Income Taxation of New York Trusts & 2025 Planning Strategies

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SUPPLEMENTARY MATERIALS

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1. Introduction. A state may impose tax on all income[2] of its "resident" trusts, but only on source income[3] of "nonresident" trusts. A New York resident trust arises when a New York settlor makes an irrevocable transfer to a trust while a domiciliary, or makes a revocable transfer that becomes irrevocable while a domiciliary of New York. A resident trust also arises when a testator with a will dies when domiciled in New York. By way of comparison, California considers the residence of the trustee or a non-contingent beneficiaries defining its resident trust. Due process limits the power of states to impose tax on trusts lacking "minimum contacts" with the state, which in turn affects how states may define their resident trusts.[4] The penumbra of

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2 The New York taxable income of a resident estate or trust is its Federal taxable income, as defined by the Internal Revenue Code for the taxable year, subject to the modifications explained in sections 118.2 through 118.5 of [20 CRR-NY 118.1]. Tax Law §618."

3 States have considerable latitude in deciding what constitutes nonresident source income. *Travis v. Yale & Towne Mfg. Co.* (40 S.Ct. 228, 252 U.S. 60, 1920).

4 See Hanson v. Denckla, 357 U.S. 235 (1958). The case involved a dispute over whether Delaware or Florida courts had jurisdiction over a trust. A Florida trust beneficiary asserted that the Florida court had jurisdiction over the trust based on her residence and the fact that the settlor and most

due process implies that the power of a state to impose tax should diminish as contacts with the state wane.[5] In fact, courts are increasingly willing to examine whether a state has sufficient "nexus" with the trust in order to impose tax.[6]

New York resident trusts were held to violate due process in cases decided by the Court of Appeals in 1963[7] and by the Third Department in 1981.[8] Following these decisions, the New York resident trust statute was amended to exempt certain trusts from tax. One objective in income tax planning is to come within this exemption when possible. The Commerce Clause operates independently of the Due Process

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beneficiaries were Florida residents. The Court held that under the Due Process Clause of the Fourteenth Amendment, the Delaware court was under no obligation to give full faith and credit to the Florida court. The Florida court could not enter a judgement without obtaining personal jurisdiction over the trustee, who had not availed himself of the "benefits and protections" of Florida law. Therefore, the Florida court had no jurisdiction over the trust or the trustee. For the next sixty years, due process has played a central role in determining whether and to what extent a state may validly impose tax on a trust.

5 See *Mercantile-Safe Deposit & Trust Co. v. Murphy*, 15 N.Y.2d 579 (N.Y. 19640; *aff'g* 19 A.D.2d 765 (3rd Dept. 1963) ("*constitutional due process requires a minimal link between the taxing state and the individual. . .the creation of a trust was an] historical fact which, absent continuing contacts, is not a constitutional nexus justifying income taxation*.")

6 See *McNeill v. Commonwealth,* 67 A.3d 185, 191 (Pa. Commw. Ct. 2013); (Imposition of tax by Pennsylvania on Pennsylvania trust with no Pennsylvania assets or source income, and no trustee violated Commerce Clause); *Linn v. Department of Revenue*, 2 N.E.3d 1203 (Ill. App. Ct. 2013) (Due process barred Illinois from imposing tax on a trust created by a domiciliary settlor who had since moved to another state.); and *Fielding v. Com'r of Revenue*, 916 N.W2d 323 (Minn. 2018) (Minnesota cannot, consistent with due process, tax all income of trust based only on the grantor's connection years earlier; therefore, "[t]he State cannot fairly ask the Trusts to pay taxes as residents in return for the existence of Minnesota law.") Following *Fielding*, Minnesota instituted a procedure for resident trusts to be taxed as nonresident trusts.

7 *Mercantile Safe Deposit and Trust v. Murphy*, 15 N.Y.2d 579 (1964), *aff'g* 19 A.D.2d 765 (3d Dept. 1963).

8 *Taylor v. State Tax Commission*, 445 N.Y.S.2d 648, 85 A.D.2d 821 (3rd

clause, and bars states from enacting statutes that place an undue burden on interstate commerce. Fewer issues arise under the Commerce Clause than under due process.

Based a recent Supreme Court case involving a Maryland statute, the New York trust resident statute would appear not to violate the Commerce Clause. Whether certain provisions of the New York statute violate due process is an open question. As a result of each state having the right to tax source income of a nonresident trust, issues of double taxation arise. Therefore, when a New York settlor considers acquiring income-producing property in another other state, the possibility that double tax may arise should be considered. Double taxation could occur if the trust also satisfies the requirements for being a resident trust in another state. New York will sometimes grant a tax credit for income tax a trust pays to another state, except is the income derives from intangibles. As will be seen in two New York cases, one currently on appeal, New York will not grant a resident tax credit if New York would not impose tax on a nonresident earning the same income in New York. The statute must be "internally consistent" in order to satisfy the Commerce Clause.

New York imposes a high rate of income tax on trusts relative to other states, except California. Despite its high rate of tax, the New York resident trust statute demands relatively more contacts than do other states before the threshold for imposing income tax is reached. This is due principally to the exemption statute. This hypothesis is substantiated empirically, since to date, the New York Court of Appeals has been the last stop for litigants challenging the constitutionality of a New York trust taxing statute. The Supreme Court has not granted certiorari to any cases appealed from New York.

New York, like most states, tends to tax nonresidents somewhat more harshly than it does its residents. A nonresident trust is any trust that is not a resident trust.[9]

[9] Any trust created by a New York domiciliary meeting the requirements of the statute is by definition a New York resident trust. Although a New York resident trust, once created, can never become a nonresident trust, a New York resident trust could become an exempt resident trust. Trusts created by nonresidents would generally be nonresident trusts. A testamentary trust created by a New York domiciliary, but at the time of death was no longer a New York domiciliary, would be a nonresident trust. Therefore, a change in domicile of a person who executes a testamentary trust out of New York

Since the definition of "residence" and "domicile" diverge for New York tax purposes, it is quite possible that a New York resident for income tax purposes would not be a domiciliary for purposes of having created a New York resident trust. It is quite possible that a domiciliary of New Jersey could be a "resident" for income tax purposes if that individual owned a home in New York and commuted to New York. What makes the analysis confusing is that New York taxes resident trusts on the basis of domicile, and not on the basis of residence. In fact, being a resident for tax purposes is irrelevant for purposes of determining whether a trust is a New York resident trust. A resident of New York for income tax purposes could well settle a nonresident resident trust if the New York tax resident lived in Florida.

Some have questioned whether New York should possess a perpetual right impose tax on a fiduciary of a trust based on the domicile of a settlor who may have left the state along with trust assets years earlier. Some also believe that the New York source rule which could in some situations deny the trust tax-exempt status if the trust had only a dollar of New York source income, is unconstitutional. However, this belief may not be of great moment, and may also be missing the point, since New York is not technically imposing tax on all trust income by reason of one dollar of New York source income; rather, it is simply not granting an exemption if the trust has any New York source income. There is a difference.

a. Components of New York Trust Law. The taxation of trusts in New York is an admixture of federal and New York statutory law, court decisions, administrative tax tribunal determinations,[10] New York tax regulations, and Memoranda and Advisory Opinions published by the Department of

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could result in significant estate tax savings in situation where the estate exceeded the exemption amount.

[10] Determinations made by the Division of Tax Appeals cannot be relied on by taxpayers as precedent. "Note: *Determinations issued by administrative law judges shall not be cited, shall not be considered as precedent nor be given any force or effect in any other proceedings conducted pursuant to the authority of the Division or in any other judicial proceedings conducted in this state*." New York State Tax Appeals website, "Tribunal Decisions."

Taxation[11] and the Commissioner. Most tax disputes involving income taxation of trusts fail to reach the Appellate Division[12] because taxing statutes impose a significant burden of proof on the taxpayer, but also because exceptions to taxation are narrowly construed by administrative tax tribunals, as required by New York law. Accordingly, unless a fiduciary is prepared to litigate in the Appellate Division or the Court of Appeals it is best to avoid protracted disputes with the Commissioner, meritorious statutory or Constitutional arguments notwithstanding. However, some aggrieved taxpayers choose to litigate tax matters as a matter of principle, which is entirely understandable, and even admirable.

b. Enduring Lack of Clarity. Although a considerable body of law has emerged following a century of Supreme Court, New York courts, and other states' decisions, there remains "an enduring lack of clarity" in the area.[13] The fairly recent *Kaestner* case decided by Supreme Court illustrated a striking disregard of due process by North Carolina whose only contact with the trust was a beneficiary residing in North Carolina who received no trust distributions. The Supreme Court may have issued a written opinion[14] – rather than merely affirm *per curiam* the decision of the North Carolina Supreme Court in favor of the trustee – to emphasize the importance of due process when a trust has minimal

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11 A Technical Memoranda (TSB-M) "*is an informational statement of changes to the law, regulations, or Department policies. It is accurate on the date issued. Subsequent changes in the law or regulations, judicial decisions, Tax Appeals Tribunal decisions, or changes in Department policies could affect the validity of the information presented in a TSB-M.*" NYS Department of Taxation and Finance Website.

12 Under a law enacted in 2023, the Department of Taxation may now commence an Article 78 proceeding challenging a determination of the Tax Appeals Tribunal in cases "premised on" the "interpretation of the state or federal constitution, international law, federal law, the law of other states, or other legal matters that are beyond the purview of the state legislature." S.B. 4009–C / A.B. 3009–C, Part V § 1.

13 *Constitutional Limits on State Taxation of Trusts*, Michael S. Canfield, State Tax Notes, Inside Deloitte, (June 2019).

