1041N at 3.

[892] Neb. Rev. Stat. § 77-2717(5).

[893] § 664(c)(1).

[894] Neb. Admin. R. & Regs. 316-23-003.02. *See* instructions to 2020 Neb. Form 1041N at 6.

ISBN 978-1-63359-383-1

The instructions to the Nebraska fiduciary income tax return give the following guidance on the filing of tax returns:[895]

> A trust, which by reason of its purposes and activities is exempt from federal income tax, is also exempt from Nebraska income tax. However, exempt trusts filing an Exempt Organization Business Income Tax Return, Federal Form 990-T, to report unrelated business income must file a Nebraska return and pay tax to Nebraska.
>
> . . . If the federal tax was computed at the fiduciary rates, the fiduciary must file a Form 1041N.

No case or ruling addresses whether the trustee of a trust created by a Nebraska testator or trustor that has minimal ties to Nebraska still must pay tax. Moreover, a regulation stipulates that:[896]

> If the settlor of a trust is domiciled in Nebraska when the trust becomes irrevocable, the trust will be considered a resident trust for the entire life of the trust. Such a trust is a resident trust even though the situs of the trust, the property held in trust, or the trustee are located in another state.

The trustee of a nongrantor trust created by a Nebraska resident may nevertheless consider taking the position that the trust is not subject to Nebraska income tax if it has no Nebraska trustee, assets, or source income.[897]

As shown in Worksheet 3, the potential tax saving for a Nebraska Resident Trust on a $1 million long-term capital gain incurred in 2020 was at least $68,007.[898] As shown in Worksheet 4, the net tax cost of including $1 million of long-term capital gain in DNI for a Nebraska resident individual rather than taxing the gain in a Nebraska trust that was structured to escape tax in 2020 was $32,749.[899]

Practice Tip: Domiciliaries of other states might consider establishing trusts in Nebraska because it does not tax trusts created by nondomiciliaries except on source income.

10. North Dakota (North Dakota Income Tax)

In North Dakota, a trustee of a Resident Trust must file a North Dakota return if such trustee must file a federal return; a trustee of a Nonresident Trust must file a North Dakota return if such trustee must file a federal return and if the trust has North Dakota-source gross income.[900]

North Dakota treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[901] and the Peace Garden State permits trustees of nongrantor trusts to take a distribution deduction.[902] In 2020, North Dakota taxed the North Dakota taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 2.90% (the 2.90% rate applied starting with such income over $13,175),[903] and the current rate schedule, adjusted for inflation, is not scheduled to change.[904]

North Dakota defines "Resident Trust" as follows:[905]

> A trust . . . is a resident trust . . . when it has a relationship to the state sufficient to create nexus. This includes, but is not limited to, the following contacts:
>
> a. A beneficiary of the trust . . . is a domiciliary or resident of this state.
>
> b. The trustee . . . is a domiciliary or resident of this state.
>
> c. Assets making up any part of the trust . . . have situs in this state.
>
> d. Any or all of the administration or income production of the trust . . . takes place within this state.
>
> e. The laws of this state are specifically made applicable to the trust . . . or to the opposite parties with respect to their fiduciary relationship.
>
> f. The trust is a revocable trust, and the grantor is a domiciliary or resident of this state.

In North Dakota, an individual is a resident for tax purposes if the individual is domiciled in the state or if the individual maintains a permanent place of abode and spends more than seven months of the income tax year within the state.[906] A "Nonresident Trust" is a trust that is not a "Resident Trust."[907]

North Dakota taxes all taxable income of Resident Trusts[908] but only North Dakota-source taxable income of Nonresident Trusts.[909] In North Dakota, trustees must make estimated tax payments for trusts[910] and must withhold tax on distributions to nonresident beneficiaries in certain circumstances.[911]

A CRT generally is exempt from federal income tax.[912] Consequently, it usually also is exempt from North Dakota income tax pursuant to the following statute:[913]

> 1. A person or organization exempt from federal income taxation under the provisions of the Internal Revenue Code of 1954, as amended, is also exempt

[895] Instructions to 2020 Neb. Form 1041N at 6.

[896] Neb. Admin. R. & Regs. 316-23-001.03. *See* instructions to 2020 Neb. Form 1041N at 7.

[897] *See* III.A.–III.E., above.

[898] For an explanation of how this figure was derived, see I.B.3., above.

[899] For an explanation of how this figure was derived, see I.B.4., above.

[900] Instructions to 2020 N.D. Form 38 at 2. *See* N.D. Cent. Code § 57-38-07, § 57-38-31(1); N.D. Admin. Code § 81-03-02.1-04(1). *See also* N.D. Office of State Tax Comm'r, *FAQ Topics: Fiduciary Income Tax* (Jan. 2021), www.nd.gov/tax.

[901] *See* N.D. Cent. Code § 57-38-01(13), § 57-38-30.3(1); instructions to 2020 N.D. Form 38 at 2.

[902] *See* N.D. Cent. Code § 57-38-01(13), § 57-38-30.3(1).

[903] N.D. Cent. Code § 57-38-30.3(1)(e), § 57-38-30.3(g), § 57-38-07; 2020 N.D. Form 38 at 2.

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

[905] N.D. Admin. Code 81-03-02.1-04(2). *See* instructions to 2020 N.D. Form 38 at 2.

[906] N.D. Cent. Code § 57-38-01(11).

[907] N.D. Admin. Code 81-03-02.1-04(4); instructions to 2020 N.D. Form 38 at 2.

[908] N.D. Cent. Code § 57-38-01(13), § 57-38-30.3(1), § 57-38-30.3(2).

[909] N.D. Cent. Code § 57-38-01(13), § 57-38-30.3(1)(f), § 57-38-30.3(2); instructions to 2020 N.D. Form 38 at 2.

[910] N.D. Cent. Code § 57-38-62; N.D. Admin. Code 81-03-04-02; instructions to 2020 N.D. Form 38 at 3.

[911] Instructions to 2020 N.D. Form 38 at 3.

[912] § 664(c)(1).

[913] N.D. Cent. Code § 57-38-09(1)–§ 57-38-09(2).

ISBN 978-1-63359-383-1

> from the tax imposed by this chapter in each year such person or organization satisfies the requirements of the Internal Revenue Code of 1954, as amended, for exemption from federal income taxation. If the exemption applicable to any person or organization under the provisions of the Internal Revenue Code of 1954, as amended, is limited or qualified in any manner, the exemption from taxes imposed by this section must be limited or qualified in a similar manner.
>
> 2. Notwithstanding the provisions of subsection 1, the unrelated business taxable income, as computed under the provisions of the Internal Revenue Code of 1954, as amended, of any person or organization otherwise exempt from the tax imposed by this chapter and subject to the tax imposed on unrelated business income by the Internal Revenue Code of 1954, as amended, is subject to the tax which would have been imposed by this chapter but for the provisions of subsection 1.

The instructions to the North Dakota fiduciary income tax return provide the following guidance (which might or might not apply to CRTs because it refers to § 501) as to the filing of tax returns by tax-exempt trusts:[914]

> A fiduciary for a trust that is tax-exempt under Internal Revenue Code § 501(a) must file a 2020 Form 38 if (1) the fiduciary is required to file a 2020 Form 1041 or Form 990-T to report the trust's unrelated business taxable income, (2) the federal income tax is calculated using the tax rates applicable to a trust, and (3) the unrelated business taxable income is reportable to North Dakota. The unrelated business taxable income is reportable to North Dakota if the trust is a North Dakota resident trust or, in the case of a nonresident trust, the unrelated business taxable income has a source in North Dakota.

Practice Tip: North Dakota and non-North Dakota testators and trustors often should be able to escape taxation by North Dakota by minimizing the North Dakota contacts listed above.

As shown in Worksheet 3, the potential tax saving for the trustee of a North Dakota Resident Trust on a $1 million long-term capital gain incurred in 2020 was at least $17,287.[915] As shown in Worksheet 4, the tax saving from including $1 million of long-term capital gain in DNI for a North Dakota resident individual rather than taxing the gain to a trust that was structured to escape tax in 2020 was $19,577.[916]

11. Ohio (Ohio Income Tax)

In Ohio, a trustee of a Resident Trust must file an Ohio return; a trustee of a Nonresident Trust must file an Ohio return if the trust has Ohio source income.[917]

Ohio treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[918] and the Buckeye State allows trustees of nongrantor trusts to take a distribution deduction.[919] In 2020, Ohio taxed the modified Ohio taxable income of nongrantor trusts at rates up to 4.797% (the 4.797% rate applied starting with such income over $221,300,[920] and the current rate schedule, adjusted for inflation, is not scheduled to change.[921]

Ohio does define ''Resident Trust,''[922] but the provision is hard to decipher. The tax return instructions describe a ''Resident Trust'' as follows:[923]

> A ''resident'' trust is a trust in whole or in part that resides in this state. If the resident trust resides in part, it is only a resident with respect to that part. See R.C. 5747.01(I)(3) and information release IT 2003-02.
>
> . . .
>
> An irrevocable trust resides in Ohio if (i) at least one ''qualifying beneficiary'' (R.C. 5747.01(I)(3)(c)) is domiciled in Ohio for all or a portion of the trust's taxable year and (ii) at any time the trust received assets from one or more of the following:
>
> - An individual who was domiciled in Ohio for income tax purposes at the time he/she transferred assets to the trust OR
> - An individual who was domiciled in Ohio for income tax purposes at the time the trust document became irrevocable even if the individual was not domiciled in Ohio at the time he/she transferred the assets to the trust OR
> - An estate of an individual who at the time of death was domiciled in Ohio for estate tax purposes OR
> - An insurance company, pension plan or court award on account of the death of an individual, and at the time of the individual's death either (i) the individual was domiciled in Ohio for estate tax purposes or (ii) the owner of the insurance policy was domiciled in Ohio for income tax purposes.

---

[914] Instructions to 2020 N.D. Form 38 at 2.

[915] For an explanation of how this figure was derived, see I.B.3., above.

[916] For an explanation of how this figure was derived, see I.B.4., above.

[917] Instructions to 2020 Ohio Form IT 1041 at 6. *See* Ohio Rev. Code Ann. § 5747.08(C).

[918] *See* Ohio Rev. Code Ann. § 5747.01(A). *See also Knust v. Wilkins*, 856 N.E.2d 243, 249 (Ohio 2006) (''[C]onclusion that income earned by a grantor trust is taxable to the grantor rather than to the trust itself — even if the trust is an ESBT — is supported by the relevant federal statutes''). *Accord Brown v. Levin*, 894 N.E.2d 35 (Ohio 2008); *Lovell v. Levin*, 877 N.E.2d 667, 673 (Ohio 2007); *Renacci v. Testa*, 71 N.E.3d 962, 974 (Ohio 2016) (''[W]e . . . remand the cause to the tax commissioner with instructions that the double-interest penalty be refunded, along with any interest paid that was associated with that penalty.'').

[919] *See* Ohio Rev. Code Ann. § 5747.01(S), § 5747.02(A).

[920] Ohio Rev. Code Ann. § 5747.02(A)(3); instructions to 2020 Ohio Form IT 1041 at 9.

[921] Ohio Rev. Code Ann. § 5747.02(A)(3).

[922] Ohio Rev. Code Ann. § 5747.01(I)(3). For Ohio income-tax purposes, an individual usually is a ''resident'' if the individual is domiciled in the state (Ohio Rev. Code Ann. § 5747.01(I)(1)). *See* Ohio Dep't of Taxation Info. Release IT 2018-01, *Residency Guidelines-Tax Imposed on Resident and Nonresident Individuals for Taxable Years 2018 and Forward* (Aug. 31, 2018), www.tax.ohio.gov.

[923] Instructions to 2020 Ohio Form IT 1041 at 8. For a more detailed description of Ohio Resident Trusts (including examples), see Ohio Dep't of Tax'n Info. Release, Trust 2003-02, *Trust Residency*, 2003 OH Tax Info. Releases Lexis 29 (reissued Dec. 2017).

ISBN 978-1-63359-383-1

Note: The list above is not all-inclusive. For additional information, see R.C. 5747.01(I)(3)(a), (e) and (f).

The tax return instructions specify that a trust's residency "is not determined based on the location of either the trustee or the administration of the trust's assets."[924]

As shown above, Ohio taxes an irrevocable inter vivos trust only if a "qualifying beneficiary is domiciled in Ohio for all or a portion of the trust's taxable year." An Ohio statute provides that "qualifying beneficiary" generally "has the same meaning as 'potential current beneficiary' as defined in section 1361(e)(2) of the Internal Revenue Code,"[925] which, in turn, says that:[926]

> [T]he term "potential current beneficiary" means, with respect to any period, any person who at any time during such period is entitled to, or at the discretion of any person may receive, a distribution from the principal or income of the trust (determined without regard to any power of appointment to the extent such power remains unexercised at the end of such period).

A "Nonresident Trust" is a trust that is not a "Resident Trust."[927] In *T. Ryan Legg Irrevocable Trust v. Testa*[928] (2016), the Supreme Court of Ohio found that an irrevocable inter vivos trust established by an Ohio resident trustor was a nonresident trust for the following reason:[929]

> The BTA correctly found that Legg was an Ohio resident when he transferred the Logistics shares to the trust, and he was an Ohio resident and a beneficiary during 2006. But the BTA failed to consider the additional requirement that some person qualify as a "potential current beneficiary." This would require the trust terms to have permitted a distribution to a beneficiary during 2006, which under the trust terms was part of the "initial period." At the BTA and again before this court, the trust points to section 2.1(a)(1) of the trust agreement, which required the trustee to accumulate income during the initial period, that is, during all of 2006.

Whereas Ohio taxes modified Ohio taxable income of Resident Trusts,[930] it taxes Nonresident Trusts only on such income from Ohio sources.[931] In Ohio, trustees must make estimated tax payments for trusts.[932]

The Ohio income tax does not apply to CRTs under the following statute:[933]

> For the purposes of this section, "trust" means any trust described in Subchapter J of Chapter 1 of the Internal Revenue Code, excluding . . . charitable remainder trusts . . .

The instructions to the Ohio fiduciary income tax return specify that:[934]

> "Trust" is specifically defined to include any trust described in IRC § 641–§ 685 that is not one of the following trusts: . . .
>
> • Charitable remainder trusts . . .
>
> See R.C. 5747.02(A)(1) and (2), 5747.02(D), 5747.01(S), and 5747.01(AA).

The trustee of a nongrantor trust created by an Ohio domiciliary might consider taking the position that the trust is not subject to Ohio income tax if it has no Ohio trustee, assets, or source income even if, in the case of an inter vivos trust, a beneficiary lives in the state.[935] In this regard, the decision of the U.S. Supreme Court in *North Carolina Department of Revenue v. The Kimberley Rice Kaestner 1992 Family Trust*[936] confirms that the presence of resident beneficiaries does not validate a state's taxation of a nonresident trustee; however, the holding of *Kaestner* was quite limited.

As shown in Worksheet 3, the potential tax saving for an Ohio Resident Trust on a $1 million long-term capital gain incurred in 2020 was at least $49,493.[937] As shown in Worksheet 4, the net tax cost of including $1 million of long-term capital gain in DNI for an Ohio resident individual rather than taxing the gain to a trust that was structured to escape tax in 2020 was $11,285.[938]

Practice Tip: Domiciliaries of other states might consider establishing trusts in Ohio because it does not tax trusts created by nondomiciliaries except on source income.

Trustees of inter vivos trusts should keep in mind that for Ohio purposes, a trust is not "irrevocable" as long as it is

---

[924] Instructions to 2020 Ohio Form IT 1041 at 3.

[925] Ohio Rev. Code Ann. § 5747.01(I)(3)(c). *See T. Ryan Legg Irrev. Trust v. Testa*, 75 N.E.3d 184, 199 (Ohio 2016) (in absence of qualifying beneficiary, the trust must be taxed as a nonresident trust).

[926] § 1361(e)(2).

[927] *See* Ohio Rev. Code Ann. § 5747.01(I)(3).

[928] 75 N.E.3d 184 (Ohio 2016). *See* Michael A. Sneeringer, *Did the Supreme Court's Legg Denial Just Kick the Can Down the Road?* 42 Tax Mgmt. Est., Gifts & Tr. J. 319 (Nov. 9, 2017); William P. LaPiana, *Ohio Fiduciary Income Tax Held to Be Constitutional*, 44 Est. Plan. 46 (June 2017); Mark A. Engel, *Nonresident Trust Taxed on Capital Gain in Ohio*, 83 State Tax Notes 925 (Mar. 13, 2017); Brian Bardwell, *Ohio Supreme Court Upholds Capital Gains Assessment Against Trust*, 2017 State Tax Today 1-7 (Jan. 3, 2017).

[929] *Legg*, 75 N.E.3d 184, 196.

[930] Ohio Rev. Code Ann. § 5747.01(S), § 5747.02(A), § 5747.02(D)(1). *See* instructions to 2020 Ohio Form IT 1041 at 6, 8. For a parsing of the categories of income, see *T. Ryan Legg Irrev. Trust v. Testa*, 75 N.E.3d 184, 193 (Ohio 2016). *See also* Ohio Dep't of Tax'n Info. Release IT 2001-03, *Nexus Standards & Filing Safe Harbors for Trusts & Estates* (reissued Feb. 15, 2018), www.tax.ohio.gov; Ohio Info. Rel. IT 2001-02, *Nexus Standards & Filing Safe Harbors for Pass-Through Entities* (reissued Feb. 15, 2018), www.tax.ohio.gov; Ohio Info. Rel. IT 2001-01, *Nexus Standards & Filing Safe Harbors for Individuals* (reissued Feb. 15, 2018), www.tax.ohio.gov.

[931] Ohio Rev. Code Ann. § 5747.01(AA), § 5747.02(A), § 5747.02(C)(1). *See* instructions to 2020 Ohio Form IT 1041 at 6. *See also Giddens v. Testa*, 72 N.E.3d 642, 645 (Ohio 2016) (dividend attributable to income earned while business was C corporation but later paid when business was S corporation was nonbusiness income); *Corrigan v. Testa*, 73 N.E.3d 381 (Ohio 2016) (capital gain incurred by nonresident on sale of LLC interest not Ohio-source income). *See* Ohio Dep't of Taxation IT 2016-01, *Guidance Relating to an Equity Investor's Apportionment of a Gain from the Sale of a Closely-Held Business* (reissued Feb. 1, 2019), www.tax.ohio.gov. For analysis of the *Giddens* case, see Robert Willens, *Ohio Court Holds S Corporation Dividends Constitute Non-Business Income*, Daily Tax Rpt., Feb. 6, 2017, at J-1.

[932] Ohio Rev. Code Ann. § 5747.09; instructions to 2020 Ohio Form IT 1041 at 7.

[933] Ohio Rev. Code Ann. § 5747.02(D).

[934] Instructions to 2020 Ohio Form IT 1041 at 6.

[935] *See* III.A.–III.E., above.

[936] 139 S. Ct. 2213 (2019). *See* III.A.9., above.

[937] For an explanation of how this figure was derived, see I.B.3., above.

[938] For an explanation of how this figure was derived, see I.B.4., above.

ISBN 978-1-63359-383-1

treated as a grantor trust under § 671–§ 678, not § 679.[939] As a result, such a trust might not be an Ohio Resident Trust if the trustor ceases to be an Ohio domiciliary before the trust ceases to be a grantor trust. But, a trust will be an Ohio Resident Trust if a trustor creates a grantor trust while a nondomiciliary if the trust ceases to be a grantor trust after he or she moves to Ohio.

12. South Dakota

South Dakota (the Mount Rushmore State) does not impose an income tax on individuals or fiduciaries. The following provision of the South Dakota Constitution would allow the state to enact one: ''[t]he Legislature is empowered to impose taxes upon income and occupations, and taxes upon incomes may be graduated and progressive and reasonable exemptions may be provided.''[940] However, the author is not aware of ongoing efforts to adopt such a tax.

13. West Virginia (West Virginia Personal Income Tax)

In West Virginia, a trustee of a Resident Trust must file a return if such trustee must file a federal return or if the trust has West Virginia-source taxable income; a trustee of a Nonresident Trust must file a return if the trust has West Virginia-source income.[941]

West Virginia treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[942] and the Mountain State permits trustees of nongrantor trusts to take a distribution deduction.[943] In 2020, West Virginia taxed the West Virginia taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 6.50% (the 6.50% rate applied starting with such income over $60,000),[944] and the current rate schedule is not scheduled to change.[945]

West Virginia defines ''Resident Trust'' as follows:[946]

A resident . . . trust means: . . .

> (2) A trust created by will of a decedent who at his death was domiciled in this State, or
>
> (3) A trust created by, or consisting of property of, a person domiciled in this State.

The residence of the fiduciary is irrelevant in determining whether a trust is a Resident Trust or a Nonresident Trust.[947] A ''Nonresident Trust'' is a trust that is not a ''Resident Trust.''[948]

West Virginia taxes all taxable income of Resident Trusts,[949] but only West Virginia-source taxable income of Nonresident Trusts.[950] Whereas West Virginia trustees are not required to make estimated tax payments for trusts[951] they must withhold tax from distributions to nonresident beneficiaries in certain circumstances.[952]

A CRT generally is exempt from federal income tax.[953] Consequently, it usually also is exempt from West Virginia income tax in accordance with the following statute:[954]

> 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 income tax on unrelated business taxable income).

No case or ruling addresses whether the trustee of a trust created by a West Virginia testator or trustor that has minimal ties to West Virginia still must pay tax, but the trustee of a nongrantor trust created by a West Virginia domiciliary might consider taking the position that the trust is not subject to West Virginia income tax if it has no West Virginia trustee, asset, or source income.[955]

As shown in Worksheet 3, the potential tax saving for a West Virginia Resident Trust on a $1 million long-term capital gain incurred in 2020 was at least $63,836.[956] As shown in Worksheet 4, the net tax cost of including $1 million of long-term capital gain in DNI for a West Virginia resident individual rather than taxing the gain to a trust that was structured to escape tax in 2020 was $29,624.[957]

Practice Tip: Domiciliaries of other states might consider establishing trusts in West Virginia because the state does not tax trusts created by nondomiciliaries except on source income.

14. Wisconsin (Wisconsin Income Tax)

In Wisconsin, a trustee of a Resident Trust must file a return if the trust has taxable income or gross income of $600 or more; a trustee of a Nonresident Trust must file a return if the trust has taxable income or gross income from Wisconsin sources of $600 or more.[958]

---

[939] Ohio Rev. Code Ann. § 5747.01(I)(3)(b).

[940] S.D. Const. art. 11, § 2.

[941] Instructions to 2020 W. Va. Form IT-141 at 2. *See* W. Va. Code § 11-21-51(a)(2); W. Va. Code St. R. § 110-21-51.1(2).

[942] *See* W. Va. Code § 11-21-4e(a), § 11-21-11, § 11-21-12.