14 The opinion was written by Justice Alito and was decided by a 7-2 majority. Justices Scalia and Thomas dissented.

contacts with the state.[15]

2. Definitions.

a. Trust. Traditionally, trusts were not considered to have a separate legal existence. Trusts were merely a "relationship" between the grantor and the trustee who managed trust property.[16] Some now consider trusts as separate legal entities. For example, Delaware Statutory Trusts have taken on many traditional corporate attributes, such as the ability to sue and be sued. When considering income tax liability of a trust, it is the fiduciary and not the trust who incurs legal liability. The Internal Revenue Code in some cases does appear to treat a trust as a separate legal entity. For example, a trust created under Delaware statutory law is recognized as a separate legal entity by the IRS for federal tax purposes. Nevertheless, the Service imposes the legal obligation to pay tax on the fiduciary and not the trust.

b. Trustee. A trustee is a fiduciary – an individual or corporate entity given control or powers of administration of property in trust with a legal obligation to administer it solely for the purposes specified. TSB-A-04(7)(I) stated that a trustee is not limited to the person named as "trustee" in the trust instrument: It includes other fiduciaries such as trust advisors, trust protectors, investment advisors, and others who act in a fiduciary capacity. This is important when considering the domicile of a trustee, as it may affect the situs of intangible property, and consequently whether a trust is exempt from tax.

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[15] If every state imposed the same tax as North Carolina on beneficiaries residing in a state who had some right to receive distributions, but actually received none, the trust would be taxed on trust income in every state in which a beneficiary resided.

[16] The California Court of Appeals, in *Breslin v. Breslin*, 2021 WL 1247885, at *1 n.3 (Cal. Ct. App. 2021), stated "Trusts are not recognized as entities and cannot sue or be sued. Only trustees can be named as parties, thus it is improper to name 'The ABC Trust as a party." [citations omitted]. Yet Delaware recognizes Delaware Statutory Trusts as separate legal entities that can sue or be sued.

c. New York Resident Trust.[17] Tax Law §605(b)(3) provides the definition of a New York "resident trust."

Tax Law, § 605(b)(3)

(a) A resident estate[18] or trust is

(1) the estate of a decedent who at such decedent's death was domiciled in New York State death[19];

(2) a trust, or portion of a trust, consisting of property transferred by will of a decedent who at such decedent's death was domiciled in New York State; or

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

(i) a person domiciled in New York 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

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17 Resident Trusts must file a return if required to file a federal return, or if the trust has New York taxable income. Exempt Resident Trusts, at one time exempt from filing, are now required to file information returns. Tax Law §658(f)(2). The return must certify that the exemption requirement is met. Trustees are required to make estimated tax payments. A nonresident trust is required to file a return if it has New York source income and New York adjusted gross income. [Instructions to 2020 N.Y. Form IT-205]. Tax Law §651(a)(2)-(3). The trustee of a New York City Resident Trust is required to file a tax return required to file a New York State return. Tax Law §1306(a),(e).

18 Note that

19 SCPA § 1605(1) provides that "[a] will of a non-domiciliary which upon probate may operate upon any property in this state and is deemed . . . to have been validly executed for probate in this state, may be admitted to probate. . . .In determining whether to entertain an application for original probate of a will of a non-domiciliary . . .the Surrogate's Court should examine the nature of New York's contacts with the decedent and his/her estate, including the following: (i) the location of the decedent's assets; (ii) the residence of the nominated fiduciaries and beneficiaries; (iii) the expense of proving the will in the decedent's domicile; (iv) the decedent's request, if any, for New York probate; (v) the good faith of the proponents; and (vi) what weight should be given to the fact that the decedent's domicile has already assumed jurisdiction over the decedent's estate." See *In re Estate of Baer*, 46 AD3d 1368 (4th Dept. 2007).

not subsequently become irrevocable;[20] or

(ii) a person domiciled in New York 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.

(b) For purposes of subdivision (a) of this section, 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.

d. Domicile and Residence Distinguished. A New York resident trust references the *domicile* of the settlor or testator. Domicile is the place of one's permanent home or the place to which one intends to return after being away.[21] A person can be a New York domiciliary without being a New York resident.A New York domicile of the settlor is the sine qua non of a New York resident trust. Statutory residency is irrelevant. Nevertheless, a statutory resident is usually – but not always – a New York domiciliary.

e. "Revocable" and "Irrevocable." 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.

f. New York Resident. Subject to an exception, a statutory resident for income tax purposes is a person domiciled in New York, or a person that maintains a

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[20] The instructions for Form IT-205 states that revocable trusts that remain revocable trusts are Resident Trusts.

[21] It is doubtful that the Department would consider a trust settled by a person living in Manhattan of not establishing a New York resident trust, even if the Manhattanite earnestly – and honestly – expresses a sincere desire to "return to" or "to live in" Nevada or Delaware. Since a person can only have one domicile, the Department would likely require clear evidence of a change in domicile to avoid characterization of the trust as a New York resident trust.

permanent place of abode in New York for substantially all of the taxable year,[22] and spends 184 or more days in the state during the taxable year. An exception exists if regardless of domicile, (i) the person has no permanent place of abode is maintained in New York during the taxable year; (ii) the person maintains a permanent place of abode outside of New York during the entire taxable year; and (iii) the person spends in the aggregate no more than 30 days of the taxable year in New York.

g. **Nonresident Trust.** A nonresident trust is a trust that is not a resident trust for any part of the taxable year.[23]

3. **Tax Imposed On Resident Trusts.** Resident trusts compute tax liability by reference to federal taxable income, with some adjustments. Nonresident trusts compute tax liability by reference to New York source income (as defined for nonresidents). Whereas the source income rules are directly applicable to nonresident resident trusts by statutory directive, they are also indirectly applicable to resident trusts as well. Their application to resident trusts is sometimes by express direction, and at other times by implication. For example, resident trusts seeking qualification as an exempt resident trust, are directed that in computing New York source income, "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."*[24]

a. **Compressed Trust Rates.** For federal tax purposes, the highest income tax rates for trusts are reached earlier than for individuals. Therefore, reducing the taxable income of trusts that accumulate income is desirable. Since trusts receive a deduction for DNI distributed to beneficiaries, that income is taxed to beneficiaries and not to the trust.

b. **Compliance.** Income tax a legal obligation of the trustee of a nongrantor trust, since trust itself, although incurring tax, is not a taxpaying entity. Since a

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22 Under "Nonresident Audit Guidelines," released by the Department of Taxation in 2022, the term"substantially all of the year" was changed to mean a period of 10 months, from 11 months.

23 Tax Law §605.

24 NY Tax Law §605(b)(3)(D)(i)(III).

grantor trust is ignored for federal income tax purposes, legal responsibility for payment of tax falls on the grantor. The trustee of a grantor trust still has enforceable legal obligations, but is not responsible for the payment of state or local tax, unless the grantor is also the trustee.

c. **2025 Federal Fiduciary Income Tax Rates.** In 2025, the federal tax on trust and estate income is 10% for income between $0 and $3,150; 24% for income between $3,150 and $11,450; 35% for income between $11,450 and $15,650; and at 37% for income over $15,650.

d. **2025 Gift & Estate Tax Amounts.**

i.	Gift Tax Annual Exclusion	$19,000
ii.	Unified Credit	$13.99M
iii.	GSTT Exemption	$13.99M

e. **Capital Gains**

i.	$47,025-$291,895	(joint; separate)	15%
	$47,025-$518,900	(single)	15%
	$47,025- $573,750	(joint)	15%

ii. Amounts over upper threshold for each filing status taxed at 20%.

f. **2025 New York Fiduciary Income Tax Rates.** The New York rate on fiduciary income between $13,900 and $80,650 is 5.5%; 6% on income between $80,650 and $215,400; 6.5% between $215,400 and $1,077,550; 9.65% between $215,400 and $1,077,550; between $5M and $25M at 10.35%; and over $25M at 10.9%.[25] New York City rates are not compressed, but will add between 3.7% and 3.9% for income over $50,000.

[25] See *NYS Estate Tax Planning*, David L. Silverman, Tax News & Comment, (December, 2023); www.nytaxattorney.com ; (discusses New York State estate tax exemption "cliff.")

i.	New York Gift Tax	$0[26]
ii.	New York Estate Tax Exclusion	$7.16M
iii.	Capital Gains	Individual rates

g. **Compliance.** Resident trusts must file a return if required to file a federal return, or if the trust has New York taxable income. Exempt resident trusts are required to file an information return certifying that the exemption requirement is met. Trustees of resident trusts are required to make estimated tax payments. A nonresident trust is required to file a return if it has New York source income and New York adjusted gross income.[27] Resident trusts are taxed on New York taxable income at the rates applicable to individual taxpayers. A New York City resident trust must file a return if required to file a New York State return.

i. **Exempt Resident Trusts.** Exempt Resident Trusts are required to file Form IT-205 Fiduciary Income Tax Return and attach Form IT-205-C New York Resident Trust Nontaxable Certification Form IT-205-C.

ii. **Estimated Tax.** Tax Law §685(c) requires that fiduciaries make estimated income tax payments. (Form IT-2106).

h. **Possible Tax Savings if Trust is Domiciled in Delaware.** An example provided by a trust fiduciary discusses the possible tax savings from a $1 million long-term capital gain accumulated in a nongrantor trust domiciled in Delaware, rather than New York:

i. "For example, a $1 million long-term capital gain accumulated in a New York resident trust would owe $107,102 in New York State and New York City income taxes in 2024. If the trust was structured so New York State and New York City taxes were not payable (e.g., an exempt resident trust), this $107,102 tax liability

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[26] However, if the donor dies within 3 years of making gift, amount included in decedent's gross estate. Tax Law §999-a. (incorporating IRC §2031 *et seq*.)

[27] Instructions to Form IT-205; Tax Law §651(a)(2)-(3).

is eliminated."[28]

i. **States With No Income Tax; High Income Tax.** States without income tax include Alaska, Florida, Nevada, New Hampshire, South Dakota, Texas, Washington, and Wyoming. Delaware (in effect) imposes no income tax on nonresidents. California has the highest rate of income tax at 13.3%. New York is second, at 10.9% (plus 3.9% for NYC residents).

j. **States Are Not Required to Follow Federal Tax Law.** While state taxing statutes must not violate the Constitution, there is no requirement that states follow federal tax law. In 2014, New York "decoupled" from federal tax law in response to PLR 201310002, which prevented New York from imposing tax on Nevada incomplete gift nongrantor trusts ("NINGs"). In the same year New York also neutralized a tax planning technique that allowed exempt resident trusts to accumulate income and then distribute the accumulated income in a subsequent year without tax. To accomplish this, New York appropriated federal "throwback" rules, which had no remaining application except to foreign trusts.

k. **2017 Tax Cuts and Jobs Act.** TCJA limited the state and local income tax deduction to $10,000 per year. Each nongrantor trust is a separate taxpayer and is entitled to a $10,000 limitation. This may be helpful where real estate is held in separate nongrantor trusts.

4. **States Resident Trusts Operate in Different Tax Orbits.** Regardless of how a state defines a resident trust – and states define it in disparate ways – a state must have some minimum connection with the assets, settlor, trustee, or beneficiaries of the trust, to impose tax. New York chooses the domicile of the settlor or testator when assets are transferred to the trust or when the testator passes to meet threshold due process requirements.[29] Only if this threshold requirement is met will New York have the right to tax income of all trust assets, wherever situated. Even if the threshold met,

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[28] *Delaware's Income Tax Advantage for New York Residents*, Jeffrey C. Wolken and Matthew T. Lee, ©2024 M&T Bank and its affiliates.

[29] Other states employ the same or other factors in defining their resident trusts.

and a New York resident trust springs into existence, due process will not allow New York to tax all resident trusts meeting the statutory definition: A related provision provides an exemption for trusts not having minimum contacts with New York. The inevitable result of differing definitions of resident trusts is complexity and overlap. Less overlap will occur in states that employ residency or domicile as a primary factor, since it would be more difficult for an individual to be a domiciliary of two states. Forty-two states use one or more of five criteria in defining the term "resident trust."[30]

a. **Eastern States Have Shown Affinity For New York Factors.** The definition New York uses to define resident trust, i.e., the domicile of the settlor or testator, has been adopted in part by many states east of the Mississippi, with the notable exception of the Carolinas. Western states have tended to focus more on other factors, one being the place of trust administration. California and Arizona look to the residence of trustee. California, the Carolinas, and Connecticut place importance on the residence of noncontingent beneficiaries. While state taxation of trusts today is not the wild west, some states' resident trust statutes provide for taxation based on contacts so tenuous as to suggest facial unconstitutionality. This, in combination with the competing definitions of what constitutes a resident trust, may cause a New York resident trust to be taxed in another state or multiple states. The following list summarizes the criteria states have chosen in defining resident trust.[31] New York employs the first two:

i. Whether the trust is a testamentary trust created under the will of testator who lived in the state at death:

(1) New York, NJ; CT; MA; VT; PA; DE;[32] MD; DC; VA; WV;

30 *State Income Taxation of Trusts*; Richard W. Nenno et al, (2022); 56th Annual Heckerling Institute on Estate Planning, University of Miami School of Law, p. 2;

31 Derived from chart prepared by Davidson, Dawson, & Clark LLP (2019).

32 Delaware does not impose income tax on accumulated income or capital gains if the irrevocable Delaware trust has only nonresident remainder beneficiaries. ©2025, Fiduciary Trust Company International (website), Wilmington, DE.

IL; IA; LA; ME; MT; MN; NE; OH, OK; UT; WI

ii. Whether the trust is an inter vivos trust created by a trustor who lived in the state:

(1) **New York, NJ; CT; VT; PA; MD; DC; VA; IL**; WV; WI; ME; MI; MN; NE; OK.

iii. Whether the trust is administered within the state;

(1) **MD; VA; SC; CO; HI; ID; IN; KS; KY; LA; MS; MT; NM; ND; OR; UT.**

iv. Whether the trustee or fiduciaries reside in the state or do business there; and

(1) **CA; AZ; DE; NM; ND.**

v. Whether a noncontingent beneficiary resides in the state.

(1) **CA; NC; SC;** GA; TN.

b. States without an income tax:

(1) **DE;[33] FL; TX; NH[34]; SD; WA; NV; TN; WY**

c. Resident Trust Taxation Regimes Among Selected States.[35]

Rate(%)		Resident Trust Factors	Basis For Exemption	Nonresidents Tax
NY	8.82	Domicile of settlor; testator	No NY trustees, assets, or source income.	NY source income
CT	7.0	Similar to NY; residence of benef.	No CT benefic. & No CT source income	CT source income
NJ	8.97	Follows New York	Follows New York	NJ source income
IL	4.95	Residence of testator	Due Process & Constitutional limitations	IL source income

[33] Delaware imposes no income tax on nonresidents without Delaware source income. Delaware Resident Individual Income Tax Return, Form PIT-NON, General Instructions (2022).

[34] New Hampshire taxes only interest and dividend income.

[35] *State Residency Factors for Taxation of Irrevocable Inter Vivos Non-Grantor Trusts*, E. Morrow, (2018)

PA	3.03	Similar to NY	Lacks sufficient contacts to establish nexus	PA source income
SC	7.0	Place of administration	Administration outside of SC	SC source income
NC	5.5	**Residence of beneficiary**	**S.Ct. held N.C. taxing statute invalid**	NC source income
DE	6.6	None[36]	Nonresident of Delaware	--
FL	--	No tax	--	--
TX	--	No tax	--	--
AZ	4.54	Residence of fiduciary	No Arizona fiduciary	AZ source income
NV	--	No tax	--	--
CA	13.3	Residnce of beneficiary; fiduciary	No CA bene & No CA fiduciary	CA source income

d. Problem of Double Taxation. It is not uncommon for two states to impose tax on the same income. New York offers a resident tax credit (RTC) in some cases for taxes imposed by other states on trust income also taxed by New York. The credit works in the following manner:

i. Internal Consistency – No Commerce Clause Violation. If New York would not tax the income of a New Jersey resident commuting to New York and working in New York, then New York will not offer a resident tax credit to a New York resident working in Connecticut and paying tax to Connecticut on income earned in that state. Thus, the New York resident could be taxed twice: Once as a New York resident on all income; and also by Connecticut on income earned in Connecticut[37] The New York taxing regime is "internal consistent" and does not violate the Commerce Clause.

ii. No Internal Consistency – Commerce Clause Violation. If, however, New York did tax the income of a New Jersey resident commuting to New York and working in New York, but did not offer a resident tax credit to the New York resident working in Connecticut and paying tax there, then the New York taxing regime would not be

[36] For Delaware domiciliaries only, trust residency factors include domicile of settlor, testator, or fiduciary.

[37] The hypothetical example would be internally *inconsistent* if New York taxed the New Jersey commuter, and failed to offer a credit to the New Yorker working in Connecticut.

"internally consistent," and would violate the Commerce Clause. The Commerce Clause violation would occur since the New Yorker might choose to work in New York rather than commute to Connecticut, know that this lead to double tax. In turn, this would cause the taxpayer and other taxpayers to seek work intrastate rather than interstate. The burden on interstate commerce is why the Commerce Clause violation occurs.

iii. Double Tax Likened to "Tariff," a "Quintessential Evil." The Supreme Court, in a recent case, likened the incidence of double tax to a tariff, which it Justice Alito noted the Constitution abhors:

(1) "We have long held that States cannot subject corporate income to tax schemes similar to Maryland's . . . Maryland admits that its law has the same economic effect as a state tariff, the quintessential evil targeted by the dormant Commerce Clause. We therefore affirm the decision of Maryland's highest court and hold that this feature of the State's tax scheme violates the Federal Constitution."[38]

iv. Resident Tax Credit Function of State Granting Credit. Whether a state grants a tax credit to its residents is not a function of the other taxing state. Rather, it is a function of the state granting the credit. New York allows a credit under Tax Law §620(a) against tax due for any income tax "imposed on such individual for the taxable year by another state" upon income "derived" from those other jurisdictions.[39] However, New York does not grant a credit for taxes paid to another jurisdiction on income earned from intangible property, such as stocks, because income earned from intangible property is not "derived from"

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[38] *Comptroller of Treasury of Md. v. Wynne*, 575 U. S. 54 (2015).

[39] Tax Law §620(c)(1) provides: "The credit under this section shall not exceed the percentage of the tax otherwise due under this article determined by dividing the portion of the taxpayer's New York income subject to taxation by such other jurisdiction by the total amount of the taxpayer's New York income."

any specific jurisdiction.[40]

5. Constitutional Limitation Imposed by Due Process. New York imposes tax on all income of a resident trust unless the trust is an *exempt* resident trust. The due process clause and the Commerce Clauses operate separately to limit the power of states to impose tax on resident trusts. For a state to impose tax on a resident trust (i) the taxpayer must have "purposefully availed" itself of contacts with the jurisdiction; (ii) the taxpayer must have "minimum contacts" with the state; and (iii) the taxpayer must satisfy the commerce clause test of tax presence in the state.[41] New York provides that a testator domiciled in New York at death, under a will probated in New York creates a basis for imposing tax on the trust. However, it is doubtful that New York may – consistent with due process – continue to tax a former domiciliary on all trust income where the settlor left New York long ago, no longer has trust assets in New York, and has trust assets in other states, even if a noncontingent beneficiary remains in New York. protections" of New York. That trust would no longer be purposely availing itself of the benefits and protections of New York, its only contact being the residence of a benficiary.

a. Emergence of New York Common Law and Statutory Exemption. If the relationship between New York and the trust becomes attenuated, due process may preclude the imposition of tax. The mechanism used to determine whether due process bars taxation is embodied in the exemption provided in Tax Law §605(b)(3)(D)(i). The elements of the exemption first appeared in the 1929 seminal Supreme Court decision in *Safe Deposit Trust Co. of Baltimore,* which held that Virginia could not impose tax on intangible property based on the presence of trust beneficiaries in Virginia where the trustee was in Maryland.

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[40] In *Tamagni v. Tax Appeals Tribunal*, *infra*, the taxpayer was a statutory resident of both New York and New Jersey could therefore be subject to tax on worldwide income in both states. However, since New York does not credit tax paid to New Jersey on income derived from intangible property, *Tamagni* paid this tax twice. The Court of Appeals found the statute did not violate the Commerce Clause. Some believe that *Maryland v. Wynne, infra,* casts doubt on the validity of *Tamagni*. (See*, U.S. Supreme Court's Wynne Decision Calls New York's Statutory Resident Scheme Into Question*; VLEX-570783814.)

[41] *After Ford: Personal Jurisdiction for E-Commerce Vendors*, David A. Fruchtman, 100 Tax Notes State 379, (2021).

The importance of due process and the concept of "minimum contacts" gained prominence following the Supreme Court decision in *International Shoe v. Washington*[42] in 1945.