[943] *See* W. Va. Code § 11-21-4e(a), § 11-21-18.

[944] W. Va. Code § 11-21-4e(a); W. Va. Code R. § 110-21-4; instructions to 2020 W. Va. Form IT-141 at 8.

[945] W. Va. Code § 11-21-4e(a).

[946] W. Va. Code § 11-21-7(c). *See* W. Va. Code St. R. § 110-21-7.3; instructions to 2020 W. Va. Form IT-141 at 2. For West Virginia income-tax purposes, an individual is a ''resident,'' with certain exceptions, if the individual is domiciled in West Virginia or if the individual maintains a permanent place of abode and spends more than 183 days in the state during the taxable year (W. Va. Code § 11-27-7(a)). Given that taxation is based on the testator's or trustor's domicile, the second test in the foregoing definition does not come into play.

[947] Instructions to 2020 W. Va. Form IT-141 at 2.

[948] W. Va. Code § 11-21-7(d); W. Va. Code R. § 110-21-7.4.

[949] W. Va. Code § 11-21-18; W. Va. Code R. § 110-21-18.

[950] W. Va. Code § 11-21-38; W. Va. Code R. § 110-21-38.

[951] W. Va. Code R. § 110-21-55.1.6.

[952] W. Va. Code § 11-21-71a(a).

[953] § 664(c)(1).

[954] W. Va. Code § 11-21-3(d).

[955] *See* III.A.–III.E., above.

[956] For an explanation of how this figure was derived, see I.B.3., above.

[957] For an explanation of how this figure was derived, see I.B.4., above.

[958] Instructions to 2020 Wis. Form 2 at 2. *See* Wis. Stat. § 71.13(1). *See also* Wis. Dep't of Revenue Pub. 106, *Wisconsin Tax Information for Retirees* at 3 (Dec. 2020), www.revenue.wi.gov; Wis. Dep't of Revenue Pub. 103, *Reporting Capital Gains and Losses for Wisconsin by Individuals, Estates, and Trusts* (Dec. 2020), www.revenue.wi.gov; Wis. Dep't of Revenue Pub. 125, *Credit for Tax Paid to Another State* (Dec. 2020), www.revenue.wi.gov. *See John J. and*

ISBN 978-1-63359-383-1

Wisconsin treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes.[959] The Badger State permits trustees of nongrantor trusts to take a distribution deduction.[960] In 2020, Wisconsin taxed the taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 7.65% (the 7.65% rate applied starting with $263,480 of such income).[961] In 2021 and later years, Wisconsin will tax such income using the same rate schedule, but the brackets are to be adjusted for inflation.[962]

Wisconsin classifies a trust as a ''Resident Trust'' in three circumstances. First, for a testamentary trust, whenever created, Wisconsin law provides:[963]

> (2) A trust created at death by will, contract, declaration of trust or implication of law by a decedent who at the time of death was a resident of this state shall be considered resident at the domicile of the decedent at the time of the decedent's death until transferred by the court having jurisdiction under s. 72.27 to another court's jurisdiction. After jurisdiction is transferred, the trust shall be considered resident at the place to which jurisdiction is transferred. The hearing to transfer jurisdiction shall be held only after giving written notice to the department of revenue under s. 879.05.

Second, for inter vivos trusts that became irrevocable or were first administered in Wisconsin before October 29, 1999, it provides:[964]

> (3) Except as provided in sub. (2) and s. 71.04(1)(b)2., trusts created by contract, declaration of trust or implication of law that are made irrevocable and were administered in this state before October 29, 1999, shall be considered resident at the place where the trust is being administered. The following trusts shall be considered to be administered in the state of domicile of the corporate trustee of the trust at any time that the grantor of the trust is not a resident of this state:
>
> > (a) Trusts that have any assets invested in a common trust fund, as defined in section 584 of the internal revenue code, maintained by a bank or trust company domiciled in this state that is a member of the same affiliated group, as defined in section 1504 of the internal revenue code, as the corporate trustee.
> >
> > (b) Trusts the assets of which in whole or in part are managed, or about which investment decisions are made, by a corporation domiciled in this state if that corporation and the corporate trustee are members of the same affiliated group, as defined in section 1504 of the internal revenue code.

Third, for irrevocable inter vivos trusts that became irrevocable or were first administered in Wisconsin on or after October 29, 1999, Wisconsin law says:[965]

> (3m)(a) Subject to par. (b) and except as provided in sub. (2) and s. 71.04(1)(b)2., only the following trusts, or portions of trusts, that become irrevocable on or after October 29, 1999, or that became irrevocable before October 29, 1999, and are first administered in this state on or after October 29, 1999, are resident of this state:
>
> > 1. Trusts, or portions of trusts, the assets of which consist of property placed in the trust by a person who is a resident of this state at the time that the property was placed in the trust if, at the time that the assets were placed in the trust, the trust was irrevocable.
> >
> > 2. Trusts, or portions of trusts, the assets of which consist of property placed in the trust by a person who is a resident of this state at the time that the trust became irrevocable if, at the time that the property was placed in the trust, the trust was revocable.
>
> (b) A trust described under par. (a):
>
> > 1. Is revocable if the person whose property constitutes the trust may revest title to the property in that person.
> >
> > 2. Is irrevocable if the power to revest title, as described in subd. 1., does not exist.

Under the first and second tests, classification of a trust as a resident trust is a function of the testator's or a corporate trustee's ''domicile,''[966] respectively. While the third test is based on a trustor's ''residence'' that term is determined by domicile as follows:[967]

> Every natural person domiciled in the state shall be deemed to be residing within the state for the purposes of determining liability for income taxes and surtaxes.

A ''Nonresident Trust'' is a trust that is not a ''Resident Trust.''[968]

Dixie R. Poehling v. Wis. Dep't of Revenue, Wis. Admin. Dec. 15-I-179, Wis. Admin. Dec. 15-I-180, Wis. Admin. Dec. 15-I-153-SC, 2017 WL 5317442 (Wis. Tax. App. Com. Oct. 25, 2017) (trust beneficiary's Wisconsin income tax liability confirmed).

[959] Wis. Stat. § 71.04(1)(b)(2), § 71.17(4).

[960] *See* Wis. Stat. § 71.122.

[961] Wis. Stat. § 71.06(1q), § 71.06(2e)(b), § 71.125. *See* instructions to 2020 Wis. Form 2 at 19; Wis. Dep't of Revenue Pub. 106, *Wisconsin Tax Information for Retirees* at 6 (Dec. 2020), www.revenue.wi.gov.

[962] Wis. Stat. § 71.06(1q), § 71.06(2e)(b).

[963] Wis. Stat. § 71.14(2). *See* instructions to 2020 Wisc. Form 2 at 1.

[964] Wis. Stat. § 71.14(3). *See* instructions to 2020 Wis. Form 2 at 1. *See also Wis. Dep't of Tax'n v. Pabst*, 112 N.W.2d 161 (Wis. 1961) (trust not administered in Wisconsin). *Contra Pabst v. Wis. Dep't of Tax'n*, 120 N.W.2d 77 (Wis. 1963) (trust administered in Wisconsin). *See* III.F.2.–III.F.3., above.

[965] Wis. Stat. § 71.14(3m). *See* instructions to 2020 Wis. Form 2 at 1.

[966] *See* Wis. Stat. § 71.01(1n) ('' 'domicile' means an individual's true, fixed, and permanent home where the individual intends to remain permanently and indefinitely and to which, whenever absent, the individual intends to return, except that no individual may have more than one domicile at any time''). *See* Mark J. Perry, Badger Institute, *Leaving Illinois for Wisconsin*, 93 Tax Notes State 733 (June 2019), www.badgerinstitute.org.

[967] Wis. Stat. § 71.02(1). *See* Wis. Dep't of Revenue Pub. 122, *Tax Information for Part-Year Residents and Nonresidents of Wisconsin for 2020* (Dec. 2020), www.revenue.wi.gov; Wis. Dep't. of Revenue Pub. 121, *Reciprocity* (Dec. 2020), www.revenue.wi.gov.

[968] *See* Wis. Stat. § 71.14(2), § 71.14(3), § 71.14(3m).

ISBN 978-1-63359-383-1

Whereas Wisconsin taxes all taxable income of Resident Trusts,[969] it taxes Nonresident Trusts only on such income from Wisconsin sources.[970] In Wisconsin, trustees must make estimated tax payments for trusts and must withhold tax from payments to nonresident beneficiaries.[971]

CRTs are exempt from Wisconsin income tax except on their unrelated business taxable income as follows:[972]

> If you are required to file a federal Form 5227 for a charitable remainder trust, you are not required to file a Wisconsin tax return. However, if the charitable remainder trust has at least $1,000 of Wisconsin sourced gross income from an unrelated trade or business, the charitable remainder trust is required to file a Wisconsin Form 4T.

Trustees of testamentary trusts should analyze whether they should change the situs of the trust as described above in order to escape Wisconsin tax. In addition, trustees paying tax by reason of administration in Wisconsin should consider changing the place of administration for the same reason. Finally, trustees of irrevocable inter vivos trusts reasonably may take the position that Wisconsin cannot tax if a trust has no Wisconsin trustee, asset, or source income.[973]

As shown in Worksheet 3, the potential tax saving for a Wisconsin Resident Trust on a $1 million long-term capital gain incurred in 2020 was at least $49,836.[974] As shown in Worksheet 4, the net tax cost of including $1 million of long-term capital gain in DNI for a Wisconsin resident individual rather than taxing the gain to a trust that was structured to escape tax in 2020 was $15,219.[975]

Practice Tip: Domiciliaries of other states might consider creating trusts in Wisconsin because it no longer taxes new trusts created by nondomiciliaries except on source income.

E. West (Other Than California)

1. Alaska

Alaska (the Last Frontier) does not impose an income tax on individuals or fiduciaries. The following provision of the Alaska Constitution does allow the state to enact one: ''The power of taxation shall never be surrendered.''[976] Nevertheless, a statute prohibits the income taxation of individuals and fiduciaries,[977] and the author is not aware of efforts to adopt such a tax.

2. Arizona (Arizona Income Tax)

In Arizona, a trustee must file a return if the trust has Arizona taxable income or gross income of $5,000 or over.[978]

Arizona treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[979] and the Grand Canyon State permits trustees of nongrantor trusts to take a distribution deduction.[980] In 2020, Arizona taxed the taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 4.50% (the highest rate applied starting with such income over $163,632)[981] and, given that the voters approved a 2020 ballot initiative,[982] the top rate increased by 3.50% to 8.00% in 2021 and later years on trust income above $250,000.[983] Lower tax brackets are adjusted for starting in 2020.[984]

Arizona defines ''Resident Trust'' as follows:[985]

> ''Resident trust'' means a trust of which the fiduciary is a resident of this state. If a trust has more than one fiduciary, the trust is a resident trust if at least one of the fiduciaries is a resident of this state. If a corporate fiduciary engaged in interstate trust administration is the sole fiduciary of a trust, or is a cofiduciary with a nonresident, the trust is a resident trust only if the corporate fiduciary conducts the administration of the trust in this state.

An individual is a resident if the individual is in Arizona for other than a temporary or transitory purpose or if the individual is domiciled in the state and is presumed to be a resident if the individual spends more than nine months in the state during the tax year.[986] A ''Nonresident Trust'' is a trust that is not a ''Resident Trust.''[987]

Arizona taxes all Arizona taxable income of Resident Trusts[988] but only Arizona-source taxable income of Nonresident Trusts.[989] In Arizona, trustees may — but are not required to — make estimated tax payments for trusts.[990]

The instructions for the Arizona fiduciary income tax return give trustees of CRTs the following guidance:[991]

> Charitable remainder trusts should file on Form 141AZ. The fiduciary should indicate that the return is for a charitable remainder trust by checking the appropriate box on line 6.

---

[969] Wis. Stat. § 71.02(1), § 71.04(1)(a).
[970] Wis. Stat. § 71.02(1), § 71.04(1)(a), § 71.04(4).
[971] Wis. Stat. § 71.09(2). *See* instructions to 2020 Wis. Form 2 at 3, 8-9.
[972] Instructions to 2020 Wis. Form 2 at 2.
[973] *See* III.A–III.E., above.
[974] For an explanation of how this figure was derived, see I.B.3., above.
[975] For an explanation of how this figure was derived, see I.B.4., above.
[976] Alaska Const. art. IX, § 1.
[977] Alaska Stat. § 43.20.012(a).
[978] Ariz. Rev. Stat. § 43-304(A)(4), § 43-304(A)(5); instructions to 2020 Ariz. Form 141AZ at 2. *See generally* Ariz. Dep't of Revenue Pub. 10, *Summary of Arizona Taxes* (Aug. 13, 2020), azdor.gov.
[979] *See* Ariz. Rev. Stat. § 43-1001(2), § 43-1001(11), § 43-1011, § 43-1301; instructions to 2020 Ariz. Form 141AZ at 3.
[980] *See* Ariz. Rev. Stat. § 43-1301.
[981] Ariz. Rev. Stat. § 43-1011(A)(6)(a), § 43-1311(B); instructions to 2020 Ariz. Form 141AZ at 20. *See* Ariz. Dep't of Revenue, *Key Changes to 2020 Tax Year Individual Income Tax Returns* (Jan. 22, 2021), www.azdor.gov.
[982] Ariz. Proposition 208 (Nov. 3, 2020). *See* Billy Hamilton, *The Underwhelming Results of This Year's Tax Ballot Measures,* 98 Tax Notes State 847 (Nov, 23, 2020); Paul Jones, *California, Alaska, and Illinois Voters Reject Tax Increases,* 98 Tax Notes State 634 (Nov. 9, 2020).
[983] Ariz. Rev. Stat. § 43-1013, § 43-1011(A).
[984] Ariz. Rev. Stat. § 43-1011(D).
[985] Ariz. Rev. Stat. § 43-1301(5). *See* instructions to 2020 Ariz. Form 141AZ at 1.
[986] Ariz. Rev. Stat. § 43-104(19).
[987] Ariz. Rev. Stat. § 43-1301(3); instructions to 2020 Ariz. Form 141AZ at 1.
[988] Ariz. Rev. Stat. § 43-1001(11), § 43-1301, § 43-1331, § 43-1332; Instructions to 2020 Ariz. Form 141AZ at 1.
[989] Ariz. Rev. Stat. § 43-1001(11), § 43-1091, § 43-1301, § 43-1331, § 43-1332.
[990] Instructions to 2020 Ariz. Form 141AZ at 4.
[991] Instructions to 2020 Ariz. Form 141AZ at 3.

ISBN 978-1-63359-383-1

> The trustee should not enter any numerical figures on the face of the return. Go directly to signature line. The trustee should not complete a Form 141AZ Schedule K-1 or Schedule K-1(NR) for any of its beneficiaries.

Practice Tip: Arizona residents and nonresident should be cautious about appointing Arizona resident individual and corporate trustees because the state taxes trusts on this basis.

As shown in Worksheet 3, the potential tax saving for an Arizona Resident Trust on a $1 million long-term capital gain incurred in 2020 was at least $43,799.[992] As shown in Worksheet 4, the net tax cost of including $1 million of long-term capital gain in DNI for an Arizona resident individual rather than taxing the gain to a trust that was structured to escape tax in 2020 was $9,124.[993]

3. *Colorado (Colorado Income Tax)*

In Colorado, a trustee of a Resident Trust must file a return if such trustee must file a federal return or if the trust has Colorado tax liability; a trustee of a Nonresident Trust must file a return if the trust has Colorado-source income and if such trustee must file a federal return or has Colorado tax liability.[994]

Colorado treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[995] and the Centennial State permits trustees of nongrantor trusts to take a distribution deduction.[996] In 2020, Colorado taxed the Colorado taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at 4.55%,[997] and that rate is not scheduled to change.[998] Colorado also imposes an alternative minimum tax equal to the excess of 3.47% of Colorado alternative minimum taxable income over the tax computed under the preceding sentence.[999]

Colorado defines ‘‘Resident Trust'' as ‘‘a trust which is administered in this state.''[1000] The term ‘‘administered in this state'' is not defined. A ‘‘Nonresident Trust'' is a trust that is not a ‘‘Resident Trust.''[1001]

Colorado taxes Resident Trusts on all Colorado taxable income[1002] (a credit is available for trusts that are classified as Resident Trusts by Colorado and one or more other states[1003]) but taxes Nonresident Trusts only on such income from Colorado sources.[1004] In Colorado, trustees may — but are not required to — make estimated tax payments for trusts[1005] and must withhold tax on distributions to nonresident beneficiaries of income from Colorado real and tangible personal property in certain circumstances.[1006]

A CRT generally is exempt from federal income tax.[1007] It therefore usually also is exempt from Colorado income tax under the following statute:[1008]

> (1) A person or organization exempt from federal income taxation under the provisions of the internal revenue code shall also be exempt from the tax imposed by this article in each year in which such person or organization satisfies the requirements of the internal revenue code for exemption from federal income taxation. . . . If the exemption applicable to any person or organization under the provisions of the internal revenue code is limited or qualified in any manner, the exemption from taxes imposed by this article shall be limited or qualified in a similar manner.
>
> (2) Notwithstanding the provisions of subsection (1) of this section to the contrary, the unrelated business taxable income, as computed under the provisions of the internal revenue code, of any person or organization otherwise exempt from the tax imposed by this article and subject to the tax imposed on unrelated business income by the internal revenue code shall be subject to the tax which would have been imposed by this article but for the provisions of subsection (1) of this section.

The instructions to the Colorado fiduciary income tax return provide trustees of CRTs with the following filing guidelines:[1009]

> Any . . . trust that is required to file a federal information return (such as the 5227 or 1041A) must also file DR 0105 with Colorado. Complete the appropriate schedules to provide beneficiary and income information.

Practice Tip: Colorado and non-Colorado testators and trustors should be cautious about creating trusts in Colorado because the state taxes trusts administered there.

---

992 For an explanation of how this figure was derived, see I.B.3., above.

993 For an explanation of how this figure was derived, see I.B.4., above.

994 Colo. Rev. Stat. § 39-22-601(3)(b); instructions to 2020 Colo. Form 105 at 3.

995 *See* Colo. Rev. Stat. § 39-22-104(1.7).

996 *See* Colo. Rev. Stat. § 39-22-401.

997 Colo. Rev. Stat. § 39-22-104(1.7)(b); Colo. Proposition 116 (Nov. 3, 2020), www.leg.colorado.gov; Governor of Colo. Executive Order D-2020-302, *Declaration of Vote on Proposition 116—State Income Tax Rate Reduction* (Dec. 31, 2020), covid19.colorado.gov/public-health-executive-orders; instructions to 2020 Colo. Form 105 at 4; 2020 Colo. Form 105 at 1. *See* Billy Hamilton, *The Underwhelming Results of This Year's Tax Ballot Measures,* 98 Tax Notes State 847 (Nov. 23 2020); Paul Jones, *California, Alaska, and Illinois Voters Reject Tax Increases,* 98 Tax Notes State 634 (Nov. 9, 2020).

998 Colo. Rev. Stat. § 39-22-104(1.7)(b).

999 Colo. Rev. Stat. § 39-22-105(1.5), § 39-22-105(2)(a), § 39-22-105(3)(b), § 39-22-105(4). *See* instructions to 2020 Colo. Form 105 at 8.

1000 Colo. Rev. Stat. § 39-22-103(10). *See* instructions to 2020 Colo. Form 105 at 3. For Colorado income-tax purposes, an individual is a ‘‘resident,'' with certain exceptions, if the individual is domiciled in Colorado or if the individual maintains a permanent place of abode and spends more than six months in the state during the taxable year (Colo. Rev. Stat. § 39-22-103(8)(a)). Given that trust taxation is based on the place of administration, the foregoing definition does not come into play.

1001 Colo. Rev. Stat. § 39-22-103(10). *See* instructions to 2020 Colo. Form 105 at 3.

1002 Colo. Rev. Stat. § 39-22-401.

1003 Colo. Rev. Stat. § 39-22-108.5. *See* instructions to 2020 Colo. Form 105 at 7-8.

1004 Colo. Rev. Stat. § 39-22-403, § 39-22-404. *See* Colo. Dep't of Revenue, *Income Tax Topics: Part-Year Residents and Nonresidents* (Jan. 2021), www.tax.colorado.gov. *See also* Colo. Dep't of Revenue GIL 20-004, *Apportionment of Income Arising From Restricted Stock Units* (Dec. 18, 2020), www.tax.colorado.gov (income earned on vesting date of restricted stock sourced to Colorado based upon number of work days in Colorado during period employee was required to work for employer before vesting date).

1005 Instructions to 2020 Colo. Form 105 at 3.

1006 Colo. Rev. Stat. § 39-22-601.

1007 § 664(c)(1).

1008 Colo. Rev. Stat. § 39-22-112. *See* Colo. Rev. Stat. § 39-22-103(11); § 7701(a)(1).

1009 Instructions to 2020 Colo. Form 105 at 3.

ISBN 978-1-63359-383-1

As shown in Worksheet 3, the potential tax saving for a Colorado Resident Trust on a $1 million long-term capital gain incurred in 2020 was $45,495.[1010] As shown in Worksheet 4, the net tax cost of including $1 million of long-term capital gain in DNI for a Colorado resident individual rather than taxing the gain to a trust that was structured to escape tax in 2020 was $10,815.[1011]

4. Hawaii (Hawaii Income Tax)

In Hawaii, a trustee of a Resident Trust must file a return if the trust has taxable income or gross income of $400 or more; a trustee of a Nonresident Trust must file a return if the trust has gross income of $400 or more (part or all of which is from Hawaii sources) and if a beneficiary is a Hawaii resident or is treated as a substantial owner.[1012]

Hawaii treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[1013] and the Aloha State permits trustees of nongrantor trusts to take a distribution deduction.[1014] In 2020, Hawaii taxed the taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 8.25%.[1015] The 8.25% rate applied to such income over $40,000.[1016] The current rate schedule for trusts is not scheduled to change.[1017]

Hawaii defines ''Resident Trust'' as follows:[1018]

> [R]esident trust means a trust of which the fiduciary is a resident of the State or the administration of which is carried on in the State.

For these purposes, an individual is a ''resident'' if the individual is domiciled in Hawaii or if the individual is in Hawaii for other than a temporary or transitory purpose (every individual who spends more than 200 days in Hawaii during a tax year is presumed to be a resident).[1019] No guidance is provided on when a corporate fiduciary is a resident or on when administration is taking place in the state. A ''Nonresident Trust'' is a trust that is not a ''Resident Trust.''[1020]

Hawaii taxes all taxable income of Resident Trusts[1021] but only Hawaii-source taxable income of Nonresident Trusts.[1022] In Hawaii, trustees must make estimated tax payments for trusts[1023] and must withhold tax from distributions to nonresident beneficiaries in certain circumstances.[1024]

Importantly, Hawaii allows Resident Trusts to exclude taxable income attributable to nonresidents as follows:[1025]

> There shall be excluded from gross income any intangible income, such as dividends and interest, earned by a trust sited in this State to the extent that, during the taxable year of the trust, the beneficial interest in the trust shall be held by a beneficiary or beneficiaries residing outside this State.