The 1963 New York Court of Appeals decision in *Mercantile Safe Deposit and Trust v. Murphy,* and then the decision by the Third Department *Taylor* v. *State Tax Commission in 1981*[43]saw the emergence of due process as a critical factor in the power of New York to impose tax, and found a constitutional basis to impose tax lacking in those cases. Both involved testamentary trusts over which New York was held to have lacked sufficient minimum contacts required to impose tax. In 1992, the Commissioner adopted regulations articulating when resident trusts would be exempt.[44]The regulations were codified by the New York legislature in 2003,[45] effective January 1, 1996.[46]Due process continues to play a preeminent role in evolving trust law. A unanimous Supreme Court in *N.C. Dep't of Revenue v. Kimberly Rice Kaestner 1992 Family Trust*[47] found the only contact with North Carolina being presence of a trust beneficiary who received no distributions, failed to provide the minimum contacts necessary to satisfy due process. A year before *Kaestner* was decided, the Minnesota Supreme Court in *Fielding v. Minnesota* held that Minnesota could not tax the income of an irrevocable trust based only on the grantor's residence when the trust was created, citing the "extremely tenuous" connection of the trust with Minnesota.[48]

i. New York Exemption Statute. As a result of the decisions in

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42 326 U.S. 310 (1945).

43 445 N.Y.S.2d 648, 85 A.D.2d 821 (3rd Dept. 1981).

44 20 NYCRR 105.23

45 Tax Law 605(b)(3)(D)(i).

46 Governor Patterson proposed eliminating the exemption in 2011. The proposals were opposed by the Trust and Estate and Tax Law Sections of the New York Bar Association, and were removed from the budget bill.

47 139 S.Ct. 2213 (2019).

48 916 N.W.2d 323 (Minn. 2018), *aff'g*, 2017 WL 2484593 (Minn. Tax Ct. 201). On June 28, 2019, the Supreme Court denied the Minnesota Department of Revenue's petition for writ of certiorari following the Minnesota Supreme Court's decision in *Fielding.*

Mercantile Safe Deposit Trust and *Taylor v. State Tax Commission*, the 2003 statute provides for a *resident trust exemption* applicable on a yearly basis.[49]A New York resident trust must satisfy three requirements in Tax Law §605(b)(3)(D).[50] If they are satisfied, the trust is an *exempt resident trust*. Since a New York resident trust arises by operation of law when the settlor or testator funds the trust, or passes while a domiciliary of New York with a will probated in New York, a New York resident trust will always be a New York resident trust, even if the settlor moves to Texas and sells all New York assets in the trust. Whether New York will seek to impose tax on the remaining trust assets is a fair question and problematic. This problem illustrates the principle that a New York resident trust will never become a nonresident trust.[51] While New York will continue to have the statutory power to tax the trust, it will not necessarily have the legal to do so, if a Constitutional right would be impaired.

(1) Effect of Change in Domicile of Settlor. An resident trust may qualify for the exemption regardless of where the settlor is domiciled. A New York resident trust to which funds are added by a former domiciliary of New York will be taxed differently – and more harshly – than same former New York resident who

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[49] States in which New York trust law is relevant include the New England states, except New Hampshire; New Jersey, Pennsylvania, Delaware, Maryland, District of Columbia, Virginia, West Virginia, Missouri, Arkansas, Alabama, Michigan, Wisconsin, Minnesota, Illinois, Oklahoma, Idaho, Utah, Montana. *Supra,* Section 9(c), "Resident Trust Taxation Regimes Among Selected States."

[50] In 2010, Governor Patterson sought unsuccessfully to repeal Tax Law §605(b)(3)(D)(i). The proposal was opposed by the New York Bar Associates, and was tabled. However, new reporting requirements for Nonresident Trusts were implemented.

[51] A testamentary trust is a New York resident trust if at the time of death, the testator is a domiciled in New York.

creates a new trust in the other state.[52] The "taint" of a resident trust follows the settlor. A New York resident trust will continue to be taxed on all trust income, whereas contributions to the New York resident trust made, for example, while the individual is a resident of Florida, will be taxed only on New York source income of the trust, as any nonresident trust would be taxed by New York. The portion of the New York resident trust arising by reason of contributions made by a former domiciliary do not satisfy the statutory requirement of a New York resident trust, and that portion of the trust will be a nonresident trust, taxed only on its New York source income.

(2) Significance of Domicile For Trust Purposes. Note that states which define resident trusts by place of administration (Maryland) or by domicile of the trustee (California) more easily permit a resident trust to change trust situs than a New York resident trust, since a trustee can be changed fairly easily in many cases. The domicile of a settlor when property was transferred to the trust or after the testator dies in New York is obviously etched in stone when the trust complies with the requirements for settling a resident trust.

b. Landmark Case 1. ***Safe Deposit Trust Co of Baltimore v. Commonwealth of Virginia,***[53] 280 U.S. 83 (1929). The settlor of a revocable inter vivos trust died with a trust consisting of stocks and bonds valued at $50,000. A tax was assessed by a county in Virginia, the domicile of his sons. *Safe Deposit Trust* continued to hold the securities in Baltimore and pay taxes to the city and state. The securities were taxable in Maryland since the property and trustee were in Maryland. Virginia argued that under the legal fiction of *mobilia sequuntur personam* (moveables follow the person), Virginia had the right to impose tax.

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[52] If the settlor of New York resident trust moved to California and installed a California trustee, trust sold all New York property, and had no New York source income, the trust would be a resident exempt trust. If the Californian made a new contribution to the trust, that portion of the trust would be a nonresident trust.

[53] 280 U.S. 83 (1929).

However, the Court held that "[a] statute of a state which undertakes to tax things wholly beyond her jurisdiction or control conflicts with the Fourteenth Amendment." The Court noted that intangible personal property may acquire a taxable situs where permanently located and protected. The Court expressed double taxation concerns:

i. "It would be unfortunate, perhaps amazing, if a legal fiction originally invented to prevent personalty from escaping just taxation should compel us to accept the irrational view that the same securities were within two states at the same instant and because of this to uphold a double and oppressive assessment."

c. Landmark Case 2. *Mercantile-Safe Deposit & Trust*[54] *v. Murphy* (1963). Decedent created a revocable inter vivos trust that became irrevocable at his death, at which time he was New York domiciliary. His will provided that upon death, trust income would be paid to his surviving spouse, a New York resident. The trustee was in Delaware,[55] there no New York assets, and no New York source income. Trust assets consisted of the accumulated income in the inter vivos trust, augmented by a pourover of assets under the will. Trust assets were within the "exclusive possession and control" of the Delaware trustee. The Court of Appeals ruled that due process[56] prevented New York from imposing tax on the Delaware trustee, despite there being a New York beneficiary:

i. "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

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54 15 N.Y.2d 579 (1964), *aff'g* 19 A.D.2d 765 (3d Dept. 1963).

55 The New York trustee had no control over trust assets, so essentially the only trustee was the Florida trustee.

56 Due process prohibits any state from "depriv[ing] any person of life, liberty, or property, without due process of law." A taxing statute must therefore satisfy a two-part test: First, there be "some definite link, some minimum connection, between a state and a person, property or transaction it seeks to tax; and second, the income attributed to the State for tax purposes [must be] rationally related to values connected with the taxing state." *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). After *Quill*, courts have focused on the minimum contacts between the state and the trustee, grantor, and beneficiaries.

> 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, the control or possession of which the beneficiaries have no present right, is in violation of the Fourteenth Amendment."

d. Landmark Case 3. ***Taylor v. State Tax Commission.***[57] A trust was created under the will of decedent, who died a New York domiciliary. The trust consisted of Florida real estate. The will appointed a New York corporate trustee and non-New York domiciliary trustees. Under Florida law, the New York corporate trustee had no power to transfer Florida property. Therefore, the only acting trustees were not domiciled in New York. None of the beneficiaries was a New York resident or domiciliary.[58]The sole involvement of the New York trustee was to hold the sale proceeds in an agency account. The Third Department held that due process bars a state from imposing tax on an entity unless the state has a sufficient nexus with the property, thus providing a basis for jurisdiction. The fact that the decedent died while domiciled in New York, making the trust a resident trust, failed to provide that nexus. The Court concluded:

i. "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."

e. Landmark Case 4. ***N.C. Dep't of Revenue v. Kimberly Rice Kaestner 1992***

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57 445 N.Y.S.2d 648, 85 A.D.2d 821 (3rd Dept. 1981).

58 The New York resident trust statute does not reference trust beneficiaries. The Connecticut resident statute attaches some importance to the existence of a resident trust beneficiary. The Supreme Court in *Kaestner* stated that tax could be imposed on a trust whose beneficiary resided in North Carolina, provided the beneficiary had a "right to demand income," and a reasonable expectation to "receive it." Neither requirement was satisified in *Kaestner*.

Family Trust.[59] **Insufficient Minimum Contacts.** The dispute involved a North Carolina statute that imposed a tax on trust income "for the benefit of" a North Carolina resident. The New York settlor had established a trust for his children thirty years earlier. During the years in dispute, the settler's daughter, a trust beneficiary, resided in North Carolina. That was the only connection North Carolina had with the trust. Daughter received no distributions during the years North Carolina imposed tax. Justice Sotomayor noted that a state has the power to impose a tax only when the "taxed entity has 'minimum contacts' with the State such that the tax does not offend 'traditional notions of fair play and substantial justice.'" The presence of in-state beneficiaries alone did not "empower" a state to tax trust income where beneficiaries have "no right to demand income and are uncertain ever to receive it." Justice Alito in a concurring opinion, remarked:

i. "Kimberley Rice Kaestner is the beneficiary of a trust established by her father. She is also a resident of North Carolina. Between 2005 and 2008, North Carolina required the trustee, who is a resident of Connecticut, to pay more than $1.3 million in taxes on income earned by the assets in the trust. North Carolina levied this tax because of Kaestner's residence within the State. States have broad discretion to structure their tax systems. But, in a few narrow areas, the Federal Constitution imposes limits on that power. See, e.g., *McCulloch v Maryland*, 4 Wheat. 316 (1819); *Comptroller of Treasury of Md. v. Wynne*, 575 U. S. 54 (2015)."

   (1) Comment. The North Carolina Court of Appeals had rejected the state's argument as well. The fact that North Carolina litigated the dispute to the Supreme Court is somewhat surprising, as is the brazenness of North Carolina in imposing a tax in the circumstances.

   (2) New York Resident Trust Under Constitutional Lens. The New York statute demands more than does the North Carolina statute in satisfying due process. However, its lingering tax

[59] 139 S.Ct. 2213 (2019).

jurisdiction over trusts whose settlers have long since left the New York along with their assets raises due process concerns. To date, the Supreme Court has had no occasion to review the New York resident trust statute. The New York resident trust statute does not reference beneficiaries and provides an exemption for trust status where due process violations might occur. Some decry the "one dollar" source rule, requiring a resident trust to have no source income to qualify as an exempt trust, but then revoke the exemption – and tax the trust on all income worldwide – if the trust has a single dollar of New York source income. However, as unfair and onerous as the tax may seem, it does not follow that it is unconstitutional.[60] Numerous cases, both state and federal, have held that an exemption from tax is a matter of legislative grace, and not a right. A contrary situation exists where New York asserts taxing jurisdiction over a trust whose settlor and assets are no longer in New York. That may well pose constitutional issues.

f. ***McCulloch v. Franchise Tax Board.***[61] California imposed tax on a trust that made a distribution to a California beneficiary of income which had accumulated over a period of five years. The California Supreme Court noted:

i. "We conclude that California could constitutionally tax plaintiff as the resident beneficiary upon the accumulated income . . .distributed to him. . . . 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

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60 See *Matter of Grace v. NYS Tax Commission*, 37 N.Y.2d 193, "An exemption from taxation *'must clearly appear, and the party claiming it must be able to point to some provision of law plainly giving the exemption*' [citations omitted]. Indeed, if a statute or regulation authorizing an exemption is found, it will be 'construed against the taxpayer,' although the interpretation should not be so narrow and literal as to defeat its settled purpose [citations omitted]. This is because an exemption is not a matter of right, but is allowed only as a matter of legislative grace."

61 390 P.2d 412 (Cal. 1964).

beneficiary."[62]

(1) *McCulloch* is distinguishable from *Kaestner* in that it involved a distribution to a resident California beneficiary of income that had accumulated in a California trust over a period of five years. The trust in *Kaestner* had no North Carolina assets or income.

6. New York Exempt Resident Trust Statute.

Tax Law §605(b)(3)(D)

(D) (i) Provided, however, a resident trust is not subject to tax[63] 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.

(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.

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62 Id.

63 The phrase "is not subject to tax" clearly establishes that once the three requirements are met, no further action is required with respect to the entitlement. Non-compliance with filing requirements may have other consequences, but would not constitute a waiver by the fiduciary to claim exempt status.

7. First Prong of Exemption Test:

a. All Trustees Are Domiciled in a State Other Than New York.

i. Trust Fiduciaries May be "Trustees." In TSB-A-04(7)(I) an Advisory Opinion[64] was issued to JP Morgan Chase Bank, as trustee of 1934 trusts established by John D. Rockefeller, Jr. The powers of the trustee are informed by a Committee, which might direct the trustee to take, or refrain from taking, any action. The Committee would be comprised of five individuals, two of whom from domiciled in New York.[65]

(1) The opinion references an earlier Advisory Opinion (TSB-A-94(7)), in which the exemption requirement was met, since (i) the trustee was domiciled in Colorado; (ii) the corpus consisted of intangibles that were held by a New York trust company deemed to be located at the domicile of the trustee in Colorado; (iii) no trust assets were employed in a business carried on in New York; and (iv) all income and gains of the trust were derived from sources outside of New York, determined as if the trust were a nonresident.

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64 An Advisory Opinion is issued at the request of a person or entity. It is limited to the facts set forth therein and is binding on the Department only with respect to the person or entity to whom it is issued and only if the person or entity fully and accurately describes all relevant facts. It is based on the law, regulations, and Department policies in effect as of the date the Opinion is issued or for the specific time period at issue in the Opinion. *New York State Department of Taxation and Finance, "Advisory Opinions"* (TSB-A); Department of Taxation and Finance website (2025).

65 The facts stipulated that no trust assets consist of real or tangible property in New York; and no trust assets are used in a trade or business carried on in New York. All income and gains of the trusts are derived from or connected to income sources outside New York, determined as if the trusts were nonresidents.

(2) Noting the "broad powers" the Committee has been granted over trust assets, the Opinion concludes that individuals in the Committee are considered to be trustees of the Trusts.[66] The opinion concludes the trusts will be exempt "only if all the trustees are domiciled outside of New York State."

b. Resident Trust Exemption Arising by Death or Replacement of Trustee. A resident trust may become an exempt resident trust by reason of the death of the only New York trustee[67]; or if the only trustee, a New York domiciliary, resigns.[68]

i. Rules For Replacing New York Trustee With Out-of-State Trustee. Most trusts provide for the removal and resignation of a trustee. The EPTL provides that a settlor who wishes to replace a trustee must obtain the written and acknowledged consent of all persons "beneficially interested" in the trust.[69] Surrogate Court approval may be required or may be deemed necessary in some cases, such as where a New York trustee refuses to resign, or where a beneficiary vociferously objects. In general, courts are now more open to consider fiduciary income tax savings as a legitimate reason to authorize the change to an out-of-state

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66 Citing Tax Law §605(b)(3)(D), The opinion stated:

> "[A]n 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 the 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."

67 TSB-A-10(4)I, (2010).

68 Id.

69 See EPTL §7-1.9, "*Revocation of Trusts.*"

trustee.[70]

8. **SECOND PRONG OF EXEMPTION TEST: The entire trust corpus, including real and tangible property, is located outside of New York.** Any tangible or intangible personal property within New York will violate this requirement. Assets such as land, cars, or valuable paintings[71] violate this requirement.

a. **Real Property.** If the existence of rental real property prevents qualification as an exempt resident trust, converting the property to an intangible asset by deeding it into a new or existing LLC or to an existing partnership, result in the property to being excluded from New York source income. However, if the intangible property derives income from a business in New York, then it will produce New York source income. Due to a change in rules governing source income of nonresidents, discussed *infra*, the sale of an interest of an entity owning real property may result in New York source income. Such a sale could also cause an exempt resident trust to lose its exempt status. TSB-M-18(1)I warns:

i. "If you were a resident trust who was previously not subject to New York State income tax because you meet the conditions to not be

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[70] *State Income Taxation of Trusts*; Richard W. Nenno et al, (2022); *supra*, p. 137.

[71] In ***Matter of Ittleson***, DTA 819383 (2005), the Department issued a $500,000 deficiency notice for gain from the sale of a Modigliani painting that hung in the vacant apartment of former New York City residents that had moved to South Carolina, and was sold for more than $8 million. The issue was whether sale proceeds were source income under Tax Law §631(b)(1)(A) and therefore subject to tax under Tax Law § 601(e), which taxes New York source income of nonresidents. The ALJ determined that the painting was only in New York for purposes of sale, and lacked the "'minimum connection' between that which the State seeks to tax and the taxing State itself." (Citing *Quill Corp. v. North Dakota*, 504 U.S. 306). However, the Tax Appeals Tribunal reversed, laying the error to the failure of the ALJ to consider the ten years the painting was in New York, instead considering only the one-year period when the Ittlesons resided in South Carolina. The language in an audit manual presented by the Ittlesons' counsel allowed for short period of exemption for artwork in New York on consignment.

subject to tax [under Tax Law § 605(b)(3)(d)], and you sold or exchanged your interest in a covered entity that owns real property in New York or shares of stock in New York co-ops, you will no longer meet the conditions and will be required to file."

ii. **Non-Income Producing Real Property.** The statute does not admit of an exception for non-income producing real or tangible personal property located in New York. Yet if no New York source income is produced by the property, a question arises as to why non-income producing property should affect qualification as an exempt resident trust. The answer is not merely academic. If a New York resident meets the exempt trust exemption requirements but for the presence of non-income producing real or tangible personal property in New York, then whether or not those assets disqualify the trust from attaining exempt status would take on enhanced importance: If the trust had income-producing assets in other states, qualification as an exempt resident trust would be necessary for the trust not be subject to tax in New York.

iii. **Possible Rationale For No Asset Rule.** Although real property may not be income-producing, the property still enjoys the benefits and protections of New York law. Like the one-dollar source rule, the exemption is a matter of "legislative grace," not taxpayer entitlement. The question lingers, however, with respect to whether an item of tangible personal property, such as a valuable diamond in a vault in New York, actually receives any significant benefits from New York so as to require the forfeiting of an otherwise applicable exemption. The Supreme Court of Minnesota, in *Fielding v. Minnesota*, in a case involving few contacts with the state, noted that

(1) "[t]he 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. . .We therefore hold that [the statute] is unconstitutional as

applied to the Trusts."[72]

b. Tangible Personal Property.

i. Personal property can be moved out of state, or sold.

c. Intangible Assets. Domicile of Trustee in New York May Present Issues.

i. Article XVI §3 of the New York Constitution provides:

(1) "Moneys, securities, and intangible personal property within the state not employed in carrying on any business in the state therein by the owner is deemed to be located at the domicile of the owner for purposes of taxation, and, if held in trust, shall not be deemed to be located in [New York] for purposes of taxation [by reason of] the trustee being domiciled in this state."

ii. Tax Law §605(b)(3)(D)(ii) provides that

(1) "[f]or purposes of [determining whether the entire corpus is located out of state], intangible property shall be located in this state if one or more of the trustees are domiciled in the state of New York."

(2) Observation: Since the situs of intangibles is generally where the trustee is domiciled (since the trustee is legal owner), the main thrust of this provision would appear to be the situation in which there are multiple trustees. In that case, all trustees would be required to be non-New York domiciliaries for the trust to qualify as an exempt resident trust.

iii. Intangible Property Acquiring Situs of New York Trustee. At first

[72] 916 N.W.2d 323 (Minn. 2018), *aff'g,* 2017 WL 2484593 (Minn. Tax Ct. 2017).

blush the rule requiring intangible property to be sitused in New York when trustees are domiciled in New York appears troublesome. However, it is not, since the presence of the New York trustee would cause the trust to fail the first prong of the exemption test anyway. If the trustee is not a New York domiciliary, the provision has no application.