Hawaii does not stipulate whether unknown or unascertained beneficiaries are deemed to be residents.

The instructions to the Hawaii fiduciary income tax return give trustees of CRTs the following guidance:[1026]

> The trustee of a charitable remainder trust shall file a Hawaii Form N-40, showing the revenues and expenses of the trust and no tax liability for the trust. Compute the taxable income and enter the amount on line 15 on page 1 as an adjustment to result in no taxable income on line 22. Schedules K-1 are to be attached to the Form N-40.

Practice Tip: Hawaii and non-Hawaii testators and trustors should be cautious about appointing Hawaii fiduciaries or establishing administration in Hawaii if the trust has resident beneficiaries because the trust will be taxable in these circumstances.

As shown in Worksheet 3, the potential tax saving for a Hawaii Resident Trust on a $1 million long-term capital gain incurred in 2020 was at least $72,172.[1027] As shown in Worksheet 4, the net tax cost of including $1 million of long-term capital gain in DNI for a Hawaii resident individual rather than taxing the gain to a trust that was structured to escape tax in 2020 was $37,753.[1028]

Practice Tip: If a trust will not have Hawaii resident beneficiaries, Hawaii and non-Hawaii testators and trustors might consider appointing a Hawaii fiduciary or having the trust administered in Hawaii.

5. Idaho (Idaho Income Tax)

In Idaho, a trustee of a Resident Trust must file a return if such trustee must file a federal return and if the trust has gross income of $100 or more; a trustee of a Nonresident Trust must file a return if such trust must file a federal return and if the trust has Idaho-source gross income of $100 or more.[1029]

[1010] For an explanation of how this figure was derived, see I.B.3., above.

[1011] For an explanation of how this figure was derived, see I.B.4., above.

[1012] Instructions to 2020 Haw. Form N-40 at 1. *See* Haw. Rev. Stat. § 235-92(3); Haw. Admin. Rules § 18-235-94.

[1013] Haw. Rev. Stat. § 235-4(e)(2). *See* Haw. Admin. Rules § 18-235-4-06(b)(3); instructions to 2020 Haw. Form N-40 at 3. The instructions mistakenly just refer to § 671–§ 678. *See* Haw. Dep't of Taxation, Tax Info. Release No. 2020-04, *Tax Basis of Hawaii Real Property Upon the Death of a Spouse in a Community Property State* (Sept. 28, 2020), tax.hawaii.gov.

[1014] *See* Haw. Rev. Stat. § 235-1, § 235-2.3(a), § 235-2.45(a). *See* Haw. Admin. Rules § 18-235-4-01.

[1015] Haw. Rev. Stat. § 235-51(d); instructions to 2020 Haw. Form N-40 at 11.

[1016] Haw. Rev. Stat. § 235-51(d); instructions to 2020 Haw. Form N-40 at 11.

[1017] Haw. Rev. Stat. § 235-51(d). The 9.00%, 10.00%, and 11.00% rates that apply to high-income individual taxpayers do not extend to trusts.

[1018] Haw. Rev. Stat. § 235-1. *See* Haw. Admin. Rules § 18-235-1.17; instructions to 2020 Haw. Form N-40 at 1.

[1019] Haw. Rev. Stat. § 235-1; Haw. Admin. Rules § 18-235-1.01.

[1020] Haw. Rev. Stat. § 235-1.

[1021] Haw. Rev. Stat. § 235-4(e)(i); Haw. Admin. Rules § 18-235-4-06(e).

[1022] Haw. Rev. Stat. § 235-4(e)(i); Haw. Admin. Rules § 18-235-4-06(f), § 18-235-4-08.

[1023] Haw. Rev. Stat. § 235-97(a)(1); Haw. Admin. Rules § 18-235-97; instructions to 2020 Haw. Form N-40 at 2.

[1024] Haw. Rev. Stat. § 235-64.2; instructions to 2020 Haw. Form N-40 at 3-4. *See* Haw. Dep't of Tax'n Announcement No. 2019-08, *Delay in Implementing the Withholding of Taxes on Income of Nonresident Partners and Beneficiaries of Partnerships, Estates, and Trusts* (July 19, 2019), tax.hawaii.gov.

[1025] Haw. Rev. Stat. § 235-4.5(a). *See* Haw. Admin. Rules § 18-235-4-03.

[1026] Instructions to 2020 Haw. Form N-40 at 1.

[1027] For an explanation of how this figure was derived, see I.B.3., above.

[1028] For an explanation of how this figure was derived, see I.B.4., above.

[1029] Idaho Code § 63-3030(a)(7)–§ 63-3030(a)(8), § 63-3030(b).

ISBN 978-1-63359-383-1

Idaho treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[1030] and the Gem State permits trustees of nongrantor trusts to take a distribution deduction.[1031] In 2020, Idaho taxed the Idaho taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 6.925% (the 6.925% rate applied starting with such income over $11,760),[1032] and the current rate schedule, adjusted for inflation, is not scheduled to change.[1033]

Idaho defines ''Resident Trust'' as follows:[1034]

> A trust other than a qualified funeral trust is treated as a resident trust if three (3) or more of the following conditions exist:
>
> a. The domicile or residency of the grantor is in Idaho;
>
> b. The trust is governed by Idaho law;
>
> c. The trust has real or tangible personal property located in Idaho;
>
> d. The domicile or residency of a trustee is in Idaho;
>
> e. The administration of the trust takes place in Idaho. Administration of the trust includes conducting trust business, investing assets of the trust, making administrative decisions, record keeping and preparation and filing of tax returns.

In Idaho, an individual is a resident for tax purposes if the individual is domiciled in the state or if the individual maintains a place of abode and spends more than 270 days there during the taxable year.[1035] A ''Nonresident Trust'' is a trust that is not a ''Resident Trust.''[1036]

Idaho taxes trustees on all taxable income of Resident Trusts[1037] but only on Idaho-source taxable income of Nonresident Trusts.[1038] In Idaho, trustees may make estimated tax payments for trusts.[1039]

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

Practice Tip: Idaho and non-Idaho residents should consider structuring trusts so that they will not be classified as Resident Trusts.

As shown in Worksheet 3, the potential tax saving for an Idaho Resident Trust on a $1 million long-term capital gain incurred in 2020 was at least $68,973.[1040] As shown in Worksheet 4, the net tax cost of including $1 million of long-term capital gain in DNI for an Idaho resident individual rather than taxing the gain in a trust that was structured to escape tax in 2020 was $33,908.[1041]

6. Montana (Montana Individual Income Tax)

In Montana, the trustee of a Resident Trust must file a return if such trust has $2,560 or more of income during the taxable year; the trustee of a Nonresident Trust must file a return if such trust has Montana-source income or at least one Montana resident beneficiary and has $2,560 or more of income during the taxable year.[1042]

Montana treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[1043] and the Treasure State permits trustees of nongrantor trusts to take a distribution deduction.[1044] In 2020, Montana taxed the taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 6.90% (the 6.90% rate applied starting with such income over $18,700),[1045] and the current rate schedule, adjusted for inflation, is not scheduled to change.[1046]

Montana defines ''Resident Trust'' as follows:[1047]

> ''Resident trust'' means any trust that establishes a sufficient connection to Montana.
>
> Factors that may be considered to determine whether a trust established sufficient connection to Montana include, but are not limited to, the testator's, grantor's, settlor's, or creator's domicile; the location where the trust was created; the location of trust property; the beneficiaries' domicile; the trustees' domicile; and the location of the trust's administration.

Examples of Resident Trusts and a description of administration are provided.[1048] A ''Nonresident Trust'' is a trust that is not a ''Resident Trust.''[1049]

Montana taxes all taxable income of Resident Trusts,[1050] but only Montana-source taxable income of Nonresident

[1030] *See* Idaho Code § 63-3011B, § 63-3026.

[1031] *See* Idaho Code § 63-3011B, § 63-3026; instructions to 2020 Idaho Form 66 at 1.

[1032] Idaho Code § 63-3024(a); Idaho Regs. § 35.01.01.075.03(e); instructions to 2020 Idaho Form 66 at 8.

[1033] Idaho Code § 63-3024(a).

[1034] Idaho Regs. § 35.01.01.035.01. *See* Idaho Code § 63-3015.

[1035] Idaho Code § 63-3013(1).

[1036] *See* Idaho Regs. § 35.01.01.035.03.

[1037] Idaho Code § 63-3026.

[1038] Idaho Code § 63-3026A; Idaho Regs. § 35.01.01.261.

[1039] Instructions to 2020 Idaho Form 66 at 3.

[1040] For an explanation of how this figure was derived, see I.B.3., above.

[1041] For an explanation of how this figure was derived, see I.B.4., above.

[1042] Mont. Admin. R. 42.30.102; instructions to 2020 Mont. Form FID-3 at 18. *See* Mont. Code Ann. § 15-30-2603.

[1043] Mont. Admin. R. 42.30.102. *See* Mont. Code Ann. § 15-30-2110; Mont. Admin. R. 42.30.101(8); instructions to 2020 Mont. Form FID-3 at 23. Given that a Montana resident individual computes tax based on federal adjusted gross income (which covers all kinds of grantor-trust income) the narrow definition of grantor-trust income in Mont. Code Ann. § 15-30-2151(5) is not available.

[1044] Mont. Code Ann. § 15-30-2152(3).

[1045] Mont. Code Ann. § 15-30-2103(1)(g), § 15-30-2103(2); instructions to 2020 Mont. Form FID-3 at 3; 2020 Mont. Form FID-3 at 2.

[1046] Mont. Code Ann. § 15-30-2103(1)(g).

[1047] Mont. Admin. R. 42.30.101(16). *See* instructions to 2020 Mont. Form FID-3 at 18-19. In Montana, an individual is a resident for tax purpose if the individual is domiciled in the state or if the individual maintains a permanent place of abode in the state and has not established a residence elsewhere (Mont. Code Ann. § 15-30-2101(28)). Given that connection to Montana is based on ''domicile'' rather than ''residence,'' the second test in the foregoing sentence does not come into play.

[1048] Mont. Admin. R. 42.30.101(16); instructions to 2020 Mont. Form FID-3 at 19.

[1049] Instructions to 2020 Mont. Form FID-3 at 19.

[1050] Mont. Code Ann. § 15-30-2103, § 15-30-2153.

ISBN 978-1-63359-383-1

Trusts.[1051] In Montana, trustees must make estimated tax payments for trusts.[1052]

The instructions to the Montana fiduciary income tax return provide trustees of CRTs with the following guidance:[1053]

> Split-interest trusts described in IRC § 4947(a)(2), including charitable lead trusts and charitable remainder trusts described in IRC § 664 that meet the definition of a split-interest trust, file federal Form 5227.
>
> If filing for a split-interest trust, complete only the heading portion of Form FID-3 and mark the "Other" box. Do not show any dollar amounts on the form itself; show dollar amounts only on the supporting statement. Include the supporting statements for the form, along with a complete copy of the federal Form 5227.

Practice Tip: Montana and non-Montana testators and trustors should consider structuring trusts so they will not be classified as Resident Trusts.

As shown in Worksheet 3, the potential tax saving for a Montana Resident Trust on a $1 million long-term capital gain incurred in 2020 was at least $48,227.[1054] As shown in Worksheet 4, the net tax cost of including $1 million of long-term capital gain in DNI for a Montana resident individual rather than taxing the gain to a trust that was structured to escape tax in 2020 was $33,776.[1055]

7. Nevada

Nevada (the Silver State) does not impose an income tax on individuals or fiduciaries. The following provision of the Nevada Constitution prohibits the enactment of such a tax as follows: "[n]o income tax shall be levied upon the wages or personal income of natural persons."[1056]

8. New Mexico (New Mexico Income Tax)

In New Mexico, 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 return if such trustee must file a federal return and if the trust has New Mexico-source income.[1057]

New Mexico treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[1058] and the Land of Enchantment permits trustees of nongrantor trusts to take a distribution deduction.[1059] In 2020, New Mexico taxed the New Mexico taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 4.90% (the 4.90% rate applied starting with such income over $16,000),[1060] and the current rate schedule is not scheduled to change, except that, starting in 2021, a trustee's New Mexico taxable income over $210,000 will be taxed at 5.90%, provided that specified certifications are made.[1061]

New Mexico defines "Resident Trust" as follows:[1062]

> A trust is domiciled in New Mexico if the trustee is domiciled in New Mexico, or if the principal place from which the trust is managed or administered is in New Mexico.

A "Nonresident Trust" is a trust that is not a "Resident Trust."[1063]

New Mexico taxes all taxable income of Resident Trusts[1064] but only New Mexico-source taxable income of Nonresident Trusts.[1065] In New Mexico, trustees must make estimated tax payments for trusts[1066] and must withhold tax from distributions to nonresident beneficiaries in certain circumstances.[1067]

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

Practice Tip: New Mexico and non-New Mexico testators and trustors should be cautious about appointing New Mexico trustees and creating trusts that will be administered in New Mexico because the state taxes on these bases.

As shown in Worksheet 3, the potential tax saving for a New Mexico Resident Trust on a $1 million long-term capital gain incurred in 2020 was at least $29,116.[1068] As shown in Worksheet 4, the tax saving from including $1 million of long-term capital gain in DNI for a New Mexico resident individual rather than taxing the gain to a trust that was structured to escape tax in 2020 was $5,611.[1069]

9. Oregon (Oregon Personal Income Tax)

In Oregon, a trustee of a Resident Trust must file a return if such trustee must file a federal return; a trustee of a Nonresi-

[1051] Mont. Code Ann. § 15-30-2104, § 15-30-2153; Mont. Admin. R. 42.30.101(12); instructions to 2020 Mont. Form FID-3 at 24-25.

[1052] Mont. Code Ann. § 15-30-2512, § 15-30-2603; instructions to 2020 Mont. Form FID-3 at 22.

[1053] Instructions to 2020 Mont. Form FID-3 at 23. *See* Mont. Admin. R. 42.30.101(3).

[1054] For an explanation of how this figure was derived, see I.B.3., above.

[1055] For an explanation of how this figure was derived, see I.B.4., above.

[1056] Nev. Const. art X, § 1(9).

[1057] Instructions to 2020 N.M. Form FID-1 at 3. *See* N.M. Stat. Ann. § 7-2-2(I), § 7-2-12.

[1058] *See* N.M. Stat. Ann. § 7-2-2(B), § 7-2-2(N), § 7-2-3; instructions to 2020 N.M. Form FID-1 at 3.

[1059] *See* N.M. Stat. Ann. § 7-2-2(B), § 7-2-2(N), § 7-2-3.

[1060] N.M. Stat. Ann. § 7-2-7(C); instructions to 2020 N.M. Form FID-1 at 9.

[1061] N.M. Stat. Ann. § 7-2-7(C); N.M. Dep't of Taxation & Revenue Bull. B-300.20, *2021 Tax Year Personal Income Tax Brackets* (Dec. 18, 2020), www.tax.newmexico.gov.

[1062] Instructions to 2020 N.M Form FID-1 at 3. *See* N.M. Stat. Ann. § 7-2-2(I), § 7-2-2(S). For New Mexico income-tax purposes, an individual is a "resident" with certain exceptions, if the individual is domiciled in New Mexico or if the individual is physically present in the state for more than 184 days for the taxable year (N.M. Stat. Ann. § 7-2-2(S)). Given that taxation is based on the trustee's domicile, the second test in the foregoing definition does not come into play. No guidance is provided as to when a corporate trustee is domiciled in New Mexico or as to when a trust is "managed or administered" in the state.

[1063] Instructions to 2020 N.M. Form FID-1 at 3. *See* N.M. Stat. Ann. § 7-2-2(I), § 7-2-2(Q); N.M. Admin. Code § 3.3.3.7.

[1064] N.M. Stat. Ann. § 7-2-2(I), § 7-2-3; N.M. Admin. Code § 3.3.3.7.

[1065] N.M. Stat. Ann. § 7-2-2(I), § 7-2-3.

[1066] N.M. Stat. Ann. § 7-2-12.2(K).

[1067] Instructions to 2020 N.M. Form FID-1 at 3. *See* N.M. Stat. Ann. § 7-2-12.2(F).

[1068] For an explanation of how this figure was derived, see I.B.4., above.

[1069] For an explanation of how this figure was derived, see I.B.4., above.

ISBN 978-1-63359-383-1

dent Trust must file a return if the trust has $600 or more of Oregon source federal gross income.[1070]

Oregon treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[1071] and the Beaver State permits trustees of nongrantor trusts to take a distribution deduction.[1072] In 2020, Oregon taxed the taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 9.90% (the 9.90% rate applied starting with such income over $125,000),[1073] and the top 9.90% rate and the income level at which it applies are not scheduled to change.[1074]

Oregon defines ''Resident Trust'' as follows:[1075]

> ''Resident trust'' means a trust . . . of which the fiduciary is a resident of Oregon or the administration of which is carried on in Oregon. In the case of a fiduciary that is a corporate fiduciary engaged in interstate trust administration, the residence and place of administration of a trust both refer to the place where the majority of fiduciary decisions are made in administering the trust.

For Oregon income-tax purposes, an individual is a ''resident,'' subject to certain exceptions, if the individual is domiciled in Oregon or if the individual maintains a permanent place of abode and spends more than 200 days in the state during the taxable year.[1076] As directed by the legislature,[1077] the Oregon Department of Revenue issued the following guidance on when a trustee is administering a trust in Oregon:[1078]

> If the trustee is a corporate fiduciary engaged in interstate trust administration, the trust is considered to be a resident of Oregon and the place of administration for that trust is considered to be Oregon if the trustee conducts the major part of its administration of the trust in Oregon. In this context, ''administration'' relates to fiduciary decision making of the trust and not to the incidental execution of such decisions. Incidental functions include, but are not limited to, preparing tax returns, executing investment trades as directed by account officers and portfolio managers, preparing and mailing trust accountings, and issuing disbursements from trust accounts as directed by account officers.

A ''Nonresident Trust'' is a trust that is not a ''Resident Trust.''[1079]

Oregon taxes all taxable income of ''Resident Trusts''[1080] but only Oregon-source taxable income of ''Nonresident Trusts.''[1081] In Oregon, trustees are not required to make estimated tax payments for trusts.[1082]

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

Practice Tip: Oregon and non-Oregon testators and trustors should be cautious about creating trusts that name Oregon resident fiduciaries and/or that are to be administered in Oregon because the state taxes on these bases.

As shown in Worksheet 3, the potential tax saving for an Oregon Resident Trust on a $1 million long-term capital gain incurred in 2020 was at least $97,300.[1083] As shown in Worksheet 4, the net tax cost of including $1 million of long-term capital gain in DNI for an Oregon resident individual rather than taxing the gain to a trust that was structured to escape tax in 2020 was $62,960.[1084]

10. Utah (Utah Individual Income Tax)

In Utah, a trustee that has Utah-source income must file a return if such trustee must file a federal return.[1085]

Utah treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[1086] and the Beehive State permits trustees of nongrantor trusts to take a distribution deduction.[1087] In 2020, Utah taxed the Utah taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at 4.95%,[1088] and the current rate schedule is not scheduled to change.[1089]

Utah defines ''Resident Trust'' as follows:[1090]

> ''[R]esident trust'' means: . . .
>
> (ii) 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

[1070] Instructions to 2020 Or. Form 41 at 3. *See* Or. Rev. Stat. § 316.272, § 316.362(1)(c), § 316.362(e), § 316.382; Or. Admin. R. 150-316-0445. *See also Hannah v. Washington Cnty. Assessor*, No. TC-MD 150449N, 2016 BL 166839, 2016 WL 3097991 (Or. T.C. May 25, 2016) (irrevocable trust does not qualify for property-tax homestead deferral). In 2020, the Portland Metropolitan Region adopted a 1% marginal tax rate on income that is believed to apply to trusts (see Paul Jones, Portland Area, *San Francisco Voters Approve New Tax Measures,* 98 Tax Notes State 740 (Nov. 16, 2020); Nikki E. Dobay & Jeff Newgard, *Unweirding Portland's Targeted Tax Regime,* 97 Tax Notes State 1359 (Sept. 28, 2020)).

[1071] *See* Or. Rev. Stat. § 316.022(6), § 316.037(1)(a); instructions to 2020 Or. Form 41 at 4.

[1072] *See* Or. Rev. Stat. § 316.022(6).

[1073] Or. Rev. Stat. § 316.037, § 316.272; 2020 Or. Form 41 at 3.

[1074] Or. Rev. Stat. § 316.037(1)(a).

[1075] Or. Rev. Stat. § 316.282(1)(d). *See* Or. Admin. R. 150-316-0400(3); instructions to 2020 Or. Form 41 at 3.

[1076] Or. Rev. Stat. § 316.027.

[1077] Or. Rev. Stat. § 316.282(3).

[1078] Or. Admin. R. 150-316-0400(5), three examples also are provided. *See* instructions to 2020 Or. Form 41 at 3.

[1079] Or. Rev. Stat. § 316.302; Or. Admin R. 150-316-0400(4).

[1080] Or. Rev. Stat. § 316.022(6), § 316.272, § 316.287; Or. Admin. Rs. 150-316-0400(6), 150-316-0410.

[1081] Or. Rev. Stat. § 316.022(6), § 316.272, § 316.307; Or. Admin. Rs. 150-316-0410, 150-316-0420.

[1082] Or. Rev. Stat. § 316.559.

[1083] For an explanation of how this figure was derived, see I.B.3., above.

[1084] For an explanation of how this figure was derived, see I.B.4., above.

[1085] Instructions to 2020 UT Form TC-41 at 1. *See* Utah Code Ann. § 59-10-504. *See also* Edwin P. Morrow, III, Geoff N. Germane & David J. Bowen, *The Art of Using Trusts to Avoid Utah Income Tax*, 31-APR Utah B.J. 22 (Mar./Apr. 2018).

[1086] *See* Utah Code Ann. § 59-10-103(1)(a), § 59-10-103(x), § 59-10-104(1).

[1087] *See* Utah Code Ann. § 59-10-103(1)(a), § 59-10-103(x), § 59-10-201.

[1088] Utah Code Ann. § 59-10-104(2)(b), § 59-10-201(1); 2020 UT Form TC-41 at 1.

[1089] Utah Code Ann. § 59-10-104(2)(b).