9. Third Prong of Exemption Test:

a. All Income and gains of the trust are derived or connected from sources outside New York State, determined as if the trust were a non-resident. None of the assets of the trust may be employed in a business carried on in New York; and all income and gains of the trust must be derived from sources outside of New York State, determined as if the trust were a nonresident.[73] The fiduciary must insure that no errant K-1's arrive showing New York source income.[74] New York source income also must not manifest itself in other ways.[75] Of particular note is that master limited partnerships, especially those relating to energy and natural resources, are publicly traded on major exchanges, and issue K-1s.[76]

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[73] *See* TSB-A-96-(4)I.

[74] If the trust owns shares of common stock of C corporations, no issue will arise since the income will relate to an intangible asset, whose situs is that of the trustee – outside of New York. However, if the security is one which may issue a K-1, such as a publicly traded partnership, then the asset would be New York source income, regardless of the domicile of the trustee.

[75] It has been argued that the "one dollar" rule violates due process, as articulated by the Court of Appeals in *Mercantile-Safe Deposit & Trust Co. v. Commissioner*, 15 NY2d 579 (1964). The Department of Taxation has declined to respond to Constitutional arguments in its advisory memoranda, stating the Department has no jurisdiction to make Constitutional judgements and must defer to the legislature.

[76] Receipt of a K-1 from one of these partnerships would preclude exempt resident trust status. A related concern is that under New York law, partners are considered to be co-owners of partnership property. This concern does not arise with an LLC, since members of an LLC have no right to LLC property. Property of an LLC is deemed owned by the LLC, and not by the members.

b. Converting Real Estate and Tangible Personal Property to Intangible Property. If exempt resident trust status under §605(b)(3)(d) is prevented only by reason of real or tangible property being sitused in New York, then transferring the property into a partnership or an LLC that elects to be taxed as a C corporation or S corporation,[77] would enable the trustee to convert a tangible interest in real property an intangible interest in the property.[78] Income from intangible interests of a nonresident trust not employed in a business or profession in New York do not constitute New York source income.

Until about fifteen years ago, creating the intangible interest was the first part of a two-step plan. In the second step, the interest was sold. Since the sale of an interest in real property would not constitute income derived from a business in New York, the sale would not produce New York source income. This ability to avoid New York source income led to statutory provision which converted income from such sales to New York source income. Various criteria and tests, discussed below, are used to determine whether the sale will be respected and not constitute New York source income, or will be converted to New York source income.

i. Gain or Loss on Sale of Intangible Interests. The definition of New York source income of nonresidents was amended in 2009 to include income from the sale of interests in partnerships, LLCs, S corporations, non-publicly traded C corporations with 100 or fewer shareholders, or shares of stock in a cooperative housing corporation in New York.[79] The

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77 Further caution is required with LLCs, especially single member LLCs. Although New York partnership law treats partners as co-owners, New York LLC law does not. As co-owners, New York partners each have an equal right to possess partnership property. However, LLC members are not co-owners of LLC property. Property owned by the LLC is the property of the LLC, not of its members.This implies that real property held in a single-member LLC might have difficulty establishing itself as an intangible. For that reason, it is advisable that a single-member LLC either admit a new member or elect to be taxed as an S or C corporation.

78 Electing to be taxed as an S or C corporation is required in the case of a SMLLC; the election may be desirable in the case of a partnership, or LLC having more than one member.

79 Tax Law §631(b)(1)(A)(1); TSB-M-18(1)I.

statute applies if the entity owns real property in New York that has a fair market value that equals or exceeds 50 percent of the fair market value of the assets the entity has owned for at least two years as of the date of sale or exchange.[80] The mechanics will be discussed *infra*.

c. **TSB-A-10(2)I. Objection to "One Dollar" Source Rule: Administrative Agencies Will Not Entertain Constitutional Arguments.** An irrevocable nongrantor trust was established by a New York domiciliary. The sole trustee was a New Jersey domiciliary. Trust corpus consisted of intangible investments in New York State bond funds, and interests in a publicly traded partnership. The Department found New York source income amounted to "less than 5% of the Trust's total income." The Petitioner acknowledged the existence of New York source income but argued imposition of tax would violate due process. Citing *Trump v. Chu*, 65 N.Y.2d. 20 (1985), the Opinion stated:

i. "[A]dministrative agencies must presume statutes to be constitutional and therefore have no authority to avoid statutory requirements on constitutional grounds."[81]

d. **New York Domiciliary Relocates to Another State.** A resident trust may continue to qualify as an exempt resident trust if the settlor moves to another state, since qualification as an exempt resident trust status does not depend on the domicile or residence of the settlor.

i. **Removal of Trust Assets From New York.** Unless the trust is an exempt resident trust, the removal of assets from New York will not necessarily affect the taxation of trust assets in other states. In this

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80 Id. The provision does not affect the tax treatment of gain or loss passed through to a partner or New York S corporation shareholder where the entity sells the property in circumstances where the interest in the entity is employed in another business carried on in New York.

81 The Opinion illustrates precisely why at times it is necessary to obtain relief outside of the Administrative Tax Tribunals. A declaratory judgment action may be brough against the Department of Taxation in State Supreme Court alleging that a statute is unconstitutional, the statute is inapplicable, or the Department exceeded its jurisdiction.

respect, the status of the trust as a New York resident trust may continue to "haunt" the trust long after assets are removed from the State. Although a trust may provide for a new situs, and the trust instrument may provide the mechanism to achieve that, it is doubtful that such a trust provision would override the statutory trust resident law in New York. On the other hand, due process might limit the ability of New York to continue to impose tax on a trust having few contacts with the state.

ii. New York defines its resident trust by reference to the domicile of the settlor (or testator). States that define a resident trust by the presence of a trustee include California, Arizona, Delaware, New Mexico and North Dakota. Some states requiring the presence of a trustee also require other criteria. Note that the situs and taxation of trusts created in these states is more amenable to change since in those states that defines a resident trust by reference to the presence of an in-state trustee (with or without additional factors) replacing the in-state trustee with an out-of-state trustee may cause the resident trust to become a nonresident trust. In New York, the domicile of the settlor when the trust was created is fixed forever. However, in one situation, the spell of New York on a trust can be avoided, albeit only at death. If a testator is not domiciled in New York at death, then the trust is not a New York resident trust.

10. Cases, Advisories, Opinions and Memoranda.

a. TSB-A-00(1)I. Resident Trust Managed by NYC Domiciliary Qualifies For Exemption.

i. Petitioner, domiciled in NYC, will contribute all of the capital to a Delaware LLC of which she holds a 1 percent membership interest as managing member with the other member, the trust, holding a 99 percent membership interest. The LLC will elect to be taxed as a partnership.

ii. The LLC will manage assets consisting of working capital <u>used to trade for its own account</u> in stocks, bonds, etc. Petitioner will conduct business of the LLC by telephone, mail, or fax from within or outside of NYS. The Trust has no NYS office, but maintains a PO box in Rockland

County. One beneficiary is in NYC. A non-New York domiciliary is trustee. Trust corpus consists of a 99 percent interest in the LLC. The trustee will be a non-managing member of the LLC.

iii. Tax Law §631(b)(1) provides that items of income, gain, loss., etc., derived from or connected with New York sources include those items attributable to (a) the ownership of any interest in real or tangible property located in New York or (b) a business, trade, profession, or occupation carried on in New York.

(1) Tax Law §631(b)(2) provides that income from intangible personal property constitutes income derived from New York sources only to the extent that such income is from property employed in a business, trade, profession, or occupation carried on in New York.

(2) Petitioner is the managing member of the LLC and its activities will be dedicated exclusively for its own account to manage monies and to use working capital to trade for its own account. This does not constitute the carrying on of a trade or business.

(3) The trust is a resident trust since petitioner was domiciled in New York when property was transferred to the trust, and when the trust became irrevocable.

(4) The trust is not taxable since (i) the trustee is a non-New York domiciliary; (ii) the situs of the intangible assets are deemed to be located outside of New York; and (iii) none of the assets is employed in a business carried in New York state; and (iv) all income and gains of the trust are derived from sources outside of New York State, determined as if the trust were a nonresident.

(5) The domicile of the trustee does affect the tax status of the trust, since if the trustee were domiciled in New York, the trust would no longer qualify as an exempt trust. However, the domicile of the beneficiary does not affect the tax status of the trust.

b. **TSB-A-96(4)I. Change in Situs of Intangible Assets May Result in Exempt Status.** An inter vivos revocable trust was created in 1961 by a New York domiciliary, who in 1996 was a Colorado domiciliary. The grantor relinquished the right to amend the trust in late 1961. After the death of the initial trustees, all trustees were non-New York domiciliaries. The corpus of the trust consisted of (i) common stock of a Delaware corporation authorized to do business in California; (ii) a note secured by real property located in Colorado; and (iii) cash, money market, government obligations, and marketable securities held by Lazard Frees & Co., LLC, located in New York City. None of the assets of the trust was employed in a business carried on in New York, and all income and gains of the trust was derived from sources outside of New York, determined as if the trust were a nonresident.

i. The requirements for an exempt resident trust were satisfied since the situs of intangible assets of the trust is deemed to be at the domicile of the non-New York trustees, who are the only trustees, and none of the assets of the Trust was employed in a business carried on in New York.

c. **DTA No 820351; Refund Erroneously Denied by Department.** *Matter of Heifer Trust.*[82] Amended returns were filed requesting a refund for taxes erroneously paid by a trust that met the exemption requirements. The auditor advised that the refunds had been denied since

i. "New York State does not recognize successor trustees without court approval. Therefore, the trust does not meet the conditions of Regulation 105.23(c)(1) as explained in our Office of Counsel . . . dated December 5, 2001 (copy enclosed)."