[1090] Utah Code Ann. § 75-7-103(1)(i)(ii)–§ 75-7-103(1)(i)(iii). *See* instructions to 2020 UT Form TC-41 at 3. For the definition of ''domicile,'' see instructions to 2020 UT Form TC-41 at 2-3. For Utah income-tax purposes, an individual is a ''resident'' if the individual is domiciled in the state (Utah Code Ann. § 59-10-103(1)(r)). For the test as to whether a beneficiary is domiciled in Utah for withholding-tax purposes, see instructions to 2020 UT Form TC-41 at 2-3.

ISBN 978-1-63359-383-1

(iii) a trust administered in this state.

The tax return instructions say that a trust will be treated as being administered in Utah in the following circumstances:[1091]

A trust is administered in Utah if:

a. the trust does not specify a place of administration and the fiduciary transacts a major portion of its trust administration in Utah,

b. The fiduciary's usual place of business is in Utah, or

c. The trust states that Utah is the place of administration, and any administration of the trust is done in this state.

A "Nonresident Trust" is a trust that is not a "Resident Trust."[1092]

Utah taxes all taxable income of Resident Trusts[1093] but only Utah-source taxable income of Nonresident Trusts.[1094] Whereas Utah trustees are not required to make estimated tax payments for trusts,[1095] they must withhold tax from distribution to beneficiaries.[1096]

Importantly, the trustee of a Resident Trust may deduct the following:[1097]

b. income of an irrevocable resident trust if:

(i) the income would not be treated as state taxable income derived from Utah sources under Section 59-10-204 if received by a nonresident trust;

(ii) the trust first became a resident trust on or after January 1, 2004;

(iii) no assets of the trust were held, at any time after January 1, 2003, in another resident irrevocable trust created by the same settlor or the spouse of the same settlor;

(iv) the trustee of the trust is a trust company as defined in Subsection 7-5-1(1)(d);

(v) the amount subtracted under this Subsection (2)(b) is reduced to the extent the settlor or any other person is treated as an owner of any portion of the trust under Subtitle A, Subchapter J, Subpart E of the Internal Revenue Code; and

(vi) The amount subtracted under this Subsection (2)(b) is reduced by any interest on indebtedness incurred or continued to purchase or carry the assets generating the income described in this Subsection (2)(b), and by any expenses incurred in the production of income described in this Subsection (2)(b), to the extent that those expenses, including amortizable bond premiums, are deductible in determining federal taxable income.

A CRT generally is exempt from federal income tax.[1098] As a result, it usually also is exempt from Utah income tax under the following tax-return instruction:[1099]

Trust income that is exempt from federal income tax is also exempt from Utah income tax.

An exempt trust with unrelated business income in Utah that files federal Form 990-T must file Utah form TC-20MC, *Tax Return for Miscellaneous Corporations.*

Utah and non-Utah testators and trustors should plan their trusts to qualify for the above deduction. No case or ruling addresses whether the trustee of a trust created by a Utah testator that has minimal ties to Utah and that is not eligible for the above deduction still must pay tax, but the trustee of a nongrantor trust created by a Utah testator might consider taking the position that the trust is not subject to Utah income tax if it has no Utah trustee, asset, or source income.[1100]

As shown in Worksheet 3, the potential tax saving for a Utah Resident Trust on a $1 million long-term capital gain incurred in 2020 was $49,495.[1101] As shown in Worksheet 4, the net tax cost of including $1 million of long-term capital gain in DNI for a Utah resident individual rather than taxing the gain to a trust that was structured to escape tax in 2020 was $15,379.[1102]

Practice Tip: Utah trustors and non-Utah testators and trustors should be cautious about creating trusts in Utah because the state taxes trusts administered there unless the above deduction is available.

11. Washington

Washington (the Evergreen State) does not impose an income tax on individuals or fiduciaries, but there are ongoing efforts to enact one.[1103]

12. Wyoming

Wyoming (the Equality State) does not impose an income tax on individuals or fiduciaries. The following provision of the Wyoming Constitution essentially prohibits the imposition of such a tax:[1104]

No tax shall be imposed upon income without allowing full credit against such tax liability for all sales, use, and ad valorem taxes paid in the taxable year by

[1091] Instructions to 2020 UT Form TC-41 at 3. *See* Utah PLR 09-016 (Mar. 1, 2010), tax.utah.gov (where Canadian trust is administered in New York, "the adding of a Utah resident individual as one of the co-trustees of the Trusts, under the facts and circumstances you provided, will not result in the Trusts being classified as resident trusts for Utah State income tax purposes").

[1092] Utah Code Ann. § 59-10-103(1)(o); instructions to 2020 UT Form TC-41 at 3.

[1093] Utah Code Ann. § 59-10-201, § 59-10-201.1, § 59-10-202.

[1094] Utah Code Ann. § 59-10-204, § 59-10-205. *See Taxpayer v. Auditing Div. of Utah State Tax Comm'n*, Utah Admin. Dec. 14-2208 (Utah State Tax Comm'n Apr. 2016), www.tax.utah.gov (capital gain and interest income were Utah-source income).

[1095] Instructions to 2020 UT Form TC-41 at 1.

[1096] Instructions to 2020 UT Form TC-41 at 4.

[1097] Utah Code Ann. § 59-10-202(2)(b). *See* instructions to 2020 UT Form TC-41 at 12-13.

[1098] § 664(c)(1).

[1099] Instructions to 2020 UT Form TC-41 at 3.

[1100] *See* III.A.–III.E., above.

[1101] For an explanation of how this figure was derived, see I.B.3., above.

[1102] For an explanation of how this figure was derived, see I.B.4., above.

[1103] *See* Roxanne Bland, *An Income Tax for Washington? Not Likely,* 97 Tax Notes State 743 (Aug. 17, 2020).

[1104] Wyo. Const. art. 15, § 18.

ISBN 978-1-63359-383-1

the same taxpayer to any taxing authority in Wyoming.

F. California (California Personal Income Tax)

1. Introduction

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.[1105]

California treats a trust as a grantor trust if the trust is classified as a grantor trust for federal purposes,[1106] and the Golden State permits trustees of nongrantor trusts to take a distribution deduction.[1107] Thanks to Proposition 30 (2012),[1108] which increased the top marginal rate to 12.3%, and the additional 1.0% Mental Health Services Tax,[1109] California taxed the taxable income (including accumulated ordinary income and capital gains) of nongrantor trusts at rates up to 13.3% in 2020 (the 13.3% rate applied starting with such income over $1 million),[1110] and, thanks to Proposition 55 (2016), the top 13.3% rate is scheduled to apply through 2030.[1111]

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:[1112]

> 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 the individual is in the state for other than a temporary or transitory purpose or if the individual is domiciled there during the year.[1113]

2. The Resident Fiduciary Test

Note that taxation is based on the residence of a fiduciary, which is a ''trustee . . . or any person, whether individual or corporate, acting in any fiduciary capacity for any person . . . or trust,''[1114] not of a trustee.[1115] Rules are provided for determining whether an individual (presumably including an individual fiduciary) is a resident,[1116] but the State Board of Equalization of the State of California ruled that California resident individual trustees who delegated their duties to nonresident corporate fiduciaries were not California resident fiduciaries.[1117] The residence of a corporate fiduciary is determined as follows:[1118]

> 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:[1119]

> 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.

In a 2018 decision involving the *Paula Trust*, a California trial court held this tax apportionment extends to source income as well as to nonsource income.[1120] Unfortunately, the California Court of Appeal, First District, reversed the lower court's decision in 2020.[1121] On October 14, 2020, the Supreme Court of California denied the taxpayers' petition to review that decision.

Suppose that the California resident individual trustee of a nongrantor trust is succeeded by a nonresident individual trustee during a tax year. Is income earned that year after the change of trustee tainted by the trust's status as a resident trust for part of the year or is all of the income recognized after the change in trustee taxed based on the trust's nonresident trust status? It appears that the latter view is correct. The author has found nothing that addresses this scenario in the trust context,

---

[1105] Instructions to 2020 Cal. Form 541 at 4. *See* Cal. Rev. & Tax Code § 18505(e)–§ 18505(f). *See also Estate of V. Baker*, California Office of Tax Appeals Decision No. 20056183 2020 WL 8084625 (Cal. Off. Tax App. Nov. 23 2020) (trustee did not establish reasonable cause for late filing of return); Matter *of Merrill L. Mago Trust 14*, Cal. Admin. Dec. 627298, 2014 WL 3414962, at *2 (Cal. St. Bd. Eq. Mar. 25, 2014) (same); Cal. Franchise Tax Bd. Private Info. Ltr. 2015-02, 2015 Cal. FTB I.L. Lexis 2 (Apr. 21, 2015), www.ftb.ca.gov (trust having California trustee but no California source income or noncontingent beneficiary has filing requirement for California nonsource income). *See* Eric R. Bardwell, *California Admits Incomplete Gift Non-Grantor Trusts Work . . . For Now*, 46 Tax Mgmt. Est., Gifts & Tr. J. 24 (Jan. 7, 2021); Eric J. Coffill & Alexandra M. Louderback, *Sourcing Problems and Pitfalls Involving the California Taxation of Trusts,* 30 J. Multistate Tax'n & Incentives 8 (June 2020). Effective January 1, 2018, appeals from the California Franchise Tax Board are heard by the California Office of Tax Appeals rather than by the California State Board of Equalization (2017 Cal. A.B. 102).

[1106] *See* Cal. Rev. & Tax. Code § 17731(a).

[1107] *See* Cal. Rev. & Tax. Code § 17731(a).

[1108] Cal. Const. art. XIII, § 36(f)(2)(A)(iii).

[1109] Cal. Rev. & Tax. Code § 17043(a); instructions to 2020 Cal. Form 541 at 11.

[1110] Cal. Const. art XIII, § 36(f)(2); Cal. Rev. & Tax. Code § 17041(a)(1), § 17041(e), § 17041(h), § 17043(a); instructions to 2020 Cal. Form 541 at 9.

[1111] Cal. Const. art. XIII, § 36(f)(2); Cal. Rev. & Tax. Code § 17041(a)(1).

[1112] Cal. Rev. & Tax. Code § 17742(a). *See* Cal. Rev. & Tax. Code § 17743–§ 17744.

[1113] Cal. Rev. & Tax. Code § 17014(a).

[1114] Cal. Rev. & Tax Code § 17006.

[1115] *See* Cal. Rev. & Tax. Code § 17006.

[1116] Cal. Rev. & Tax. Code § 17014.

[1117] *Yolanda King Family Tr.*, No. 357825, 2007 WL 3275357, at *1 (Cal. St. Bd. Eq. Oct. 4, 2007).

[1118] Cal. Rev. & Tax. Code § 17742(b). *See Ronald Family Trust*, 2000 WL 1137423 (Cal. St. Bd. Eq. May 4, 2000).

[1119] Cal. Rev. & Tax. Code § 17743. *See* Cal. Code Reg. tit. 18, § 17743.

[1120] *Paula Tr. v. Calif. Franchise Tax Bd.*, No. CGC-16-556126, 2018 BL 494940 (Cal. Super. Ct. Feb. 6, 2018).

[1121] *Steuer v. Franchise Tax Bd.*, 265 Cal. Rptr. 3d 216, 2020 WL 3496779, at *7 (Cal. Ct. App. 2020). *See* Roxanne Bland, *California's Tangled Trust Tax Laws*, 98 Tax Notes State 295 (Oct. 19, 2020); Andrea Muse, *Appeals Court Rules Trust Taxable on California Source Income*, 97 Tax Notes State 76 (July 6, 2020).

ISBN 978-1-63359-383-1

but a publication of the California Franchise Tax Board provides in pertinent part:[1122]

> If you changed your residency during 2009, compute income and deductions using resident rules for the period of the year you were a California resident and nonresident rules for the period of the year you were a nonresident.

3. The Resident Noncontingent Beneficiary Test

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 ruled that a beneficiary who could receive distributions only on a corporate trustee's exercise of discretion was a contingent beneficiary.[1123] Furthermore, in a 2006 Technical Advice Memorandum,[1124] 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.[1125]

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:[1126]

> 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 recodified as R.C. 5808.14(B)(1)
>
> . . . .

Finally, the California Court of Appeal, First District, held in 2020 that a beneficiary's interest was contingent because "[t]he settlor intended the trustees to have absolute discretion."[1127]

A trust that has multiple beneficiaries is taxed as follows:[1128]

> 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.

4. The Throwback Tax

Rules are provided for the taxation of California resident beneficiaries on untaxed income from prior years through a throwback tax as follows:[1129]

> (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 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.

[1122] Cal. Franchise Tax Bd. Pub. 1100, *Taxation of Nonresidents and Individuals Who Change Residency* (Rev. May 2020), www.ftb.ca.gov.

[1123] *Yolanda King Family Tr.*, No. 357825, 2007 WL 3275357, at *1.

[1124] Cal. Franchise Tax Bd. TAM 2006-0002, *Clarification of California Revenue & Taxation Code § 17742*, 2006 Cal. FTB TAM Lexis 14 (Franchise Tax Bd. Feb. 17, 2006), www.ftb.ca.gov.

[1125] Cal. Franchise Tax Bd. TAM 2006-0002. For authority that the receipt of current income does not warrant imposition of an ad valorem tax on the entire principal, see *Brooke v. City of Norfolk*, 277 U.S. 27, 28–29 (1928). *See* III.A.2., above. *Accord N.C. Dep't of Revenue v. The Kimberley Rice Kaestner 1992 Family Trust*, 139 S. Ct. 2213, 2227 n.* (2019). *See* III.A.9., above.

[1126] *Newcomer v. Nat'l City Bank*, 19 N.E.3d 492, 514–15 (Ohio Ct. App. 2014).

[1127] *Steuer v. Franchise Tax Bd.*, 265 Cal. Rptr. 3d 216, 2020 WL 3496779, at *9 (Cal. Ct. App. 2020).

[1128] Cal. Rev. & Tax. Code § 17744. *See* Cal. Code Reg. tit. 18, § 17744.

[1129] Cal. Rev. & Tax. Code § 17745. *See McCulloch v. Franchise Tax Bd.*, 390 P.2d 412 (Cal. 1964); *In the Matter of the Appeal of the First Nat'l Bank of Chic.*, Cal. Admin. Decision 64-SBE-054, 1964 WL 1459 (Cal. St. Bd. Eq. June 23, 1964), www.boe.ca.gov; *In the Matter of the Appeal of C. Pardee Erdman*, Cal. Admin. Decision 70-SBE-007, 1970 WL 2442 (Cal. St. Bd. Eq. Feb. 18, 1970), www.boe.ca.gov. *See also* III.H.2.b.–III.H.2.d., above. It should be noted that the U.S. Supreme Court did not endorse the throwback-tax structure in its 2019 *N.C. Dep't of Revenue v. The Kimberley Rice Kaestner 1992 Family Trust* decision (139 S. Ct. 2213, 2225 n.13 (2019)) ("The Trust also raises no challenge to the practice known as throwback taxation, by which a State taxes accumulated income at the time it is actually distributed. *See, e.g.*, Cal. Rev. & Tax. Code § 17745(b)").

ISBN 978-1-63359-383-1

(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.

5. Other Rules

A ''Nonresident Trust'' is a trust that is not a ''Resident Trust.''[1130]

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.[1131] Computation of tax is quite complicated if a trust has source income, resident and nonresident fiduciaries, and resident and nonresident noncontingent beneficiaries.

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 residences of the trustees and then on the residences of the noncontingent beneficiaries.

Example: 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).[1132]

In California, trustees must make estimated tax payments for trusts.[1133]

6. CRTs

A CRT generally is exempt from California income tax in accordance with the following statute:[1134]

> For taxable years beginning on or after January 1, 2014, Section 664(c)(2) of the Internal Revenue Code, relating to excise tax, shall not apply and, in lieu thereof, the unrelated business taxable income, as defined in Section 23732, of every charitable remainder annuity trust or charitable remainder unitrust shall be subject to tax under Section 17651.

The instructions to the California fiduciary income tax return require trustees of CRTs to file California Form 199.[1135]

7. Planning

Practice Tip: A 2016 article advises:[1136]

> 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 noncontingent beneficiaries (and taxable on their share of trust income).

As shown in Worksheet 3, the potential tax saving for the trustee of a California Resident Trust on a $1 million long-term capital gain incurred in 2020 was at least $107,549.[1137] As shown in Worksheet 4, the net tax cost of including $1 million of long-term capital gain in DNI for a California resident individual rather than taxing the gain to a trust that was structured to escape tax in 2020 was $72,862.[1138]

The California Franchise Tax Board may enter into voluntary disclosure agreements with certain fiduciaries and trust beneficiaries in accordance with procedures that were amended in 2017.[1139]

[1130] *See* Cal. Rev. & Tax. Code § 17015, § 17742(a).

[1131] Cal. Rev. & Tax. Code § 17041(a)(1), § 17041(b), § 17041(i)(1)(B), § 17043(a), § 17301, § 17731(a), § 17951(a); Cal. Code Reg. tit. 18, § 17743–§ 17744. *See* instructions to 2020 Cal. Form 541 at 15. *See also* Eric J. Coffill & Alexandra M. Louderback, *Troublesome Sourcing Issues in California Nonresident Taxation*, 29 J. Multistate Tax'n & Incentives 8 (Nov/Dec. 2019).

[1132] Cal. Franchise Tax Board Legal Ruling 1959-238, *Trusts: Accumulated Income; Taxation When There Are Both Resident and Nonresident Trustees and Beneficiaries* (Oct. 27, 1959), www.ftb.ca.gov.

[1133] *See* Cal. Rev. & Tax. Code § 19136.

[1134] Cal. Rev. & Tax. Code § 17755. *See* Cal. Rev. & Tax Code § 17651.

[1135] Instructions to 2020 Cal. Form 541 at 4.

[1136] Kathleen K. Wright, *The Wacky World of California Trusts*, 80 State Tax Notes 433, 437 (May 9, 2016).

[1137] For an explanation of how this figure was derived, see I.B.3., above.

[1138] For an explanation of how this figure was derived, see I.B.4., above.

[1139] Cal. Rev. & Tax. Code § 19191–§ 19192. *See* Amy Hamilton, *Franchise Tax Board Expands Voluntary Disclosure Program*, 86 State Tax Notes 116 (Oct. 9, 2017).

ISBN 978-1-63359-383-1

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.[1140] 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.

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 imposition of tax violates the state's or the U.S.'s Constitution; and

(3) Determine whether trust assets generate source income taxable by one or more states.

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 domiciliary or resident trustees or fiduciaries, the statute will not apply if the trust has nondomiciliary or nonresident trustees or fiduciaries or establishes administration elsewhere. Similarly, a statute that taxes trusts created by domiciliary or resident testators and trustors will not extend to trusts created by nondomiciliaries or nonresidents. In other situations, taxability will be murky.

Regarding (2) 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 domiciliary or resident testators and trustors or having domiciliary or resident beneficiaries may not collect tax in all circumstances even if it has jurisdiction over the trustee.

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 U.S. Constitution. The constitutionality of the state income taxation of trusts based on the domicile or residence of the testator or trustor has not been directly addressed by the U.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[1141] and the Negative or Dormant Commerce Clause.[1142]

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. *Testamentary Trust Created by Domiciliary or Resident*

The most legally uncomplicated way for an individual to escape a tax based on the domicile or 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 domicile or 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, clients should not create testamentary trusts if they want to minimize state income taxes. Instead, they should fund revocable trusts created and maintained in another state during their lifetimes because courts are less likely to sustain tax on the income of inter vivos trusts than on that of testamentary trusts.[1143] Inter vivos trusts might also escape income tax that otherwise would be payable by probate estates.

Of course, some clients will create testamentary trusts. II.C., above, lists 16 states that tax a testamentary 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,[1144] imposition of tax might be subject to attack in one of the other states.

In New York and New Jersey, the rules for eliminating income tax on testamentary trusts are clear and should be followed strictly. In Idaho, where the testator's domicile or residence is one of several factors that determine taxability, the attorney should arrange other factors to save tax. Delaware, Maryland, Massachusetts, Missouri, Montana, and Rhode Island tax a testamentary trust that has at least one resident beneficiary, which, as covered in III.H., above, is a constitutionally suspect basis for taxation. If the applicable tax law does not apportion tax based on the number of resident and nonresi-

[1140] *See Matter of Michael A. Goldstein v. Tax Appeals Trib. of N.Y.*, 957 N.Y.S.2d 433, 436 (App. Div. 2012) (for years in question, interest on refund ran from date of filing of amended not original return).

[1141] U.S. Const. amend. V, amend. XIV, § 1. *See* Bradley E.S. Fogel, *What Have You Done for Me Lately? Constitutional Limitations on State Taxation of Trusts*, 32 U. Rich. L. Rev. 165, 185 (Jan. 1998). *See also* Donald T. Williamson & David Harr, *The Dormant Commerce Clause After Wynne — Where Do We Go From Here?* 61 Tax Mgmt. Memo. 70 (Mar. 16, 2020).

[1142] U.S. Const. art. I, § 8, cl. 3. For a summary of the development of dormant-commerce-clause jurisprudence, see *Steiner v. Utah Tax Comm'n*, 449 P.3d 189, 2019 WL 3820119, at *4-8 (Utah 2019).

[1143] *See* 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, 5-9 (Fall 2006); Bradley E.S. Fogel, *What Have You Done for Me Lately? Constitutional Limitations on State Taxation of Trusts*, 32 U. Rich. L. Rev. 165, 210-13 (Jan. 1998).

[1144] *Residuary Trust A U/W/O Kassner v. Dir. Div. of Tax'n*, 28 N.J. Tax 541 (Super. Ct. App. Div. 2015). *See* III.D.2., above.

ISBN 978-1-63359-383-1

dent 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 domiciliary or resident trustee or fiduciary, tax easily can be eliminated by appointing a nondomiciliary or nonresident trustee or 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 domiciliary's or 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 domiciliary or resident of another state to create a trust.

C. Inter Vivos Trust Created by Domiciliary or 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. However, a trustor might not be willing and able to relocate for just this purpose.

II.D., above, lists 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*[1145] held that Connecticut income taxation on this basis was constitutional if a trust had a resident noncontingent beneficiary, *Mercantile-Safe Deposit and Trust Company v. Murphy*[1146] held that New York could not tax such a trust that had a domiciliary current discretionary beneficiary, and *Blue v. Department of Treasury*[1147] held that Michigan could not tax such 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[1148] and *Linn v. Department of Revenue*[1149] held that Illinois could not tax a resident inter vivos trust that had no Illinois connections for the year in question. Furthermore, *Fielding v. Commissioner of Revenue*[1150] held in 2018 that Minnesota could not tax four resident inter vivos trusts in comparable circumstances.

With proper planning, the attorney easily can eliminate taxation by New York and New Jersey in many situations. In Idaho, the attorney often can arrange other factors to eliminate taxation. In Alabama, Connecticut, Delaware, Maryland, Massachusetts, Michigan, Missouri, Montana, 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 5.00%)[1151] that could be eliminated by appointing a non-Massachusetts trustee.

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 domiciliary or 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.