A Petition for redetermination of a deficiency or for refund of personal tax was made for tax years 2000, 2001 and 2002. The New York trustee had resigned and had been replaced by a non-New York domiciliary trustee pursuant to an explicit trust provision. The sole "issue" was whether the resignation of the New York trustee was "valid." The Department argued that since under EPTL §7-1.6 the Supreme Court has the "power" to replace a trustee in the event of

[82] DTA No. 820351, (2006).

a trustee resignation, the trust was required to seek court approval. The ALJ noted the provision cited by the Department had no application to inter vivos trusts, and the Department was "directed" to refund the entire amount of tax paid as requested in the amended fiduciary income tax returns.

ii. **Comment:** Confirming that assertions of law made by the Department are correct is important. The above case should not have required litigation. However, litigation may at times be required to achieve a remedy where the Department pursues cases lacking merit.

d. **Dual State Resident Trusts.** TSB-A-11(4), (2011) noted that a resident trust arises under §605(b)(3)(C) when a trust consists of property of a person domiciled in New York at the time such property became irrevocable, if it was revocable when such property was transferred to the trust but has since become irrevocable. The trusts never owned and do not own any property in New York and have no New York source income. In 2005, when Trustee 1 resigned, Trustee 2, a Connecticut resident, remained as the sole trustee. At that point, the trusts were no longer subject to New York income tax[83] since they qualified as exempt resident trusts. Also in 2005, the grantors moved to Florida, after which they made further contributions to the trusts. The trusts became nonresident trusts with respect to those additional contributions. The portion contributed before moving to Florida qualify as exempt resident trusts. Even though exempt under §605(b)(3)(D), they are still 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. The nonresident portions are taxable only on their New York source income pursuant to Tax Law §631.

i. **Note.** The settlor or testator, if seeking exempt resident trust status, must ensure that the trust contains no trust "advisor" or "protector" in New York, nor have a corporate trustee domiciled in New York that would in adversely affect the result under TSB-A-04(7)I.

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[83] As of tax year 2010, though meeting the requirements for exemption, exempt resident trusts are required to file Form IT-205 *Fiduciary IncomeTax Return* and attach Form IT-205-C *New York Resident Trust Noncertification* to Form IT0205.

e. **Trust Entitled to Exemption, But Not Claimed.** *Matter of Joseph Lee Rice Family Trust*, DTA No. 822892 (2010). The trust qualified as an exempt resident trust for the years 1996 through 2003. The trustee was a partner at Debevoise and Plimpton. The returns were prepared by (then) Richard Eisner, LLP & Co. The partner had moved to Vero Beach in 1995, remaining of counsel until his resignation as trustee in 2005. After realizing that exempt status had mistakenly not been claimed, a request for refund of taxes erroneously paid was made pursuant to Tax Law §697(d).[84] A refund was issued, but only for the period of time in which the returns could be amended. The ALJ noted that the mistake was not "evident" on the face of the original return, which listed the address of the trustee as being at the address of the law firm in Manhattan. Therefore, the Department had no role in the error.

f. **Trust created by Exercise of Power of Appointment.** TSB-A-03(6)(I). This advisory concerned the New York decanting statute, EPTL § 10-6.6.

i. **Opinion.** A general power of appointment is one that can be exercised wholly in favor of the donee of the power, his or her estate, creditors or creditors of the estate. A person possessed of a presently exercisable general power of appointment is the owner of the power. However, if the holder of the power cannot exercise it in favor of himself or herself, or his or her estate, etc., then the power is a special power of appointment. Under IRC §2041, property over which a decedent possessed a general power of appointment is included in the decedent's gross estate. For purposes of Tax Law §605(b)(3), (4), the residency of an appointive trust created by the exercise of either a special or general

[84] Tax Law § 697(d), *Special refund authority*, provides: " Where no questions of fact or law are involved and it appears from the records of the tax commission that any moneys have been erroneously or illegally collected from any taxpayer or other person, or paid by such taxpayer or other person under a mistake of facts, pursuant to the provisions of this article, the tax commission at any time, without regard to any period of limitations, shall have the power, upon making a record of its reasons therefor in writing, to cause such moneys so paid and being erroneously and illegally held to be refunded."

power of appointment[85] is determined based on the domicile of the donor of the property transferred to the trust.

ii. A person who transfers property held in trust to an appointive trust by the exercise of a general power of appointment is considered the donor of the trust property for purposes of determining the residency of the appointive trust. However, 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 for purposes of determining the residency of the appointive trust. Rather, the donor of the special power of appointment (to whom the special power is conferred upon) is considered the donor of the trust property for purposes of determining the residency of the appointive trust.

iii. Therefore, if the power involved in a special power, then a New York resident trust will remain a New York resident trust after the power is exercised and the assets are decanted into the appointive trust. If the power is a general power, then residency of the appointive trust will be determined by the residence of the person exercising the general power, since that person will be considered the owner of the assets.

g. Exempt Resident Trust Status Inherently Unstable. An inadvertent investment in marketable securities of publicly traded partnerships that issue a Form K-1 will cause an exempt resident trust to lose its exempt trust status. A

[85] IRC §2014(c) provides that the term "general power of appointment" means a power which is exercisable in favor of the individual possessing the power, his estate, his creditors, or the creditors of his estate; except that—(1) A power to consume, invade, or appropriate property for the benefit of the possessor limited by an ascertainable standard relating to the health, education, support, or maintenance of the possessor shall not be deemed a general power of appointment.

sale of an interest in certain intangible property could also cause the trust to have New York source income. Either of these occurrences could open the floodgates causing all of the trust, wherever situated, to being taxed. Some assert that this so called "one-dollar" rule which may operate to tax all income of the trust that was formerly untaxed, violates due process. However, it probably does not, since a statute providing for an exemption from is provided as a matter of "legislative grace," and is required to be construed against the taxpayer.

h. Exemption Begins Once Requirements Met. According to the Department, "once a resident trust satisfies the conditions [for the resident trust exemption], it is no longer subject to further taxation." The trusts must "accrue to the period of their taxable residence any income . . .accruing prior to the Trusts' change of taxable status." Therefore, if exemption status results by reason of the replacement of a New York trustee by a Connecticut trustee in August, the trust would no longer be taxable at that point. If the trust subsequently were to have New York source income, it would no longer meet the requirements for the resident trust exemption, and its tax-exempt status would terminate at that point.[86]

i. Resident Trust Exemption May Be Prorated. The three-prong test for exemption may be met during the year, as could be the case if the only impediment to exemption were the existence of a New York Trustee who moved to Florida or elsewhere during the year; or was replaced by a out-of-state trustee. In that situation, the exemption is prorated.[87]

ii. Exemption Requirements Met in Previous Years But Not Claimed. If the trust continues to pay tax as a resident trust even though it meets

[86] TSB-A-10(4)I.

[87] Id.

the resident exemption requirement in earlier years, it may file an amended return for those years. However, New York will issue a refund only from date of filing of the amended return, not from the original filing date.[88]

i. Appealing an Adverse Tax Appeals Tribunal Determination. The taxpayer may appeal an adverse determination of the Tax Appeals Tribunal to the Appellate Division, Third Department in an Article 78 proceeding. The determination will be upheld unless it is "arbitrary and capricious" and has "no reasonable basis," the standard for review for such proceedings. A recent change in the law allows the Commissioner to appeal an adverse determination by the Tax Appeals Tribunal in some cases. Article 78 appeals must be brought within four months of an adverse determination. As a result of the short four-month period of time in which to commence an Article 78 proceeding, an entire body of law has evolved concerning the date when an agency made a determination. This directly affects when an Article 78 proceeding must be commenced in order for it not to be time-barred. The rules for service of process, as well as who must be served, are also fairly complicated in Article 78 proceedings.

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[88] See *Matter of Goldstein, v. Tax Appeals Tribunal*, 957 NYS2d 433 (2012). *Goldstein* commenced an Article 78 proceeding to review a determination of the Tax Appeals Tribunal denying additional interest on refunds of income tax resulting from an IRS audit. The Department determined that pursuant to Tax Law §688 prior to its amendment, interest was allowed only from the date of filing of the amended returns. (A statutory change allowing interest from the original filing date did not become effective until after the date Petitioner filed amended returns.) Petitioner argued that statutory provisions established his entitlement to interest from the original filing date. The Appellate Division disagreed and affirmed the determination.

i. **Note:** The Department has always had the right to appeal an adverse determination by the Division of Tax Appeals to the Tax Appeals Tribunal. In the Matter of *Ittleson*, *supra*, the Division of Taxation filed an exception to the Division of Tax Appeals determination in favor *Ittleson.* The Tax Appeals Tribunal reversed the determination and sustained the Notice of Deficiency for nearly $500,000 resulting from the sale of a painting worth over $7 million situated in the Petitioner's empty Manhattan apartment after Petitioner had relocated to South Carolina.

ii. If under the same facts today, the Tax Appeals Tribunal had instead sustained the decision of the ALJ, the Commissioner of Taxation, depending on various factors present in the case, the Division might have the right to appeal a determination of the Tax Appeals Tribunal if "premised on the interpretation of the state or federal constitution . . .or other legal matters that are beyond the purview of the state legislature." If unsuccessful at the Appellate Division, the Commissioner could presumably then take the appeal to the Court of Appeals. The added "legs" given to the Department by the statutory change further diminishes the probability that a trust fiduciary – even one whose claim has some merit – will ultimately be successful challenging a Notice of Determination or other appealable determination. Even if the fiduciary is ultimately successful, the cost to beneficiaries will be higher.

iii. **Relief Outside of The Administrative Tax Tribunals.** In general, a taxpayer may not seek relief in state court without first exhausting administrative remedies. However, an exception exists, and the taxpayer may seek declaratory or injunctive relief if (i) the tax is unconstitutional or does not apply to the taxpayer; or (ii) the statute is inapplicable to the taxpayer; or (iii) the Department exceeded its jurisdiction. Forcing the Department to litigation outside of its home forum comes with substantial benefits: The case is transferred to the Office of the Attorney

General, whose in-house counsel have less fealty to the Department than the latter's own in-house counsel. Counsel for the Attorney General may be inclined to settle meritorious cases, rather than engage in a constitutional or other dispute that could set negative precedent; or challenge a taxpayer whose equitable claim might appeal to the court's equitable jurisdiction.

j. Distinction Between Inter Vivos and Testamentary Trusts. An inter vivos trust may be less vulnerable to state taxation, due to the protection offered by due process, than a testamentary trust. This has important implications in planning and suggests that inter vivos trusts may be superior to testamentary trusts in more than a few cases. The Illinois Supreme Court in *Linn v. Dep't of Revenue*, 2 N.E.3d 1203, (Ill. App. 2013) remarked:

i. "[A]n irrevocable inter vivos trust does not owe its existence to the laws and courts of the state of the grantor in the same way a testamentary trust[89] does and thus does not have the same

[89] A testamentary trust takes effect at the death of the testator, and is subject to probate in the county in which the decedent resides. A testamentary trust may be either a provision in a will or a stand-alone document. If it is in a will, it will be revocable, as wills are always revocable – they "speak" at death. A stand-alone testamentary trust may be either revocable or irrevocable. A testamentary trust, whether in a will or in a stand-alone document, does not operate during the testator's life, but rather takes effect when the testator passes.