D. Trust Administered in State

An attorney should think long and hard before allowing a client to create a trust in one of the 12 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, Iowa, Montana, and North Dakota, which tax based on several factors. Taxation can also 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 a state that taxes on that basis.

E. Trust Having Domiciliary or Resident Trustee or Fiduciary

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

F. Trust Having Domiciliary or Resident Beneficiary

The six states listed in II.G., above, tax a trust in whole or in part because it has domiciliary or resident beneficiaries, which, as noted in III.H., above, is a questionable basis for taxation. Attorneys should ensure that income on assets attributable to nondomiciliary or nonresident beneficiaries will not be taxed unnecessarily. They also should make sure that tax on accumulated income and capital gains that might ultimately be distributed to nondomiciliary or nonresident beneficiaries will not be taxed prematurely.

[1145] 733 A.2d 782 (Conn. 1999). *See* III.C.3., above.

[1146] 255 N.Y.S.2d 96 (N.Y. 1964), *aff'g* 242 N.Y.S.2d 26 (App. Div. 1963). *See* III.B.2., above.

[1147] 462 N.W.2d 762 (Mich. Ct. App. 1990). *See* III.B.7., above.

[1148] 67 A.3d 185 (Pa. Commw. Ct. 2013). *See* III.D.5., above.

[1149] 2 N.E.3d 1203, 1211 (Ill. App. Ct. 2013). *See* III.D.3., above.

[1150] 916 N.W.2d 323 (Minn. 2018), *aff'g* No. 8911-R, 2017 BL 194423, 2017 WL 2484593 (Minn. Tax. Ct. May 31, 2017). *See* III.D.4., above.

[1151] Mass. Gen. Laws ch. 62, § 4; 2020 Mass. Form 2 at 2.

ISBN 978-1-63359-383-1

VI. Planning Considerations for Existing Trusts

A. Introduction

With the assistance of counsel, trustees should review the trusts that they administer 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.[1152] At the same time, the trustee and the advising attorney must make sure that steps taken to eliminate one state's tax will not subject a trust to tax elsewhere.

B. Testamentary Trust Created by Domiciliary or 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 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 U.S. 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 such a trust as an 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. Iowa and Wisconsin recognize that a change of situs will end a testamentary trust's liability for tax;[1153] Nebraska takes a contrary position.[1154]

C. Inter Vivos Trust Created by Domiciliary or Resident

To determine whether a state's income tax on an inter vivos trust created by a domiciliary or resident can be eliminated, the trustee and attorney should go through a process comparable to that described above. It appears that changing the situs of an inter vivos trust might terminate tax liability in Iowa[1155] but not in Nebraska.[1156]

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. Trust Having Domiciliary or Resident Trustee or Fiduciary

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

F. Trust Having Domiciliary or Resident Beneficiary

Short of having the beneficiary move, it is difficult if not impossible to prevent a domiciliary or 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 Portfolio, states tax the income of trusts based on one or more of five criteria — (1) the domicile or residence of the testator, (2) the domicile or residence of the trustor, (3) the place of administration, (4) the domicile or residence of the trustee or fiduciary, and (5) the domicile or residence of the beneficiary. Only the testator, trustor, or beneficiary can change domicile or residence for criteria (1), (2), and (5). But it is possible to control the place of administration (criterion (3)) and the domicile or residence of the trustee or fiduciary (criterion (4)).

The practitioner's first step is to examine the tax rules for the state in question to ensure that whatever steps are taken will further the objective of minimizing state income tax. The terms ''administration,'' ''domicile,'' or ''residence'' might have very different meanings for tax and for other purposes. For example, some states provide guidance on when a trust is being admin-

---

[1152] *See Matter of Michael A. Goldstein No. 1 Tr. v. Tax Appeals Trib. of N.Y.*, 957 N.Y.S 2d 433, 436 (App. Div. 2012) (for years in question, interest on refund ran from date of filing of amended not original return).

[1153] *See* Iowa Admin. Code r. 701-89.3(1) (''The situs of a testamentary trust for tax purposes is the state of the decedent's residence at the time of death until the jurisdiction of the court in which the trust proceedings are pending is terminated. In the event of termination and the trust remains open, the situs of the trust is governed by the same rules as pertain to the situs of inter vivos trusts''); instructions to 2020 Wis. Form 2 at 1 (''A trust created by a decedent's will (testamentary trust) is resident of Wisconsin if the decedent was domiciled in Wisconsin at the time of death, unless transferred by a court having jurisdiction to another court's jurisdiction'').

[1154] *See* Neb. Admin. R. & Regs. 316-23-002.02D (''[A] trust, once established as a resident . . . trust, cannot be changed to a nonresident . . . trust because of the change of residence of any of the parties involved, or of the change in location of any of the property involved.''). *See also* instructions to 2020 Neb. Form 1041N at 7.

[1155] *See* Iowa Admin. Code r. 701-89.3(2) (''If an inter vivos trust is created by order of court or makes an accounting to the court, its situs is the state where the court having jurisdiction is located until the jurisdiction is terminated'').

[1156] *See* Neb. Admin. R. & Regs. 316-23-001.03 (''If the settlor of a trust is domiciled in Nebraska when the trust becomes irrevocable, the trust will be considered a resident trust for the entire life of the trust. Such a trust is a resident trust even though the situs of the trust, the property held in trust, or the trustee are located in another state''). Factors are then given to establish the situs of grantor and nongrantor trusts.

ISBN 978-1-63359-383-1

istered within the state;[1157] other states specify how to establish the domicile or residence of a corporate trustee.[1158]

2. Changing Place of Administration

As described in II.E., above, 12 states tax trust income solely because the trust is administered in that state and six 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 of an existing trust, the practitioner should look for a clause that allows the trustee, adviser, 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.

Section 108(c) of the Uniform Trust Code (UTC),[1159] a form of which is in effect in 35 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 administration to another State or to a jurisdiction outside of the United States.

Rules are provided for notice to beneficiaries,[1160] objections by beneficiaries,[1161] and transfers of assets to successor trustees.[1162]

Also, UTC § 111, a version of which is in effect in 35 states, allows the "interested persons" to enter into a nonjudicial settlement agreement as follows:[1163]

> (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,"[1164] 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,[1165] and authorizes an interested person to request court involvement.[1166] The matters that may be resolved via nonjudicial settlement agreement include:[1167]

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

The place of administration of a trust might also be changed with the trustor's consent under the nonjudicial settlement agreement statutes of at least eight states[1168] or without the trustor's consent under the nonjudicial settlement agreement statutes of at least six states[1169] that have not enacted the UTC.

In some situations, it will be possible to change the place of administration only with court involvement. For instance, California has had a court procedure for transferring a trust to another jurisdiction since 1991.[1170] At least two other states have statutes that address the same subject.[1171]

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:[1172]

> [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.

[1157] *See* VIII.D., below. For an extensive discussion of the implications of a change of a trust's place of administration, see 7 Austin W. Scott, William F. Fratcher & Mark L. Ascher, *Scott and Ascher on Trusts* § 45.5.3.1–§ 45.5.3.2 at 3292-3307 (5th ed. 2010).

[1158] *See* II.D., above (Massachusetts); IV.A.4.d., above (New York).

[1159] UTC § 108(c) (amended 2018). The text of the UTC and a list of states that have enacted it may be viewed at www.uniformlaws.org.

[1160] UTC § 108(d) (amended 2018). 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*, No. 317003 & 317096, 2015 BL 51771, 2015 WL 847129, at *2 (Mich. Ct. App. Feb. 26, 2015)).

[1161] UTC § 108(e) (amended 2018).

[1162] UTC § 108(f) (amended 2018).

[1163] UTC § 111(b) (amended 2018). *See* Linda Kotis, *Nonjudicial Settlement Agreements: Your Irrevocable Trust Is Not Set in Stone*, 31 Prob. & Prop. 32 (Mar./Apr. 2017).

[1164] UTC § 111(a) (amended 2018).

[1165] UTC § 111(c) (amended 2018).

[1166] UTC § 111(e) (amended 2018).

[1167] UTC § 111(d)(5) (amended 2018).

[1168] Cal. Prob. Code § 15404(a); Del. Code Ann. tit. 12, § 3342; Ga. Code Ann. § 53-12-9; Idaho Code § 15-8-302, § 15-8-103(1)(c)(iii), § 15-8-103(3); Iowa Code § 633A.2202; N.Y. Est. Powers & Trust Law § 7-1.9; S.D. Codified Laws § 55-3-24; Wash. Rev. Code § 11.98.051, § 11.96A.220, § 11.96A.030(2)(c)(iii), § 11.96A.030(5).

[1169] Del. Code Ann. tit. 12, § 3338(d)(5); Ga. Code Ann. § 53-12-9; Idaho Code § 15-8-302, § 15-8-103(1)(c)(iii), § 15-8-103(3); Nev. Rev. Stat. § 164.940(3)(m), § 164.942; S.D. Codified Laws § 55-3-24; Wash. Rev. Code § 11.98.051, § 11.96A.220, § 11.96A.030(2)(c)(iii), § 11.96A.030(5).

[1170] 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. 2010).

[1171] Nev. Rev. Stat. § 164.130; Wash. Rev. Code § 11.98.055.

[1172] Restatement (Second) of Conflict of Laws § 271 cmt. g (1971) (cross-reference omitted).

ISBN 978-1-63359-383-1

> 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.
>
> 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:[1173]

> 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.[1174] 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 require the change.[1175]

3. Changing a Domiciliary or Resident Trustee or Fiduciary to a Nondomiciliary or Nonresident Trustee or Fiduciary

If the governing instrument provides for the removal and replacement of the trustee or fiduciary without the necessity for court proceedings, the nomination of a trustee or fiduciary 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 or fiduciary 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:[1176]

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

A change of trustee or fiduciary also might be accomplished with the trustor's consent via the stand-alone nonjudicial settlement agreement statutes of at least eight states[1177] or without the trustor's consent via the stand-alone nonjudicial settlement agreement statutes of at least six states.[1178]

Otherwise, the beneficiaries must either obtain the trustee's or fiduciary's agreement to resign or convince the local probate court to remove the trustee or fiduciary. Courts are beginning to include state income-tax minimization as a pertinent factor when considering petitions, including under the state's versions of UTC § 706,[1179] to replace trustees.[1180] Many of the considerations in a court proceeding that were described in VI.G.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.

[1173] Restatement (Second) of Conflict of Laws § 272 cmt. e (1971).

[1174] *See Estate 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 N.Y. Trust Co.*, 87 N.Y.S.2d 787, 794–95 (Sup. Ct. N.Y. Cty. 1949).

[1175] *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 (Sup. 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).

[1176] UTC § 111(d)(4) (amended 2018).

[1177] Cal. Prob. Code § 15404(a); 30 Del. C. § 3342; Ga. Code Ann. § 53-12-9; Idaho Code § 15-8-302, § 15-8-103(1)(c)(ii), § 15-8-103(3); Iowa Code § 633A.2202; N.Y. Est. Powers & Trusts Law § 7-1-9; S.D. Codified Laws § 55-3-24; Wash. Rev. Code § 11.96A.220, § 11.96A.030(2)(c)(ii), § 11.96A.030(5).

[1178] 30 Del. C. § 3338(d)(4); Ga. Code Ann. § 53-12-9; Idaho Code § 15-8-302, § 15-8-103(1)(c)(ii), § 15-8-103(3); Nev. Rev. Stat. § 164.940(3)(j), § 164.942; S.D. Codified Laws § 55-3-24; Wash. Rev. Code § 11.96A.220, § 11.96A.030(2)(c)(ii), § 11.96A.030(5).

[1179] UTC § 706 (amended 2018).

[1180] *See Beardmore v. JPMorgan Chase Bank*, No. 2014-CA-001536-MR, 2017 BL 104708, 2017 WL 1193190, at *6 (Ky. Ct. App. Mar. 31, 2017) ("The move to Delaware would provide a significant aggregate tax savings over those years"); *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"). *See also* Martin M. Shenkman, Gail E. Cohen & Gerard F. Joyce, Jr., *Considerations for Non-Professional Fiduciaries*, 159 Tr. & Est. 45, 51 (May 2020) ("[I]t may be advisable to divide a trust pursuant to its terms to have a trust's passive assets (assets that aren't source income to a high tax state or located in that state) bifurcated and the subsequent subtrust moved to a different state to effectuate significant state income tax savings").

ISBN 978-1-63359-383-1

For example, under the duty to administer the trust in accordance with its terms and applicable law, § 76 of the Third Restatement of Trusts[1181] offers the following comment:[1182]

> 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),[1183] which is in effect in at least three states,[1184] 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 pursuant to the Nebraska version of § 7-305,[1185] the Supreme Court of Alaska replaced the corporate trustee and transferred the situs of the trust out of Alaska in a 2004 case,[1186] 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.[1187]

Similarly, § 108(b) of the UTC,[1188] a version of which is the law in 29 states, specifies that:

> (b) 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 and in other states that do not impose this duty by statute, trustees cannot ignore the issue because, as noted above, § 76 of the Third Restatement of Trusts indicates that the duty exists under common law.

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.[1189] 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.[1190] Hence, trustees and attorneys may take steps to prevent state income tax in GST exempt trusts without adverse tax consequences.

J. Personal Jurisdiction and Taxing State's Forum Options

1. Limitations on Personal Jurisdiction

In considering whether a particular state has jurisdiction to tax, it is important to remember that a trust is a relationship not an entity. The trust does not pay tax; the trustee does, and it should not be assumed that a state has jurisdiction to tax a nonresident trustee. The U.S. Supreme Court explained:[1191]

> Traditionally, a trust was not considered a distinct legal entity, but a "fiduciary relationship" between multiple people. Such a relationship was not a thing that could be hauled into court; legal proceedings involving a trust were brought by or against the trustees in their own name. And when a trustee files a lawsuit or is sued in her own name, her citizenship is all that matters for diversity purposes. For a traditional trust, therefore, there is no need to determine its membership, as would be true if the trust, as an entity, were sued.

The Court addressed the limits of personal jurisdiction in *Bristol-Myers Squibb Co. v. Superior Court of California*.[1192] There, Justice Alito, writing for himself and seven other Justices (Justice Sotomayor dissented), described the limits on forum courts' exercise of personal jurisdiction:[1193]

> It has long been established that the Fourteenth Amendment limits the personal jurisdiction of state

[1181] Restatement (Third) of Trusts § 76 (2003).

[1182] Restatement (Third) of Trusts § 76 cmt. b(2) (2003) (cross-references omitted).

[1183] UPC § 7-305 (amended 2010).

[1184] *See, e.g.*, Alaska Stat. § 13.36.090; Haw. Rev. Stat. § 560:7-305; Idaho Code § 15-7-305.

[1185] *In re Zoellner Trust*, 325 N.W.2d 138 (Neb. 1982).

[1186] *Marshall v. First Nat'l Bank Alaska*, 97 P.3d 830 (Alaska 2004).

[1187] *In re Wege Trust*, No. 271244, 2008 BL 355629, 2008 WL 2439904 (Mich. Ct. App. June 17, 2008).

[1188] UTC § 108(b) (amended 2018).

[1189] *See* Reg. § 26.2601-1(b)(4)(i)(D)(2). *See* Nathan R. Brown, Raj. A Malviya & Brandon A.S. Ross, *Ten Common GST Planning Mistakes*, 74 Tax Law. 165 (Winter 2021). For further discussion of the applicability of the generation-skipping transfer tax, see 850 T.M., *Generation-Skipping Transfer Tax*.

[1190] *See, e.g.*, PLR 201845006, PLR 201829005, PLR 201820007, PLR 201820008, PLR 201814005, PLR 201647001, PLR 201604001, PLR 201525001, PLR 201518002–201518005.

[1191] *Americold Realty Tr. v. Conagra Foods, Inc.*, 136 S. Ct. 1012, 1016 (2016) (citations omitted). *Accord United States v. Fridman*, 974 F.3d 163, 181 n.11 (2d Cir. 2020) (quoting *Loubier*); *Raymond Loubier Irrevocable Tr. v. Loubier*, 858 F.3d 719, 722 (2d Cir. 2017) ("[I]t is the trustees' citizenship, not that of beneficiaries, that matters for purposes of diversity"); *Wang By and Through Wong v. New Mighty U.S. Tr.*, 843 F.3d 487, 487 (D.C. Cir. 2016) ("a so-called 'traditional trust' carries the citizenship of its trustees"). For a review of relevant authorities, see *Loubier*, 858 F.3d 719, 725–31.

[1192] 137 S. Ct. 1773 (2017).

[1193] 137 S. Ct. 1773, 1779 (citations and internal quotation marks omitted; emphasis added).

ISBN 978-1-63359-383-1

> courts. Because a state court's assertion of jurisdiction exposes defendants to the State's coercive power, it is subject to review for compatibility with the Fourteenth Amendment's Due Process Clause, which limits the power of a state court to render a valid personal judgment against a nonresident defendant. The primary focus of our personal jurisdiction inquiry is the *defendant's* relationship to the forum State.

He elaborated:[1194]

> Since our seminal decision in *International Shoe*, our decisions have recognized two types of personal jurisdiction: ''general'' (sometimes called ''all-purpose'') jurisdiction and ''specific'' (sometimes called ''case-linked'') jurisdiction. For an individual, the paradigm forum for the exercise of general jurisdiction is the individual's domicile; for a corporation, it is an equivalent place, one in which the corporation is fairly regarded as at home. A court with general jurisdiction may hear *any* claim against that defendant, even if all the incidents underlying the claim occurred in a different State. But only a limited set of affiliations with a forum will render a defendant amenable to general jurisdiction in that State.
>
> Specific jurisdiction is very different. In order for a state court to exercise specific jurisdiction, the *suit* must arise out of or relate to the defendant's contacts with the *forum*. In other words, there must be an affiliation between the forum and the underlying controversy, principally, an activity or an occurrence that takes place in the forum State and is therefore subject to the State's regulation. For this reason, specific jurisdiction is confined to adjudication of issues deriving from, or connected with, the very controversy that establishes jurisdiction.

Justice Alito continued:[1195]

> In determining whether personal jurisdiction is present, a court must consider a variety of interests. These include the interests of the forum State and of the plaintiff in proceeding with the cause in the plaintiff's forum of choice. But the primary concern is the burden on the defendant. Assessing this burden obviously requires a court to consider the practical problems resulting from litigating in the forum, but it also encompasses the more abstract matter of submitting to the coercive power of a State that may have little legitimate interest in the claims in question. As we have put it, restrictions on personal jurisdiction are more than a guarantee of immunity from inconvenient or distant litigation. They are a consequence of territorial limitations on the power of the respective States. The States retain many essential attributes of sovereignty, including, in particular, the sovereign power to try causes in their courts. The sovereignty of each State implies a limitation on the sovereignty of all its sister States. And at times, this federalism interest may be decisive. As we explained in *World-Wide Volkswagen, even if the defendant would suffer minimal or no inconvenience from being forced to litigate before the tribunals of another State; even if the forum State has a strong interest in applying its law to the controversy; even if the forum State is the most convenient location for litigation, the Due Process Clause, acting as an instrument of interstate federalism, may sometimes act to divest the State of its power to render a valid judgment*.

Justice Alito described the controversy in *Bristol-Myers*:[1196]

> More than 600 plaintiffs, most of whom are not California residents, filed this civil action in a California state court against Bristol-Myers Squibb Company (BMS), asserting a variety of state-law claims based on injuries allegedly caused by a BMS drug called Plavix. The California Supreme Court held that the California courts have specific Jurisdiction to entertain the nonresidents' claims. We now reverse.

He observed:[1197]

> Our settled principles regarding specific jurisdiction control this case. In order for a court to exercise specific jurisdiction over a claim, there must be an affiliation between the forum and the underlying controversy, principally, an activity or an occurrence that takes place in the forum State. When there is no such connection, specific jurisdiction is lacking regardless of the extent of a defendant's unconnected activities in the State. Even regularly occurring sales of a product in a State do not justify the exercise of jurisdiction over a claim unrelated to those sales.

He continued:[1198]

> The present case illustrates the danger of the California approach. The State Supreme Court found that specific jurisdiction was present without identifying any adequate link between the State and the nonresidents' claims. As noted, the nonresidents were not prescribed Plavix in California, did not purchase Plavix in California, did not ingest Plavix in California, and were not injured by Plavix in California. The mere fact that *other* plaintiffs were prescribed, obtained, and ingested Plavix in California — and allegedly sustained the same injuries as did the nonresi-

---

[1194] 137 S. Ct. 1773, 1779–80 (citations and internal quotation marks omitted; emphasis in original). *Accord Genuine Parts Co. v. Cepec*, 137 A.3d 123, 129–30 (Del. 2016). Other recent U.S. Supreme Court decisions addressing general jurisdiction are: *Daimler A.G. v. Bauman*, 571 U.S. 117 (2014); *Goodyear Dunlop Tire Operations, S.A. v. Brown*, 564 U.S. 915 (2011).

[1195] 137 S. Ct. 1773, 1780–81 (citations and internal quotation marks omitted; emphasis added).

[1196] 137 S. Ct. 1773, 1777. Other recent U.S. Supreme Court decisions involving specific jurisdiction are: *Walden v. Fiore*, 571 U.S. 277 (2014); *J. McIntyre Mach. Ltd. v. Nicastro*, 564 U.S. 873 (2011). *See Black v. Black*, 2020 COA 64, 2020 WL 1814272, at *15 (Colo. Ct. App. Apr. 9, 2020) (''the court properly exercised specific personal jurisdiction over Bernard in his capacity as Joanne's conservator, as a trustee of the Trusts, and in his individual capacity'').

[1197] 137 S. Ct. 1773, 1781 (2017) (citations and internal quotation marks omitted).

[1198] 137 S. Ct. 1773, 1781 (citation and internal quotation marks omitted; emphasis in original).

ISBN 978-1-63359-383-1

dents — does not allow the State to assert specific jurisdiction over the nonresidents' claims. As we have explained, a defendant's relationship with a third party, standing alone, is an insufficient basis for jurisdiction. This remains true even when third parties (here, the plaintiffs who reside in California) can bring claims similar to those brought by the nonresidents. Nor is it sufficient — or even relevant — that BMS conducted research in California on matters unrelated to Plavix. What is needed — and what is missing here — is a connection between the forum and the specific claims at issue.

The Court concluded that California courts lacked specific personal jurisdiction as follows:[1199]

> In today's case, the connection between the nonresidents' claims and the forum is even weaker. The relevant plaintiffs are not California residents and do not claim to have suffered harm in that State. In addition, as in *Walden*, all the conduct giving rise to the nonresidents' claims occurred elsewhere. It follows that the California courts cannot claim specific jurisdiction.

The leading personal-jurisdiction case in the trust field is *Hanson v. Denckla*,[1200] summarized at III.A.6., above.

The 2005 decision of a federal district court in Delaware in *Walker v. West Michigan National Bank and Trust* is pertinent to this discussion.[1201] In concluding that the court lacked personal jurisdiction over a nonresident corporate trustee, Judge Robinson wrote:[1202]

> [P]laintiff has not alleged that any of West Michigan's activities with respect to tax preparation occurred in Delaware. Mere effect on plaintiff's tax liability does not establish personal jurisdiction under § 3104(c)(2). If such were the case, then in whatever jurisdiction plaintiff lived, West Michigan, could be hauled into a foreign court of which it had no notice. This is not consistent with traditional notions of fair play and substantial justice, as such, the court is without jurisdiction over West Michigan.

The 2013 decision of a federal district court in Pennsylvania in *Bernstein v. Stiller*[1203] dealt with a comparable issue. In that case, trust beneficiaries sought accountings and removal of the trustees in Pennsylvania and contended that the trustees' filing of a state income-tax return declaring the trust to be a Resident Trust gave the court jurisdiction.[1204] Judge Surrick held:[1205]

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

A court will have personal jurisdiction over a foreign trustee in certain situations, such as when it has in rem jurisdiction,[1206] or when the defendant waives any objection to the existence of personal jurisdiction,[1207] or when it appointed the trustee.[1208] The foregoing cases 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. To date, however, the existence of jurisdiction has not been challenged in any reported case involving the state taxation of trust income.

Challenging the existence of jurisdiction might seem daunting, but, if the amount of tax involved is substantial and if the trustee's connections with the taxing state are minimal, it might be worth the effort. In this regard, an intermediate Louisiana appellate court held in 2020 that Louisiana courts lacked personal jurisdiction over a nonresident corporation in order to impose franchise and corporate taxes.[1209] This option will not be available, of course, if the trustee must file a refund request in the taxing state.

2. *Perils for Taxing State of Litigating in Foreign Court*

The author is 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 has the author found pertinent law review articles or other authorities that analyze the 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 (not in federal court) for the following reasons:[1210]

> 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

[1199] 137 S. Ct. 1773, 1782.

[1200] 357 U.S. 235 (1958). *See* III.A.6., above.

[1201] 324 F. Supp. 2d 529 (D. Del. 2004), *aff'd*, 145 F. App'x 718 (3d Cir. 2005).

[1202] 324 F. Supp. 2d 529, 534 (citation and internal quotation marks omitted).

[1203] No. 09-659, 2013 BL 172426, 2013 WL 3305219 (E.D. Pa. June 27, 2013).

[1204] No. 09-659, 2013 BL 172426, 2013 WL 3305219, at *1.

[1205] No. 09-659, 2013 BL 172426, 2013 WL 3305219, at *7.

[1206] *Black v. Black*, 2020 COA 64, 2020 WL 1814272, at *10 (Colo. Ct. App. Apr. 9, 2020).

[1207] 2020 WL 1814272, at *12.

[1208] *See Ohlheiser v. Shepherd*, 228 N.E.2d 210, 215 (Ill. App. Ct. 1967). *But see Bernegger v. Thompson*, No. 2015AP2546, 2016 BL 240636, 2016 WL 3919232, at *4 (Wis. Ct. App. July 21, 2016) ("[I]t would not comport with due process requirements to subject out-of-state defendants to the jurisdiction of Wisconsin courts").

[1209] *Robinson v. Jeopardy Productions, Inc.*, 2020 U.S.P.Q.2d 11245, 2020 WL 6162836, at *4 (La. Ct. App. Oct. 21, 2020) ("we affirm the trial court's judgment granting the declinatory exception raising the objection of lack of personal jurisdiction filed by Jeopardy Productions, Inc. and dismissing the Louisiana Department of Revenue's petition to collect taxes"). *See* Saylor Sims, Debasish Chakrabarti & Richard Jackson, *Louisiana Court Rules No Jurisdiction Despite Economic Presence*, 99 Tax Notes State 691 (Feb. 15, 2021).

[1210] 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 Indiana ex rel. Harmeyer v. Kroger Co.*, No. 1:17-cv-00538, 2017 BL 200473, 2017 WL 2544111, at *4 (S.D. Ind. June 13, 2017) ("the State of Indiana is not considered a citizen of any State and, therefore, its presence in the litigation destroys diversity jurisdiction").

ISBN 978-1-63359-383-1

agencies or their officers; hence, diversity jurisdiction will not be available for such cases.

Second, federal courts generally are not available to resolve state tax controversies under comity principles and the Tax Injunction Act (TIA)[1211] both of which are described in VI.K.4., below.

Third, 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.''[1212]

K. Taxpayers' Forum Options in Tax Controversies

1. Introduction

Taxpayers seeking to challenge state tax audits or assessments typically must follow the taxing state's administrative appeals process.[1213] A taxpayer's options in Iowa were described in 2019 as follows:[1214]

> Upon the filing of a proper protest, individuals are encouraged to utilize the informal procedures provided by the Department's regulations so that a settlement may be reached without the necessity of initiating a contested case proceeding. During the informal process, the Department reviews and evaluates the validity of said protest and determines the correct amount of tax owing or refund due. While there are no rules governing the timing of the Department's actions during the informal process, it is unfortunate that it took so long in Mr. and Ms. Geib's case. Nevertheless, Mr. and Ms. Geib had the option to waive the informal procedure for their protest and proceed directly to a contested case proceeding by notifying the Department that they wished to do so. No such waiver was submitted in this case.

Taxpayers generally view this option as unappetizing. A 2020 article explains why:[1215]

> Taxpayers frequently face an uphill battle when attempting to reverse a tax assessment or obtain a tax refund at the state and local tax levels. This is because SALT jurisdictions typically stack the deck against taxpayers in any way they can, including enacting legal authority presuming the correctness of their own tax assessment determinations and imposing substantial evidentiary burdens on taxpayers to overcome these presumptions.

A taxpayer who believes that such a process will be unproductive, might consider one of the following alternatives:

- Bypass the administrative appeals process and go directly to court in the taxing state

- Sue the taxing state's tax agency in the courts of another state

- File suit in federal court.

Unfortunately, none of the above alternatives is likely to be worth the effort.

Practice Tip: Practitioners should beware of deadlines for filing appeals regarding adverse administrative determinations. The author has seen numerous instances in which appeals were dismissed simply because they were not filed on time.

2. Bypass Administrative Appeals Process

The taxpayer probably will be disappointed with this alternative because:[1216]

> While statutes and case law vary from state-to-state, some states allow taxpayers the ability to file a declaratory judgment motion in state court to contest a purely legal or constitutional issue, without first having gone through the administrative appeals process. Technically, this is asking a state court judge to decide a purely legal issue in the taxpayer's favor. However, in response to a declaratory judgment action the states will often argue that the case is not ''ripe,'' that there are ''factual issues'' that make the case inappropriate for declaratory judgment, or that more generally the taxpayer should have ''exhausted administrative remedies'' rather than having gone directly to state court. A case may be dismissed on procedural grounds for any one of these reasons. And in some states statutes and case law bar taxpayers from bringing declaratory judgment actions to contest tax claims in any event.

[1211] 28 U.S.C. § 1341.

[1212] Jennifer Carr, *State Sovereign Immunity and Franchise Tax Board v. Hyatt*, 78 State Tax Notes 539 (Nov. 16, 2015).

[1213] Jeffrey S. Reed, *Challenging State Taxes After Franchise Tax Board v. Hyatt*, 29 J. Multistate Tax'n & Incentives 38 (Aug. 2019).

[1214] Iowa Dep't of Inspections & Appeals, Div. of Administrative Hearings, *In the Matter of Geib*, DIA No. 191DR0088 at 2 (Sept. 13, 2019), dia.iowa.gov (citations omitted). *See* Wis. Dep't of Revenue Pub. 506, *Taxpayers' Appeal Rights* (Feb. 2021), www.revenue.wi.gov; Ariz. State Board of Equalization, *Notice of Proposed Rulemaking 2020* (Aug. 21, 2020), www.sboe.az.gov; S.C. Dep't of Revenue Info. Ltr. # 20-22, *Tax Appeal Process and Procedures — Information Guides* (July 30, 2020), dor.sc.gov; Wis. Dep't of Revenue Pub. 507, *How to Appeal to the Tax Appeals Commission* (June 2020), www.revenue.wi.gov. *See also Landowners United Advocacy Found., Inc. v. Cordova*, 822 Fed. App'x 797, 2020 WL 4382862, at *3 (10th Cir. 2020) (''Under Colorado's statutory scheme, if a conservation easement tax credit is denied, taxpayers can appeal the denial and receive an administrative hearing. Taxpayers can further appeal a negative ruling to a state district court for a de novo review and that district court's ruling is appealable to the Colorado Court of Appeals and ultimately the Colorado Supreme Court.'') (citations omitted).

[1215] Robert P. Merten, III & Nicholas J. Kump, *Let's Jiggle the Door Handle to Federal Court for SALT Disputes*, 95 Tax Notes State 473, 474 (Feb. 10, 2020). *See* Arthur R. Rosen & Tyler Moses, *Exasperation, Frustration, Disappointment*, 98 Tax Notes State 229 (Oct. 19, 2020).

[1216] Jeffrey S. Reed, *Challenging State Taxes After Franchise Tax Board v. Hyatt*, 29 J. Multistate Tax'n & Incentives 38, 38 (Aug. 2019) (footnote omitted). *See Warehouse Mkt. Inc. v. State of Okla. Tax Comm'n*, 481 P.3d 250, 2021 WL 345414, at *8 (Okla. 2021) (''As a tax protest, administrative remedies must be exhausted before a protestant may resort to relief in the courts''); *Christensen v. Utah State Tax Comm'n,* 469 P.3d 962, 2020 WL 3753769, at *8 (Utah 2020) (''The Christensens did not exhaust their administrative remedies prior to seeking judicial review. The district court erred when it denied the Commission's motion to dismiss''); *Kali Fam. Ltd. P'ship v. Town of Milton*, 99 Mass. App. Ct. 1112, 2021 WL 710811 at *2 (Mass. App. Ct. Feb. 24, 2021) (''Kali's exclusive remedy was the administrative remedy of abatement''); *Dabreo v. Deschutes Cnty. Assessor*, No. TC-MD 190386N, 2020 BL 281057, 2020 WL 4283999, at *3 (Or. Tax Ct. July 27, 2020) (''Plaintiffs failed to establish good and sufficient cause under ORS 305.288(3) for their failure to timely appeal to BOPTA for the 2019-20 tax year. As a result, the court concludes that Defendant's motion to dismiss must be granted'').

ISBN 978-1-63359-383-1

3. Sue in Courts of Another State

The U.S. Supreme Court precluded this option in its decision in *Franchise Tax Board of California v. Hyatt*,[1217] where the court held:[1218]

> This case . . . requires us to decide whether the Constitution permits a State to be sued by a private party without its consent in the courts of a different State. We hold that it does not and overrule our decision to the contrary in *Nevada v. Hall*, 440 U.S. 410 (1979).

4. File Suit in Federal Court

a. Background

The third alternative usually will be barred as well. This is because federal courts generally are not available to resolve state tax controversies under comity principles[1219] and/or the Tax Injunction Act (TIA),[1220] which provides:[1221]

> 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.

The history of the TIA has been summarized as follows:[1222]

> Federal courts have limited jurisdiction; they can only hear cases listed in the Constitution or specifically permitted by Congress. Accordingly, many laws affirmatively establish the federal courts' authority to decide a dispute. The TIA, by contrast, affirmatively limits federal court jurisdiction. Before the TIA [1937], out-of-state taxpayers could sue a state in federal court based on diversity of citizenship, but state residents did not have the same option. Thus, the TIA was intended to equalize the ''highly unfair picture'' in which citizens would have to ''pay first and then litigate,'' while diverse plaintiffs from outside the state could litigate the case in federal court without first paying the tax amounts at issue.

There are instances however, when the TIA does not prevent a taxpayer from seeking relief in federal court:[1223]

> [S]ome case types have cleared its hurdle and provide a framework for making it into federal court. These include cases involving exactions that are not taxes; cases not seeking to prevent the assessment, levy, or collection of a tax; and cases in which no plain, speedy, and efficient remedy is available.

The Seventh Circuit has described the comity doctrine as follows:[1224]

> Out of respect for state functions, the comity doctrine restrains federal courts from entertaining claims for relief that risk disrupting state tax administration. This doctrine reflects the reluctance of federal courts to interfere by injunction with states' fiscal operations and the concomitant desire to show scrupulous regard for the rightful independence of state governments.
>
> Specifically, as relevant here, the comity doctrine bars taxpayers from asserting § 1983 claims against the validity of state tax systems via federal lawsuits. Taxpayers seeking such relief must instead seek protection of their federal rights by state remedies, provided of course that those remedies are plain, adequate, and complete.

That court also has distinguished between relief available under the TIA and the comity doctrine:[1225]

> The TIA divests federal courts of subject-matter jurisdiction in cases where the relief sought would diminish or encumber state tax revenue. Comity, by contrast, is a doctrine of abstention.

b. A.F. Moore & Associates, Inc. v. Pappas (2020)

An instance in which a ''plain, speedy, and efficient remedy'' was not available in state court was *A.F. Moore & Asso-*

[1217] 139 S. Ct. 1485 (2019). *See* Amy Hamilton, *Supreme Court Bans Suits Against States in Another State's Courts*, 92 State Tax Notes 695 (May 20, 2019). *See also* Billy Hamilton, *The 'Horrible Quarter Century' of FTB v. Hyatt Ends*, 92 State Tax Notes 827 (June 3, 2019).

[1218] 139 S. Ct. 1485, 1490.

[1219] *See, e.g.*, *Landowners United Advocacy Found., Inc. v. Cordova*, 822 Fed. App'x 797, 803 (10th Cir. 2020) (''Comity principles prohibit the district court from exercising jurisdiction over LUAF's claims''); *Perry v. Coles County, Ill.*, 906 F.3d 583, 586 (7th Cir. 2013) (''[T]he district court correctly dismissed plaintiffs' amended complaint based on the comity doctrine.''); *Campaniello v. N.Y. State Dep't of Taxation*, 737 F. App'x 594, 597 (2d Cir. 2018) (''[T]he Plaintiffs-Appellants' requested relief is also barred by the doctrine of comity''); *Wayside Church v. Van Buren Cnty.*, 847 F.3d 812, 822–23 (6th Cir. 2017) (''[T]he district court erred in finding that the claims were not barred by . . . the doctrine of comity''); *Kelly v. Ala. Dep't of Revenue*, 638 F. App'x 884, 892 (11th Cir. 2016) (''[T]he district court lacked subject matter jurisdiction under . . . principles of comity''). *See also Assoc. for Accessible Medicines v. James*, 974 F.3d 216, 227 n.9 (2d Cir. 2020) (''Having concluded that the TIA barred the District Court from enjoining the stewardship payment, we do not reach New York's alternative argument that the District Court should have abstained under the doctrine of tax comity''); *Diversified Ingredients, Inc. v. Testa*, 846 F.3d 994, 997, 997–98 (8th Cir. 2017) (''[W]e decline to consider whether dismissal was also appropriate under prudential comity principles'').

[1220] *See, e.g.*, *Accessible Medicines*, 974 F.3d 216, 221 (opioid stewardship payment ''is a tax and that the District Court should have dismissed the challenges to the payment requirement for lack of subject matter jurisdiction'' under the TIA); *Landowners*, 822 Fed. App'x 797, 803, 2020 WL 4382862, at *5 (''the TIA . . . prohibit[s] the district court from exercising jurisdiction over LUAF's claims''); *Campaniello*, 737 F. App'x 594, 596 (''Because New York offers an adequate remedy to the Plaintiffs-Appellants, we conclude that we are without jurisdiction under the TIA to grant them any injunctive relief''); *Armstrong v. Walborn*, 743 F. App'x 83, 84 (9th Cir. July 19, 2018) (''[T]he Tax Injunction Act (TIA) deprives the federal courts of subject matter jurisdiction over the Armstrongs' claims and affirm the district court's dismissal of their action''); *Wayside Church*, 847 F.3d 812, 822–23 (''[T]he district court erred in finding that the claims were not barred by the Tax Injunction Act. . . .''); *Diversified Ingredients*, 846 F.3d 994, 997 (''[T]he TIA deprived that court of subject matter jurisdiction''); *Kelly*, 638 F. App'x 884, 892 (''[T]he district court lacked subject matter jurisdiction under the TIA . . .''). *See also Perry*, 906 F.3d 583, 586 (''As an initial matter, we note that the district court concluded it was unnecessary to address the applicability of the Tax Injunction Act''). *See* Andrea Muse, *Tenth Circuit Rejects Challenge to Tax Credit Process*, 97 Tax Notes State 652 (Aug. 10, 2020).

[1221] 28 U.S.C. § 1341. *See* Hayes R. Holderness & Arthur R. Rosen, *Congress Should Sprinkle Some SALT on the Federal Courts*, 89 State Tax Notes 329 (July 23, 2018).

[1222] Robert P. Merten, III & Nicolas J. Kump, *Let's Jiggle the Door Handle to Federal Court for SALT Disputes*, 95 Tax Notes State 473, 474 (Feb. 10, 2020).

[1223] 95 Tax Notes State 473, 474.

[1224] *Perry*, 906 F.3d 583, 587–88 (citations and internal quotation marks omitted).

[1225] 906 F.3d 583, 587 (citations and internal quotation marks omitted).

ISBN 978-1-63359-383-1

ciates, Inc. v. Pappas.[1226] There, the court described the taxpayers' challenge:[1227]

> The Equal Protection Clause entitles owners of similarly situated property to roughly equal tax treatment. A group of taxpayers asserts that the tax assessor for Cook County violated that guarantee by assessing their properties at the rates mandated by local ordinance while cutting a break to other owners of similarly situated property. The taxpayers pursued a refund in Illinois court, where they remain tied up in litigation after more than a decade. Frustrated, they turned to federal court for relief, arguing that Illinois's procedural rules for challenging property taxes prevent them from proving their federal constitutional claims in state court.

The Seventh Circuit held:[1228]

> Since the defendants agree that the taxpayers cannot make their equal protection case in state court, the taxpayers have no ''remedy'' at all for their claims — never mind a ''plain, ''speedy and efficient'' one — and the Tax Injunction Act does not bar their federal suit.

The court also held that the comity doctrine was not a bar to federal court either:[1229]

> The Court has explained that the ''plain, adequate, and complete'' requirement in the comity analysis is identical to the ''plain, speedy and efficient'' requirement under the Tax Injunction Act. Since the Act does not bar the federal district court from exercising jurisdiction over this challenge, neither does the principle of comity.

Finally, the court concluded that access to federal court was not barred by another procedure available under Illinois law:[1230]

> An Illinois taxpayer appealing a decision from the county Board of Review can either do so directly in circuit court under the procedures outlined in section 23-15, or first through the Property Tax Appeal Board under the procedures outlined in 35 ILCS 200/16-160. At oral argument, counsel for the defendants was asked whether the taxpayers would have had a forum for their constitutional claims if they had chosen to pursue relief at the Property Tax Appeal Board under section 16-160 instead of in court under section 23-15. The defendants' counsel conceded that the Appeal Board has taken the position that it cannot consider the type of evidence that would prove that the Assessor did not apply uniform rates. Counsel speculated that Illinois courts might take a different view but admitted, ''We don't know . . . whether a constitutional claim can be made'' at the Appeal Board. Such an unclean path to relief is not a sufficiently ''plain'' remedy under the Tax Injunction Act.

c. Freed v. Thomas (2020)

An instance in which a state tax was not at issue was *Freed v. Thomas*, where the taxpayer sought to recover excess proceeds from the foreclosure sale of his residence to pay overdue property taxes.[1231] The Sixth Circuit held:[1232]

> [N]either the TIA nor the principle of comity preclude this suit from proceeding in federal court because Freed is not challenging state tax collection or administration.

d. Frances M. Rosen Irrevocable Trust v. Oklahoma Tax Commission (2001)

Frances M. Rosen Irrevocable Trust v. Oklahoma Tax Commission[1233] is an example of a situation in which the federal-court option might now produce a better result for a taxpayer. Oklahoma classifies a trust created by a domiciliary trustor as a resident trust.[1234] In *Rosen*, the trustor, an Oklahoma domiciliary, created an irrevocable trust in 1990 and appointed a Colorado domiciliary individual as trustee. By 1994, the trustor and the trustee had moved to Nevada. The trustee filed refund requests for 1994, 1995, and 1996, claiming that the trust was a nonresident trust. Without considering state or federal constitutional arguments, the court held:[1235]

> [T]his irrevocable trust was created in Oklahoma and by its own terms requires the trust to be construed and regulated by the laws of Oklahoma. This is analogous to a business which operates in Oklahoma but is incorporated in another state. The business must comply with the laws in the state in which it is incorporated as well as the laws of the state in which it operates.

The *Rosen* decision does not reveal whether constitutional arguments were raised. If Oklahoma law precludes taxpayers from raising them, a taxpayer in a *Rosen*-type situation might explore the federal-court option.

[1226] 948 F.3d 889 (7th Cir. 2020). *See* Andrea Muse, *Seventh Circuit Allows Challenge to Cook County Assessments*, 95 Tax Notes State 441 (Feb. 3, 2020). For a subsequent opinion, see *In re A.F. Moore & Assocs.*, 974 F.3d 836, 2020 WL 5422791 (7th Cir. 2020). *See also* Andrea Muse, *Federal Circuit Orders Cook County Assessment Challenge to Proceed*, 97 Tax Notes State 1299 (Sept. 21, 2020).

[1227] 948 F.3d 889, 890–91 (citation omitted).

[1228] 948 F.3d 889, 896.

[1229] 948 F.3d 889, 896 (citation omitted).

[1230] 948 F.3d 889, 896 n.2 (citations omitted).

[1231] 976 F.3d 729 (6th Cir. 2020) *See* Jennifer McLoughlin, *Sixth Circuit Revives Suit Over Foreclosure Sale Proceeds*, 98 Tax Notes State 189 (Oct. 12, 2020).

[1232] 976 F.3d 729, 741.

[1233] 31 P.3d 406 (Okla. Civ. App. 2001).

[1234] 68 Okla. Stat. § 2353(6).

[1235] *Rosen*, 31 P.3d 406, 407.

ISBN 978-1-63359-383-1

VII. Reliance on Availability of Home State Courts Is Misplaced

A. *Exercise of Jurisdiction*

1. Introduction

In sustaining the ability to tax, the courts in *District of Columbia v. Chase Manhattan Bank*[1236] and *Chase Manhattan Bank v. Gavin*[1237] 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:[1238]

> 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,[1239] and a later comment describes the implications of such a designation as follows:[1240]

> 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:[1241]

> 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.[1242]

The Scott treatise summarizes the applicable principles as follows:[1243]

> 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:[1244]

> (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 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-four 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."[1245]

To determine a trust's "principal place of administration," UTC § 108(a) stipulates:[1246]

> 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

---

[1236] 689 A.2d 539 (D.C. 1997). *See* III.C.2., above.

[1237] 733 A.2d 782 (Conn. 1999). *See* III.C.3., above.

[1238] Restatement (Second) of Conflict of Laws § 267 (1971). *See* 7 Austin W. Scott, William F. Fratcher & Mark L. Ascher, *Scott and Ascher on Trusts* § 45.2.2.4.1, at 3102-14, § 45.2.2.4.2, at 3114-22, § 45.2.2.5, at 3122-25 (5th ed. 2010); Norman M. Abramson, Susan Gary, George G. Bogert & George T. Bogert, *The Law of Trusts and Trustee*, § 292, at 22-33 (3d ed. 2014).

[1239] Restatement (Second) of Conflict of Laws § 267 cmt. c (1971).

[1240] Restatement (Second) of Conflict of Laws § 267 cmt. d (1971).

[1241] Restatement (Second) of Conflict of Laws § 267 cmt. e (1971).

[1242] Restatement (Second) of Conflict of Laws § 267 cmt. e (1971).

[1243] 7 Austin W. Scott, William F. Fratcher & Mark L. Ascher, *Scott and Ascher on Trusts* § 45.2.2.6, at 3125 (5th ed. 2010).

[1244] UTC § 202 (amended 2018).

[1245] UTC § 202 cmt. (amended 2018).

[1246] UTC § 108(a) (amended 2018). *See In re Seneker Trust*, No. 317003 & 317096, 2015 BL 51771, 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] . . .").

ISBN 978-1-63359-383-1

(2) all or part of the administration occurs in the designated jurisdiction.

Thirty-five states have adopted a form of § 108.

4. UPC Approach

The UPC's approach is a bit different. UPC § 7-203 provides:[1247]

> The Court will not, over the objection of a party, entertain proceedings under Section 7-201 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 2008 version of the UPC,[1248] at least seven states have statutes based on § 7-203.[1249] 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.[1250]

Section 7-101 of the UPC defines "principal place of administration" as follows:[1251]

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

5. Comment

Case law 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.[1252] 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 domicile or residence. Section 103 of the Second Restatement of Conflict of Laws states:[1253]

> 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,[1254] 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:[1255]

> 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 trust 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 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 U.S. Supreme Court held in *Hanson v. Denckla*[1256] 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:[1257]

> 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. . . .

[1247] UPC § 7-203 (amended 2010).

[1248] The text of the UPC may be viewed at www.uniformlaws.org.

[1249] *See* Alaska Stat. § 13.36.045; 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.

[1250] *In re Seneker Trust*, No. 317003 & 317096, 2015 BL 51771, 2015 WL 847129, at *1.

[1251] UPC § 7-101 (amended 2010). *See* Alaska Stat. § 13.36.005; Haw. Rev. Stat. § 560:7-101; Idaho Code § 15-7-101; Mich. Comp. Laws § 700.7209; Mo. Rev. Stat. § 456.027(3); Neb. Rev. Stat. § 30-3816.

[1252] *See, e.g.*, *Bartlett v. Dumaine*, 523 A.2d 1, 14–15 (N.H. 1986);*Balt. Nat'l Bank v. Cent. Pub. Util. Corp.*, 28 A.2d 244 (Del. Ch. 1942). *See also* 7 Austin W. Scott, William F. Fratcher & Mark L. Ascher, *Scott and Ascher on Trusts* § 45.2.2.4.1, at 3112 n.36 (5th ed. 2010).

[1253] Restatement (Second) of Conflict of Laws § 103 (1971).

[1254] Restatement (Second) of Conflict of Laws § 103 cmts. a-b (1971).

[1255] 7 Austin W. Scott, William F. Fratcher & Mark L. Ascher, *Scott and Ascher on Trusts* § 45.2.2.6, at 3126 (5th ed. 2010).

[1256] 357 U.S. 235 (1958).

[1257] 7 Austin W. Scott, William F. Fratcher & Mark L. Ascher, *Scott and Ascher on Trusts* § 45.2.2.6, at 3128-29 (5th ed. 2010) (footnotes omitted).

ISBN 978-1-63359-383-1

> 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 judgment would unduly interfere with the Delaware 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.

The Scott treatise suggests that the same principle should apply in other contexts.[1258]

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:[1259]

> [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 *Bartlett v. Dumaine*.[1260]

[1258] 7 Austin W. Scott, William F. Fratcher & Mark L. Ascher, *Scott and Ascher on Trusts* § 45.2.2.6, at 3129 (5th ed. 2010).

[1259] *Lewis v. Hanson*, 128 A.2d 819, 835 (Del. 1957), *aff'd sub nom.*, *Hanson v. Denckla*, 357 U.S. 235 (1958) (citation omitted).

[1260] 523 A.2d 1 (N.H. 1986).

ISBN 978-1-63359-383-1

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:[1261]

> 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.

As covered in VI.H., above, trustees in more than half the states have a statutory duty to locate trusts in appropriate jurisdictions.

The author is 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 is the author aware of a reported case in which a trustee has been surcharged for failing to minimize income tax. However, it is possible and the author understands 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.[1262] To minimize penalties and interest in unclear situations, the attorney might advise the trustee to file a timely return each year 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.[1263] 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.

Practice Tip: In clear cases, the author's firm will take the position that state fiduciary income tax is not due. If the issue is uncertain, it will file a return and pay tax unless counsel in the relevant state provides a reasoned opinion advising not to do so.

C. *Establishing Domicile or 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 domiciliaries, residents, nondomiciliaries, or nonresidents is crucial in many states. Whereas Massachusetts[1264] deems all such beneficiaries to be residents, Delaware and Rhode Island determine their residences based on the residences of currently identifiable beneficiaries.[1265] Maryland's subtraction of capital gain income for nonresident beneficiaries is not available if "there are no remaindermen of the trust in being."[1266] The issue also is relevant in Connecticut, Hawaii, Michigan, and North Carolina where no pertinent guidance exists. As described in II.G., above, basing taxation in whole or in part on the presence of domiciliary or 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.[1267] 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.5., above, it is 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), Arkansas (perpetual trusts), Nevada (365-year trusts), North Carolina (perpetual trusts), Oklahoma (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.[1268] In 2018, the Attorney General of Arizona opined that "A.R.S. § 14-

[1261] Restatement (Third) of Trusts § 76 cmt. b(2) (2003).

[1262] *See, e.g.*, Ky. Rev. Proc. KY-RP-19-03, *Administration of Guidance* (July 26, 2019), revenue.ky.gov; Wis. Dep't of Revenue Pub. 111, *How to Get a Private Letter Ruling* (Feb. 2021); Colo. Dep't of Revenue Bull. 18-01, *All Prior Revenue Bulletins Rescinded* (Feb. 28, 2018), www.colorado.gov/revenue; Mich. Dep't of Treasury Revenue Admin. Bull. 2016-20, *Issuance of Bulletins, Letter Rulings, and Other Guidance for Taxpayers* (Oct. 5, 2016) www.michigan.gov/treasury; Cal. Franchise Tax Bd. Notice 2009-08, *Franchise Tax Board Ruling Guidelines* (Oct. 12, 2009), www.ftb.cal.gov *See also* Andrea Muse, *More Focus on Publication of DOR Rulings with Proposed Bill*, 99 Tax Notes State 647 (Feb. 8, 2021); Andrea Muse, *Questions Persist on Publication of DOR Guidance*, 99 Tax Notes State 646 (Feb. 8, 2021); Cal. Franchise Tax Bd. Info. Ltr. 2012-01, 2012 Cal. FTB I.L. Lexis 1 (Franchise Tax Bd. Nov. 28, 2012).

[1263] *See* Bradley E.S. Fogel, *What Have You Done for Me Lately? Constitutional Limitations on State Taxation of Trusts*, 32 U. Rich L. Rev. 165, 228-29 (Jan. 1998).

[1264] Mass. Gen. Laws ch. 62, § 10(a). *See* Mass. Reg. Code tit. 830, § 62.10.1(2)(b); instructions to 2020 Mass. Form 2 at 4.

[1265] 30 Del. C. § 1636(b); R.I. 280-RICR-20-55-7.6.

[1266] Md. Code Ann., Tax-Gen. § 10-207(o)(3).

[1267] *See* II.E., above.

[1268] *See* Ariz. Const. art. 2, § 29; Ark. Const. art. 2, § 19; Nev. Const. art. 15, § 4; N.C. Const. art. 1, § 34; Okla. Const. art. 2, § 32; 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

ISBN 978-1-63359-383-1

2901(A)(2) and (3) likely violate Article II, § 29 of the Arizona Constitution.''[1269]

This concern is also acute in Nevada where voters disapproved a ballot initiative to repeal the constitutional prohibition in 2002. Regarding this issue, Professor Sitkoff and a co-author wrote that:[1270]

> [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*[1271] — and a 2015 decision of the same court — *Bullion Monarch Mining, Inc. v. Barrick Gold Strike Mines, Inc.*[1272] — 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:[1273]

> 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.[1274]

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.''[1275] Not surprisingly given the nature of the interest, the court held that it did not.[1276] In the course of the opinion, the court discussed a 1974 case, *Rupert v. Stienne*,[1277] as endorsing statutes that depart from the common law. Nevertheless, *Rupert*, which dealt with the ''old common-law rule of interspousal immunity,''[1278] 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. The best way to resolve the issue, of course, 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. For example, it appears that this is the case in New York.[1279]

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. New York's approach to this issue is covered in IV.A.5., above. Connecticut adopted a comparable rule in 2014.[1280]

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 12 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.[1281] The court concluded that:[1282]

> 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 and S corporation income allocated outside New Jersey.[1283]

(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 ''[t]he 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)). For analyses of these constitutional prohibitions, see Dan W. Holbrook, *Is Tennessee's Rule Against Perpetuities Unconstitutional?* 55-DEC Tenn. B.J. 29 (Dec. 2019); Les Raatz, *State Constitutional Perpetuities Provisions: Derivation, Meaning, and Application*, 48 Ariz. St. L.J. 803 (Fall 2016). *See also* Daniel G. Worthington, et al., *Which Trust Situs Is Best in 2020?* 159 Tr. & Est. 70, 70 (Jan. 2020) (''While Tennessee has a 360 term-of-years RAP period, it also has decanting and directed trust statutes and recently improved its asset protection laws. Tennessee, like Nevada, is one of the states that has a constitutional prohibition of perpetuities that may be of a concern''); Charlie Kearns, Maria Todorova & Justin Stone, *Ladders Out of Chaos: State Constitutional Limitations on State and Local Taxes*, 29 J. Multistate Tax'n & Incentives 8 (July 2019). *See generally* Barbara R. Grayson, et al., *Drafting Trusts to Stand the Test of Time*, 158 Tr. & Est. 30 (Nov. 2019).

1269 Ariz. Attorney General Opinion No. I18-006, *Arizona's Rule Against Perpetuities* (July 2, 2018), www.azag.gov.

1270 Steven J. Horowitz & Robert H. Sitkoff, *Unconstitutional Perpetual Trusts*, 67 Vand. L. Rev. 1769, 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.

1271 111 P.2d 49 (Nev. 1941). *See* Steven J. Oshins, *The Rebuttal to Unconstitutional Perpetual Trusts*, LISI Est. Plan. Newsl. #2265 (Dec. 22, 2014), www.leimbergservices.com.

1272 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.

1273 *Sarrazin*, 111 P.2d 49, 51 (citation omitted; emphasis added).

1274 *Sarrazin*, 111 P.2d 49, 53.

1275 *Bullion Monarch Mining*, 345 P.3d 1040, 1041.

1276 345 P.3d 1040, 1044.

1277 528 P.2d 1013 (Nev. 1974).

1278 *Bullion Monarch Mining*, 345 P.3d 1040, 1042.

1279 *See* IV.A.3., above.

1280 Conn. Gen. Stat. § 12-711(b)(6).

1281 *Tina Schiller Tr. v. Dir., Dep't of Treasury, Div. of Tax'n for State of N.J.*, 14 N.J. Tax 173 (Super. Ct. App. Div. 1994).

1282 14 N.J. Tax 173, 181.

1283 *Residuary Tr. A U/W/O Kassner v. Dir. Div. of Tax'n*, 28 N.J. Tax 541, 548 (N.J. Super. Ct. App. Div. 2015). *See* III.D.2., above. *Accord Hill v. Dir., State Div. of Tax'n*, 29 N.J. Tax 318 (N.J. Sup. Ct. App. Div. 2016).

ISBN 978-1-63359-383-1

Minnesota adheres to the New Jersey approach. Thus, in *Fielding v. Commissioner of Revenue*,[1284] the Minnesota Supreme Court observed:

> The dispute between the Trusts and the Commissioner implicates the extent of the Trusts' tax liability to Minnesota. If the Trusts are residents, Minnesota can tax the Trusts' worldwide income. If the Trusts are not residents, Minnesota's tax authority is restricted.

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.[1285]

The Supreme Court of Ohio held that the gain from the sale of a nonresidents' interest in an LLC was not Ohio-source income.[1286] Later that year, though, the same court held that:[1287]

> [W]e conclude that the trust's capital gain constituted a "qualifying trust amount" subject to Ohio income tax on an apportioned basis but that the trust had a legal basis for seeking a reduced Ohio allocation. We also conclude that the tax assessment did not violate the Due Process Clause of the United States Constitution or the Equal Protection Clauses of the United States and Ohio Constitutions.

G. Combining Nondomiciliary or Nonresident Trustee With Domiciliary or Resident Adviser, Protector, or Committee

The author is often asked whether New York tax or the tax of another state can be prevented by appointing domiciliary or resident advisers, protectors, or committee members to work with a nondomiciliary or nonresident trustee. This approach is risky — and should be avoided if at all possible — if the adviser is a fiduciary and/or exercises investment, distribution, or other management duties.[1288] There is authority though, that the strategy will work if the adviser is only a custodian or agent[1289] or if the adviser delegates the fiduciary/management responsibilities.[1290]

H. Changing Testator or Trustor by Exercise of Power

The author is sometimes asked whether the identity of the testator or trustor in a state that taxes based on the domicile or 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.[1291] 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 Trust.[1292] 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.

For the most part, the authorities for decanting are not encouraging. For example, regulations under § 671[1293] 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[1294] and the available state tax rulings, other than in Virginia and possibly New Jersey (where an unpublished letter ruling has been issued),[1295] indicate that the identity of the trust creator would not change.[1296] In the 2013 *Linn v. Department of Revenue case*,[1297] a trust created through the exercise of a trustee decanting power escaped Illinois income tax because:[1298]

> 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.

Section 25 of the Uniform Trust Decanting Act (UTDA) addresses the issue directly. It specifies, "a settlor of a first trust is deemed to be the settlor of the second trust with respect to the portion of the principal of the first trust subject to the exercise of the decanting power."[1299] States that have enacted the

[1284] 916 N.W.2d 323, 328 (Minn. 2018) (citations omitted).

[1285] *See* Minn. Stat. § 290.17 subd. 2(c).

[1286] *Corrigan v. Testa*, 73 N.E.3d 381 (Ohio 2016). *See* Roxanne Bland, *Passthrough Entities: The Constitutional Dimension*, 86 State Tax Notes 569 (Nov. 6, 2017); 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).

[1287] *T. Ryan Legg Irrev. Tr. v. Testa*, 75 N.E.3d 184, 186 (Ohio 2016).

[1288] *See* IV.A.4.d., above.

[1289] *See, e.g.*, III.B.3., above.

[1290] *See* IV.F.2., above.

[1291] *See* N.Y. TSB-A-03(6)I, 2003 WL 22970581 (N.Y. Dep't Tax'n Fin. Nov. 21, 2003), www.tax.ny.gov; Conn. Dep't of Revenue Services Ruling 2005-2, *Income Tax/Residency of Appointive Trust* (Jan. 14, 2005), www.ct.gov/drs. *See also* IV.A.4.e., above.

[1292] *See* P.D. 16-62, 2016 WL 2940441 (Va. Dep't Tax'n Apr. 20, 2016), www.tax.virginia.gov. *See also* IV.C.12., above.

[1293] *See* Reg. § 1.671-2(e)(5). *See also* PLR 200736002 (["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").

[1294] *See, e.g.*, Alaska Stat. § 13.36.158(a); Ariz. Rev. Stat. § 14-10819(C); Conn. Gen. Stat. § 45a-572; Del. Code Ann. tit. 12, § 3528(c); Fla. Stat. § 736.04117(7)(a); Ind. Code § 30-4-3-36(c); Iowa Code § 633A.4215(7); 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.D. Cent. Code § 59-16.1-06; 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); Wis. Stat. § 701.0418(8)(a); Wyo. Stat. § 4-10-816(a)(xxviii).

[1295] *See* IV.B.8., above.

[1296] *See* IV.A.4.e., above.

[1297] 2 N.E.3d 1203 (Ill. App. Ct. 2013).

[1298] 2 N.E.3d 1203, 1208.

[1299] Unif. Trust Decanting Act § 25 (2015). The text of the Uniform Trust Decanting Act and a list of the states that have enacted it may be viewed at www.uniforms.org.

ISBN 978-1-63359-383-1

UTDA and Texas,[1300] which has not enacted the UTDA, have comparable provisions.[1301]

I. *State Income Taxation of CRTs*

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 two states — New Jersey and Pennsylvania — tax CRTs at the trust level.

Accordingly, in 2009, the New Jersey Division of Taxation announced that:[1302]

> 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:[1303]

> Charitable Remainder Annuity Trusts (CRATs) and Charitable Remainder Unitrusts (CRUTs) 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 undistributed income may benefit any private individual in subsequent years; or
> - 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 undistributed income, and report the income to the beneficiary on the same basis as any other ordinary trust.

Clients often create CRTs to diversify portfolios of low-basis securities without 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 as well.

To the author's knowledge, every other state that imposes an income tax generally exempts CRTs from taxation.

J. *Self-Settled Trust Option — The ''ING Trust''*

Many domestic APTs are grantor trusts for federal income-tax purposes under § 677(a) because the trustee may distribute income to — or accumulate it for — the trustor without the approval of an adverse party. However, a client might use a type of domestic APT known as the incomplete gift nongrantor trust (ING Trust'') to eliminate income tax on undistributed ordinary income and capital gains imposed by Pennsylvania, which has not adopted the federal grantor-trust rules for irrevocable trusts, or, if clients are willing to subject distributions to themselves to the control of adverse parties, to eliminate income tax on such income imposed by one of the 42 states that have adopted the federal grantor-trust rules. In dozens of private letter rulings issued since 2013,[1304] the IRS has ruled that domestic APTs that followed the ING-Trust approach qualified as incomplete gifts and as nongrantor trusts. Most — if not all — of the early rulings involved Nevada law in large part because, at the time, Nevada was the only domestic APT state that allowed a trustor to keep a nongeneral lifetime power of appointment. Alaska, Delaware, and South Dakota now offer that option as well.[1305] The trustor of an ING Trust might be able to receive tax-free distributions of the untaxed income in later years.[1306] Given that, since 2014, ING Trusts are no longer available for New York domiciliaries,[1307] New Yorkers who are interested in reducing New York State and New York City income tax should consider establishing domestic APTs as completed gifts and nongrantor trusts. In addition, because New York's anti-ING Trust provision applies to taxpayers who create ''Resident Trusts''[1308] and because Resident Trusts are

---

[1300] *See* Tex. Prop. Code § 112.077.

[1301] *See* Ala. Code § 19-3D-25; Cal. Prob. Code § 19525; Colo. Rev. Stat § 15-16-925; 760 ILCS 3/1225; Neb. Rev. Stat. § 30-4525; N.M. Stat. Ann. § 46-12-125; N.C. Gen. Stat. § 36C-8B-25; Va. Code Ann. § 64.2-779.22; Wash. Rev. Code § 11.107.050(3); W.Va. Code § 44D-8B-25.

[1302] N.J. Div. of Tax'n Technical Bull. TB-64, *Charitable Remainder Trusts* (June 29, 2009), www.state.nj.us/treasury.

[1303] Instructions to 2020 Form PA-41 at 3. *See* 72 P.S. § 7301(c.1).

[1304] *See, e.g.*, PLR 202017018, PLR 202014001–PLR 202014005, PLR 202007010, PLR 202006002–PLR 202014006, PLR 201925005–PLR 201925010, PLR 201908008, PLR 201908003–PLR 201908007, PLR 201852009, PLR 201852014, PLR 201850001–PLR 201850006, PLR 201848002, PLR 201848009, PLR 201838002–PLR 201838007, PLR 201836006, PLR 201832005–PLR 201832009. *See McKenney v. United States*, 973 F.3d 1291, 1300 n.6 (11th Cir. 2020) (''Private letter rulings do not have the force of law and are not binding. Nevertheless, they may constitute 'persuasive authority' because they represent the views of the IRS, which is charged with administering the Tax Code'') (citations omitted).

[1305] Alaska Stat. § 34.40.110(b)(2); Del. Code Ann. tit. 12, § 3570(11)(b)(2); Nev. Rev. Stat. § 166.040(2)(b); S.D. Codified Laws § 55-16-2(2)(b).

[1306] *See* Eric. R. Bardwell, *California Admits Incomplete Gift Non-Grantor Trusts Work . . . For Now*, 46 Tax Mgmt. Est., Gifts & Tr. J. 24, 26-28 (Jan. 7, 2021); Lindsay R. DeMoss D'Andrea, *Incomplete Gift Non-Grantor Trusts: How Kaestner Highlights the Importance of Planning for State Income Tax*, 34 Prob. & Prop. 42 (May/June 2020).

[1307] *See* N.Y. Tax Law § 612(b)(41).

[1308] N.Y. Tax Law § 612(b)(41).

ISBN 978-1-63359-383-1

trusts created by New York domiciliaries,[1309] the ING Trust option should be available to ''statutory residents'' (i.e., individuals who maintain a permanent place of abode and spend more than 183 days in New York State and/or New York City during a tax year).[1310] Arkansas taxpayers were unable to escape Arkansas income tax on capital gains incurred in 2017 by structuring an ING Trust to exploit an apparent disconnect between the federal and the Arkansas grantor-trust rules.[1311] The technique is still viable for domiciliaries or residents of other states.

In 2015, the author's firm successfully resisted the California Franchise Tax Board's efforts to tax an ING Trust, thus saving the trustor millions of dollars of California income tax. There, the Franchise Tax Board initially contended that an improperly drafted ING trust was a grantor trust for California purposes, the trustee successfully petitioned the Delaware Court of Chancery to reform the trust, and the Franchise Tax Board withdrew its objection.[1312] A proposal would eliminate the ING-Trust option for Californians beginning in 2022.[1313]

The author of one article concluded:[1314]

> Few advisers are likely to say that the NING or DING trust is guaranteed to provide the desired results. A better 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.

The days of the ING Trust might be numbered for two reasons. First, Professor McCouch of the University of Florida Levin College of Law published an article early in 2020 in which he questioned several tax aspects of the vehicle.[1315] Second, in January of 2021, the IRS announced that it will not issue Private Letter Rulings on the income-, estate-, and gift-tax implications of ING Trusts until it issues pertinent guidance.[1316]

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:[1317]

> [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 advisers 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 advisers. Nevertheless, they have a duty to put the interests of clients before their own and risk liability for not doing so. In the author's experience, attorneys' and accountants' fears in this regard are unwarranted. As an attorney for a Delaware trust company, the author frequently works with attorneys from throughout the country and never has seen a non-Delaware attorney lose a client to a Delaware attorney because the latter always appreciates the limited role. 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.F.–III.G., above, a state may tax based on the place of administration and the domicile or residence of the trustee or fiduciary, but practitioners can plan around these options. Taxing nondomiciliary or nonresident trustees based on the domiciles or residences of testators, trustors, and beneficiaries is problematic. The best choice might be to tax domiciliary or resident beneficiaries on current distributions and collect tax on past distributions via a throwback tax as is done in California, New York, and Pennsylvania with the recognition that beneficiaries might move to eliminate tax. It should be noted, however, that the U.S. Supreme Court did not endorse the throwback-tax structure in *North Carolina Depart-*

[1309] N.Y. Tax Law § 605(b)(3)(B)–§ 605(b)(3)(C).

[1310] N.Y. Tax Law § 605(b)(1)(B).

[1311] *In the Matter of* * * *, Ark. Dep't of Fin. & Admin., Office of Hearings & Appeals Opinion No. 20-755 (Aug. 7, 2020), www.ark.org/dfa. *See* IV.C.2., above.

[1312] For a case in which a trust was reformed to escape the reciprocal-trust doctrine and to bind the IRS under *Commissioner v. Estate of Bosch* (387 U.S. 456) (1967)), see *Matter of Jill Petrie St. Clair Trust Reformation*, 464 P.3d 326 (Kan. 2020).

[1313] *See* Eric R. Bardwell, *California Admits Incomplete Gift Non-Grantor Trusts Work . . . For Now*, 46 Tax Mgmt. Est., Gifts & Tr. J. 24, 28-29 (Jan. 7, 2021).

[1314] Robert W. Wood, *Sellers and Settling Litigants Lured by Tax Savings of NING and DING Trusts,* 77 State Tax Notes 565, 568 (Aug. 10, 2015).

[1315] Grayson M.P. McCouch, *Adversity, Inconsistency, and the Incomplete Nongrantor Trust*, 39 Va. Tax Rev. 419 (Spring 2020).

[1316] Rev. Proc. 2021-3 § 5.01(9), § 5.01(10), § 5.01(15), § 5.01(17).

[1317] ABA Comm. on Ethics and Prof'l Responsibility, Formal Op. 352 at 3 (1985). *See* Darren T. Case, *Forget the Cold Winters, I'm Moving Somewhere Warm: Avoiding Unauthorized Practice and Other Ethical and Practical Pitfalls When Your Client Relocates*, 43 Tax Mgmt. Est., Gifts & Tr. J. 279 (Nov. 8, 2018); Dennis J. Ventry, Jr., *Lowering the Bar: ABA Formal Opinion 85-352*, 112 Tax Notes 69 (July 3, 2006).

ISBN 978-1-63359-383-1

ment of Revenue v. The Kimberley Rice Kaestner 1992 Family Trust.[1318]

[1318] *See N.C. Dep't of Revenue v. The Kimberley Rice Kaestner 1992 Family Trust*, 139 S. Ct. 2213, 2225 n.13 (2019) (''The Trust also raises no challenge to the practice known as throwback taxation, by which a State taxes accumulated income at the time it is actually distributed. *See, e.g.*, Cal. Rev. & Tax. Code § 17745(b)'').

ISBN 978-1-63359-383-1

TABLE OF WORKSHEETS

ISBN 978-1-63359-383-1

Bases of State Income Taxation of Nongrantor Trusts for 2020

State	Citations	Top 2020 Rate	Trust Created by Will of Domiciliary/Resident	Inter Vivos Trust Created by Domiciliary/Resident	Trust Administered in State	Trust With Domiciliary/Resident Trustee/Fiduciary	Trust With Domiciliary/Resident Beneficiary	Tax Dep't Website
Alabama	Ala. Code § 40-18-1(33), § 40-18-5(l)(c); Ala. Admin. Code r. 810-3-29-.07(2)(b)–(c); instructions to 2020 Ala. Form 41 at 2.	5.00% on taxable income over $3,000	✓[1]	✓[1]				**revenue.alabama.gov**
Alaska	No income tax imposed.							**www.dor.alaska.gov**
Arizona	Ariz. Rev. Stat. § 43-1011(A)(6)(a), § 43-1013, § 43-1301(5), § 43-1311(B); instructions to 2020 Ariz. Form 141AZ at 1, 20.	4.50% on taxable income over $163,632				✓		**www.azdor.gov**
Arkansas	Ark. Code Ann. § 26-51-201(a)(9), § 26-51-201(a)(10), § 26-51-201(d), § 26-51-203(a); 2020 Ark. Regular Tax Table at 28; 2020 Ark. Indexed Tax Brackets	6.60% on net income over $82,000	✓[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 2020 Cal. Form 541 at 9, 11.	13.30% on taxable income over $1 million				✓	✓[3]	**www.ftb.ca.gov**
Colorado	Colo. Rev. Stat. § 39-22-103(10), § 39-22-104(1.7); instructions to 2020 Colo. Form 105 at 3, 4; 2020 Colo. Form 105 at 1.	4.55% on taxable income			✓			**www.tax.colorado.gov**

ISBN 978-1-63359-383-1

Connecticut	Conn. Gen. Stat. § 12-700(a)(9)(E), § 12-701(a)(4)(C)–(D); Conn. Agencies Regs. § 12-701(a)(4)-1; instructions to 2020 Form CT-1041 at 5, 16; 2020 Form CT-1041 at 2.	6.99% on taxable income	✓	✓[4]				**portal.ct.gov/drs**
Delaware	Del. Code Ann. tit. 30, § 1102(a)(14), § 1601(9); instructions to 2020 Del. Form 400 at 1–2; 2020 Del. Form 400 at 2.	6.60% on taxable income over $60,000	✓[5]	✓[5]		✓[5]		**www.revenue-.delaware.gov**
District of Columbia	D.C. Code § 47-1806.03(a)(10), § 47-1809.01, § 47-1809.02; instructions to 2020 D.C. Form D-41 at 7, 8.	8.95% on taxable income over $1 million	✓	✓				**otr.cfo.dc.gov**
Florida	No income tax imposed.							**floridarevenue.com**
Georgia	Ga. Code Ann. § 48-7-20(b)(1), § 48-7-20(d), § 48-7-22; instructions to 2020 Ga. Form 501 at 7.	5.75% on taxable net income over $7,000					✓[2]	**dor.georgia.gov**
Hawaii	Haw. Rev. Stat. § 235-1, § 235-51(d); Haw. Admin. Rules § 18-235-1.17; instructions to 2020 Haw. Form N-40 at 1, 11.	8.25% on taxable income over $40,000			✓[5]	✓[5]		**tax.hawaii.gov**
Idaho	Idaho Code § 63-3015(2), § 63-3024(a); Idaho Admin. Code Regs. 35.01.01.035.01, 35.01.01.075.03(e); instructions to 2020 Idaho Form 66 at 8.	6.925% on taxable income over $11,760	✓[6]	✓[6]	✓[6]	✓[6]		**tax.idaho.gov**
Illinois	35 ILCS 5/201(a), 5/201(b)(5.4), 5/201(c), 5/201(d), 5/1501(a)(20)(C)–(D); Ill. Admin. Code tit. 86, § 100.3020(a)(3)–(4); instructions to 2020 Form IL-1041 at 5–6; 2020 Form IL-1041 at 3.	6.45% on net income	✓	✓				**www.revenue.illinois.gov**

ISBN 978-1-63359-383-1

Indiana	Ind. Code § § 6-3-1-12(d), 6-3-2-1(a)(3); Ind. Admin. Code tit. 45, r. 3.1-1-21(d); instructions to 2020 Ind. Form IT-41 at 1, 4; 2020 Ind. Form IT-41 at 1.	3.23% on taxable income			✓			**www.in.gov/dor**
Iowa	Iowa Code § 422.5(1), § 422.5A(9); Iowa Admin. Code r. 701-89.3(1)–(2); 2020 Iowa Form IA 1041 at 4.	8.53% on taxable income over $74,970			✓[6]	✓[6]		**tax.iowa.gov**
Kansas	Kan. Stat. Ann. § 79-32,109(d), § 79-32,110(a)(2)(F), § 79-32,110 (d); instructions to 2020 Kan. Form K-41 at 2; 2020 Kan. Form K-41 at 4.	5.70% on taxable income over $30,000			✓			**www.ksrevenue-.org**
Kentucky	Ky. Rev. Stat. Ann. § 141.020(2)(a), § 141.030(1); 103 Ky. Admin. Reg. 19:010; instructions to 2020 Ky. Form 741 at 2; 2020 Ky. Form 741 at 2.	5.00% on taxable income				✓[5]		**revenue.ky.gov**
Louisiana	La. Rev. Stat. Ann. § 47:300.1(3), § 47:300.10(3); instructions to 2020 La. Form IT-541 at 1.	6.00% on taxable income over $50,000	✓		✓[7, 8]			**www.revenue.louisiana.gov**
Maine	Me. Rev. Stat. Ann. tit. 36, § 5102(4)(B)–(C), § 5111(1-F), § 5403; instructions to 2020 Form 1041ME at 1, 3.	7.15% on taxable income over $52,600	✓	✓				**www.maine.gov/revenue**

ISBN 978-1-63359-383-1

Maryland	Md. Code Ann., Tax–Gen. § 10-101(k)(1)(iii), § 10-105(a)(1)(viii), § 10-106(a)(1)(iii); instructions to 2020 Md. Form 504 at 1, 5, 6.	5.75% (plus county tax between 2.25% and 3.20%) on taxable net income over $250,000	✔[5]	✔[5]	✔[5]			**www.marylandtaxes.gov**
Massachusetts	Mass. Gen. Laws ch. 62, § 4, § 10(a), § 10(c); Mass Regs. Code tit. 830, § 62.10.1(1); instructions to 2020 Mass. Form 2 at 2, 4, 23; 2020 Mass. Form 2 at 2.	5.00% on taxable income (12.00% for short-term gains and gains on sales of collectibles)	✔[5]	✔[2, 5]				**www.mass.gov/orgs/massachusetts-department-of-revenue**
Michigan	Mich. Comp. Laws § 206.16, § 206.18(1)(c), § 206.51(1)(b); instructions to 2020 MI-1041 at 2; 2020 MI-1041 at 1.	4.25% on taxable income	✔	✔[9]				**www.michigan.gov/taxes**
Minnesota	Minn. Stat. § 290.01 Subd. 7b, § 290.06 Subd. 2c, § 290.06 Subd. 2d; instructions to 2020 Minn. Form M2 at 1, 13, 18.	9.85% on taxable net income over $136,735	✔[10]	✔[10]	✔[11]			**www.revenue.state.mn.us**
Mississippi	Miss. Code Ann. § 27-7-5(1)(c); instructions to 2020 Miss. Form 81-110 at 3, 11.	5.00% on taxable income over $10,000			✔			**www.dor.ms.gov**
Missouri	Mo. Rev. Stat. § 143.011, § 143.061, § 143.331(2)–143.331(3); instructions to 2020 Form MO-1041 at 4, 11.	5.40% on taxable income over $8,584	✔[12]	✔[12]				**dor.mo.gov**

ISBN 978-1-63359-383-1

Montana	Mont. Code Ann. § 15-30-2103; instructions to 2020 Mont. Form FID-3 at 3, 18–19; 2020 Mont. Form FID-3 at 2.	6.90% on taxable income over $18,700	✓[6]	✓[6]	✓[6]	✓[6]	✓[6]	**mtrevenue.gov**
Nebraska	Neb. Rev. Stat. § 77-2714.01(6)(b)–77-2714.01(6)(c), § 77-2715.03(2)–77-2715.03(3), § 77-2717(1)(a)(ii); Neb. Admin. R. & Regs. 316-23-001; instructions to 2020 Neb. Form 1041N at 7, 8.	6.84% on taxable income over $16,580	✓	✓				**www.revenue.nebraska.gov**
Nevada	No income tax imposed.							**tax.nv.gov**
New Hampshire	No income tax imposed on nongrantor trusts.							**www.revenue.nh.gov**
New Jersey	NJSA § 54A:1-2(o)(2)– § 54A:1-2(o)(3), § 54A:2-1(b)(7); instructions to 2020 Form NJ-1041 at 3, 30.	10.75% on taxable income over $1 million	✓[13]	✓[13]				**www.state.nj.us/treasury/taxation**
New Mexico	N.M. Stat. Ann. § 7-2-7(C); instructions to 2020 N.M. Form F1D-1 at 3, 9.	4.90% on taxable income over $16,000			✓	✓		**www.tax.newmexico.gov**
New York State	N.Y. Tax Law § 601(c)(1)(B)(iii), § 605(b)(3); N.Y. Comp. Codes R. & Regs. tit. 20, § 105.23; instructions to 2020 N.Y. Form IT-205 at 2, 10.	8.82% on taxable income over $1,077,550	✓[13]	✓[13]				**www.tax.ny.gov**
New York City	N.Y. Tax Law § 1304(a)(3)(A), § 1304-B(a)(1)(ii), 1305(c); N.Y.C. Admin. Code § 11-1701, § 11-1704.1, § 11-1705; instructions to 2020 N.Y. Form IT-205 at 16, 18.	3.876% on taxable income over $50,000	✓[13]	✓[13]				**www.tax.ny.gov**

ISBN 978-1-63359-383-1

North Carolina	N.C. Gen. Stat. § 105-153.7(a), § 105-160.2; 2020 N.C. Form D-407A at 1, 2; 2020 N.C. Form D-407 at 1.	5.25% on taxable income					✓[14]	**www.ncdor.gov**
North Dakota	N.D. Cent. Code § 57-38-30.3(1)(e), § 57-38-30.3(1) (g); N.D. Admin. Code § 81-03-02.1-04(2); instructions to 2020 N.D. Form 38 at 2; 2020 N.D. Form 38 at 2.	2.90% on taxable income over $13,175			✓[6]	✓[6]	✓[6]	**www.nd.gov/tax**
Ohio	Ohio Rev. Code Ann. § 5747.01(I)(3), § 5747.02(A)(3), § 5747.02(D); instructions to 2020 Ohio Form IT 1041 at 8, 9.	4.797% on taxable income over $221,300	✓	✓[5]				**www.tax.ohio.gov**
Oklahoma	Okla. Stat. tit. 68, § 2353(6), § 2355(C)(1)(f), § 2355(G), § 2355.1A; Okla. Admin. Code § 710:50-23-1(c); instructions to 2020 Okla. Form 513 at 3, 17.	5.00% on taxable income over $7,200	✓	✓				**www.ok.gov/tax**
Oregon	Or. Rev. Stat. § 316.037, § 316.282(1)(d); Or. Admin. R. 150-316.0400(3); instructions to 2020 Or. Form 41 at 3; 2020 Or. Form 41 at 3.	9.90% on taxable income over $125,000			✓	✓		**www.oregon.gov/dor**
Pennsylvania	72 P.S. § 7301(s), § 7302; 61 Pa. Code § 101.1; instructions to 2020 Form PA-41 at 5; 2020 Form PA-41 at 1.	3.07% on taxable income	✓[15]	✓[15]				**www.revenue.pa.gov**

ISBN 978-1-63359-383-1

Rhode Island	R.I. Gen. Laws § § 44-30-2.6(c)(3)(A)(II), § 44-30-2.6(c)(3)(E), § 44-30-5(c)(2)–§ 44-30-5(c)(4); 280-RICR-20-55-7.7; instructions to 2020 Form RI-1041 at 1-1; 2020 RI-1041 Tax Rate Schedules at 1.	5.99% on taxable income over $8,300	✓[5]	✓[5]				**www.tax.ri.gov**
South Carolina	S.C. Code Ann. § 12-6-30(5), § 12-6-510(A), § 12-6-520; instructions to 2020 Form SC1041 at 1, 3.	7.00% on taxable income over $15,400			✓			**dor.sc.gov**
South Dakota	No income tax imposed.							**dor.sd.gov**
Tennessee	Tenn. Code Ann. § 67-2-102(4), § 67-2-110(a); instructions to 2020 Tenn. Form INC. 250 at 1, 2.	1.00% on income (interest and dividends only)					✓	**www.tn.gov/revenue**
Texas	No income tax imposed.							**www.comptroller.texas.gov/taxes**
Utah	Utah Code Ann. § 59-10-104(2)(b), § 59-10-202(2)(b), § 75-7-103(1)(i)(ii)–(iii); instructions to 2020 UT Form TC-41 at 3, 6, 12–13; 2020 UT Form TC-41 at 1.	4.95% on taxable income	✓[16]		✓[16, 8]			**www.tax.utah.gov**
Vermont	Vt. Stat. Ann. tit. 32, § 5811(11), § 5822(a)(5), § 5822(a)(6), § 5822(b)(2); instructions to 2020 Vt. Form FIT-161 at 2; 2020 Vt. Form FIT-161 at 2.	8.75% on taxable income over $9,750	✓	✓				**www.tax.vt.gov**

ISBN 978-1-63359-383-1

Virginia	Va. Code Ann. § 58.1-302, § 58.1-320, § 58.1-360; 23 Va. Admin. Code § 10-115-10; instructions to 2020 Va. Form 770 at 1, 9.	5.75% on taxable income over $17,000	✓	✓	✓[17]			**www.tax.virginia.gov**
Washington	No income tax imposed.							**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 2020 W. Va. Form IT-141 at 2, 8.	6.50% on taxable income over $60,000	✓	✓				**www.tax.wv.gov**
Wisconsin	Wis. Stat. § 71.06(1q), § 71.06(2e)(b), § 71.125(1), § 71.14(2), § 71.14(3), § 71.14 (3m); instructions to 2020 Wis. Form 2 at 1, 19.	7.65% on taxable income over $263,480	✓	✓[18]	✓[19]			**www.revenue.wi.gov**
Wyoming	No income tax imposed.							**revenue.wyo.gov**

[1] Provided that trust has domiciliary or resident fiduciary or current beneficiary for more than seven months during taxable year.
[2] Provided that trust has resident fiduciary.
[3] Other than beneficiary whose interest is contingent.
[4] Provided that trust has resident noncontingent beneficiary.
[5] Provided that trust has resident beneficiary.
[6] Provided that other requirements are met.
[7] Unless trust designates governing law other than Louisiana.
[8] Testamentary trust created by nonresident; inter vivos trust created by resident or nonresident.
[9] Unless trustee, assets, administration, and beneficiaries 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 taxable year.
[13] Unless trust has no trustee, asset, or source income in state and trustee files informational return.
[14] Unless trust does not have resident trustee and resident beneficiaries have not received income, have no right to demand it, and are uncertain ever to receive it (Kaestner, 139 S. Ct. 2213 (2019)). Tax might be eliminated in other situations.
[15] Unless settlor is no longer resident or is deceased and trust lacks sufficient contact with Pennsylvania to establish nexus.
[16] Post-2003 trust having Utah corporate trustee may deduct all nonsource income but must file Utah return if must file federal return.
[17] Until July 1, 2019
[18] Trust created or first administered in Wisconsin after October 28, 1999, only.
[19] Irrevocable inter vivos trust administered in Wisconsin before October 29, 1999, only.

ISBN 978-1-63359-383-1

Minnesota 2020 Schedule M2RT Resident Trust Questionnaire

Link to ‘‘Minnesota 2020 Schedule M2RT Resident Trust Questionnaire’’

ISBN 978-1-63359-383-1

State Income Tax on $1 Million Capital Gain Incurred by Nongrantor Trust in 2020

Name	2020 Savings
Alabama	$ 38,063
Arizona	43,799
Arkansas	32,036
California	107,549
Colorado	45,495
Connecticut	69,893
Delaware	64,977
District of Columbia	85,016
Georgia	57,250
Hawaii	72,172
Idaho	68,973
Illinois	64,500
Indiana	32,297
Iowa	83,261
Kansas	56,537
Kentucky	50,000
Louisiana	46,743
Maine	71,072
Maryland (Baltimore County)	87,868
Massachusetts	50,000
Michigan	42,496
Minnesota	94,648
Mississippi	49,640
Missouri	53,810
Montana	48,227
Nebraska	68,007
New Jersey	74,484
New Mexico	29,116
New York State	68,493
New York State plus New York City	107,124
North Carolina	52,495
North Dakota	17,287
Ohio	45,493
Oklahoma	49,808
Oregon	97,300
Pennsylvania	30,700
Rhode Island	59,765
South Carolina	38,670
Utah	49,495
Vermont	86,789
Virginia	57,237

ISBN 978-1-63359-383-1

Worksheet 3

West Virginia	63,836
Wisconsin	49,836

ISBN 978-1-63359-383-1

Cost/Saving From Including $1 Million Capital Gain in Distributable Net Income in 2020

State	2020 Cost/(Savings)
Alabama	$ 5,546
Arizona	9,124
Arkansas	(2,114)
California	72,862
Colorado	10,815
Connecticut	35,729
Delaware	30,538
District of Columbia	49,819
Georgia	22,787
Hawaii	37,753
Idaho	33,908
Illinois	15,379
Indiana	(1,853)
Iowa	48,960
Kansas	22,122
Kentucky	15,747
Louisiana	12,392
Maine	36,958
Maryland (Baltimore County)	53,558
Massachusetts	15,659
Michigan	8,177
Minnesota	58,793
Mississippi	15,224
Missouri	19,025
Montana	33,776
Nebraska	32,749
New Jersey	40,363
New Mexico	(5,611)
New York State	33,831
New York State plus New York City	72,156
North Carolina	17,815
North Dakota	(19,577)
Ohio	11,285
Oklahoma	15,324
Oregon	62,960
Pennsylvania	(3,421)
Rhode Island	23,287
South Carolina	3,688
Utah	15,379
Vermont	47,379
Virginia	22,809

ISBN 978-1-63359-383-1

Worksheet 4

West Virginia	29,624
Wisconsin	15,219

ISBN 978-1-63359-383-1

Pennsylvania Form REV-65 Board of Appeals Petition Form

Links to "Pennsylvania Form REV-65 Board of Appeals Petition Form"[1] and the "Instructions for Rev-65".

[1] Available at www.revenue.pa.gov/FormsandPublications/otherforms/Documents/rev-65.pdf.

ISBN 978-1-63359-383-1