An inter vivos trust, as its name implies, is implemented during the life of the settlor. An inter vivos trust may also be either revocable or irrevocable. An irrevocable inter vivos trust will operate during the settlor's life, and unless it is drafted to terminate at the settlor's death, will continue after death. If it was revocable during the settlor's lifetime, and does not terminate at the settlor's death, it will become irrevocable when the settlor

permanent tie to the taxing state." [*D.C. v. Chase Manhattan Bank,* 689 A.2d 539, 547, n. 11(D.C. App. 1997].

ii. ***Matter of The Amauris Trust.***[90] **Nonresident Trust Taxable Only on Source Income.** At a time when he was living in New York, Thomas Peterffy created a grantor trust 1990, giving remainder interests to his children. Peteriffy retained an income interest in the trust, in the form of a swap power. Therefore, the trust was a grantor trust under IRC §671 *et seq.*, and Peterffy, not the trust, was the tax owner. The trust became

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passes. An inter vivos trust may be funded with a "peppercorn" during life, or may be fully funded during the settlor's life. It may also be funded through the decedent's "pourover" will. The use of inter vivos revocable trusts in New York became more common when legislation was passed enabling the grantor to also be a trustee.

Only wills containing testamentary trusts are probated. Inter vivos trusts, whether or not revocable, and stand-alone testamentary trusts, are not probated. It is for this reason that the Courts have held that an inter vivos trust – whether or not irrevocable – has less affinity to the state in which it operates than does a testamentary trust *within a will*. A trust is also a private document, whereas a will is public document.

It should also be noted that in general, inter vivos trusts, or stand-alone testamentary trusts drafted during the testator's lifetime, may be more considerably more detailed than their typical will counterpart. There no entirely sufficient explainable reason for this, other than perhaps the desire to use a stand-alone document to avoid encumbering a will with a massive trust instrument. Since trusts may themselves be quite lengthy, inserting a thirty page trust into a will might make the entire document more complex and difficult to administer. Yet there is actually no reason why the lengthy trust could not be within a will. Although trusts may also be challenged, there is generally less of an inclination – and ability – to challenge the terms of a trust.

90 NYS Division of Tax Appeals, DTA Nos. 821369 & 821497 (2008)

irrevocable in 2000. Peterffy filed a U.S. gift tax return for the gifts of the remainder interests. The trust filed New York nonresident returns for the tax years 2001, 2002, and 2003. New York audited and issued a notice of deficiency asserting the right to tax all income of the trust. Mr. Peterffy's domicile in New York at the time of the creation of the grantor trust was an insufficient connection to satisfy the due process. Peterffy argued that since the trusts are inter vivos trusts, not created by the probate of a will in New York, there is no "continuing connection" with New York. Even assuming the trusts were resident trusts, imposition of tax would violate the Commerce Clause since New York provided no benefit to the trusts during the years at issue. The trust was an inter vivos trust, not created by the will of a New York domiciliary, thus resulting in no connection with New York. Even assuming the trusts are resident trusts, by failing to limit taxation to source income, New York violates due process and commerce clause violations occur. The New York source income of the trust consisted of income from a limited liability company indirectly owned by the trust during the years in question. The Division of Tax Appeals apparently agreed with this reasoning.

NEW YORK NONRESIDENT SOURCE INCOME RULES
NY Tax Law §631(a)[91]

[91] This list is current as of January 1, 2024. The list is not exhaustive, but contains all of the major provisions.

11. New York Source Income Inclusions. New York source income of a nonresident[92] individual includes the sum of income, gains, losses, and deductions entering into federal adjusted gross income, derived from or connected with New York sources, including:

a. Income from real[93] or tangible personal property located in New York State

[92] States have considerable latitude in deciding what constitutes nonresident source income. Thus, in *Travis v. Yale & Towne Mfg. Co.* (40 S.Ct. 228, 1920), the Supreme Court held that New York, limiting taxation of nonresidents to their in-state income, was a sufficient justification for similarly limiting nonresident deductions to expenses derived from sources producing that in-state income. Determination of nonresident source income starts by reference to the income of a resident. For example, a nonresidents' income from a business, trade, profession or occupation in New York is first calculated as if the nonresident were a resident, and then reduced by a percentage. Tax Law §601(e)(1); see *Brady v. State of New York*, 80 N.Y.2d 596, *cert denied,* 509 U.S. 905.

[93] The term 'real property located in this state' includes an interest in a partnership, limited liability corporation, S corporation, or non-publicly traded C corporation with one hundred or fewer shareholders (hereinafter the "entity") that owns real property located in New York or owns shares of stock in a cooperative housing corporation where the cooperative units relating to the shares are located in New York; provided, that the sum of the fair market values of such real property, cooperative shares, and related cooperative units equals or exceeds fifty percent of all the assets of the entity on the date of sale or exchange of the taxpayer's interest in the entity. Only those 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. If the entity owns real property in New York State, and all of its assets have been owned for less than two years as of the

(including gains and 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.*[94]

i. **TSB-M-09(5)I:** In 2009, Tax Law §631(b)(1)(A)(1) was amended with respect to source income of nonresident individuals.[95] Source income of

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date of the sale or exchange, the 50 percent test is deemed met. The gain or loss derived from New York sources from the taxpayer's sale or exchange of an interest in an entity that is subject to the provisions of this subparagraph 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*, and the cooperative housing corporation stock and related cooperative units 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."*

94 Prior to the amendment, the sale of an interest in one of these entities would not have been nonresident New York source income, since gains from the sale of intangible property are excluded from New York source income of a nonresident, "unless [the gains] are part of the income received from carrying on a business, trade, or occupation in NYS." The sales contemplated by the statute are sales of intangible property gains from the disposition of which are expressly excluded form New York source income.

95 TSB-M-09(5)I confirms that the statute applies to "nonresident taxpayers," which includes trusts and estates (or, more precisely, their fiduciaries). The provision applies to exempt resident trusts as well. Tax Law §605(b)(3)(D), in stating the requirements for exempt resident trusts, states that "[a]ll income and gains of the trust [must be] derived or connected with sources outside of New York, *determined as if the trust were a nonresident trust*." Accordingly, TSB-M-18(1)I warns: "If you were a resident trust who was previously not subject to New York tax because you meet the conditions to not be subject to tax [citing Tax Law § 605(b)(3)(D)], and you sold or exchanged your interest in a *covered entity* that owns real property in New York or shares of stock in New York co-ops, you will no longer meet the conditions and will be required to file."

a nonresident individual was amended to include gains or losses from the sale or exchange of an interest in certain entities that owns real property in New York, and meet specific requirements. The rules are intended to discourage entities from converting to intangible status and then selling interests in the entities that would not constitute New York source income. Entities covered included partnerships, limited liability companies, S corporations, or non-publicly traded C corporations with 100 or fewer shareholders. In 2017, the definition of New York source income of a nonresident individual was expanded to include the gain or loss from the sale of ownership interests in certain entities that own

Clearly, the sale of an interest in an entity exceeding the percentage threshold (a "covered entity") would result in an exempt resident trust losing its exempt status. However, what if the trust was a non-exempt New York Resident trust? There would be no resident trust exemption to lose. One could argue that the exemption statuate §605(b)(3)(D), which requires an exempt trust to use the nonresident source rules, only applies to trusts seeking exempt status, and is inapplicable to nonresident trusts in general. In that case, a nonresident trust would not be required use the nonresident source rules. This would lead to an incongruous result, since a sale could result in an exempt resident trust becoming non-exempt, while at the same time not creating source income for a non-exempt New York resident trust. There appears to be no reason why the legislature would intend to allow a non-exempt resident trust to avoid source income in a situation where an exempt resident trust cannot. Still, the fact remains that there is there is no statutory provision requiring a resident trust to be treated as a nonresident rust for the purposes of the exemption statute or TSB-M-18(1)I. One must infer that the requirement of the exemption statute applies to all New York resident trusts, even those not seeking exempt status. In other words, the taxpayer is required to assume something that is not articulated, but appears to be an à fortiori assumption.

shares in cooperative housing corporations[96] located in New York. The 2017 change applies to a sale or exchange of an interest that occurs on or after January 1, 2017.

ii. Mechanism to Determine Applicability of Statutory Provision. All or a portion of the gain or loss from a nonresident taxpayer's sale or exchange of an interest in an entity is considered to be derived from New York sources if the entity owns real property in New York that has a fair market value that equals or exceeds 50 percent of the fair market value of the assets the entity has owned for at least two years as of the date of the sale or exchange. If the entity owns real property in New York State, and all of its assets have been owned for less than two years as of the date of the sale or exchange, then the 50 percent test is deemed met. Examples of the application of the 50 percent rule appear in TSB-M-09(5)I.[97]

(1) Provision will apply if either (a) or (b) is satisfied on date of sale or exchange of the taxpayer's interest in the entity:

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[96] A CHC is a legal entity that owns real property, usually a multi-unit building, for the use of its shareholders. The 2017 amendment taxes gain or loss from the sale of interests in entities owning shares in cooperative housing corporations. An earlier 2004 amendment taxes gain or loss in connection with the sale of coop stock in connection with the transfer of a proprietary leasehold.

[97] Note: The new law does not affect the existing tax treatment of gain and loss passed through to a partner or New York S corporation shareholder where the entity itself sells real property located in New York. In addition, the new law does not affect the existing tax treatment of the gain or loss from the sale of an interest in an entity where the interest in the entity is employed in another business carried on in New York State. If the entity carries on a business in New York State, then the intangible property exclusion would no longer apply.

(a) The fair market value of real property located in New York equals or exceeds 50 percent of the fair market value of the entity assets on the date of the sale or exchange; or
(b) The entity owns New York property and all assets have been owned for less than two years as of date of sale or exchange.

(2) Portion of gain to be included in nonresident source income is a fraction of gain:

(a) Numerator of Fraction:
(i) The fair market value of the entity's real property located in New York on date of the sale or exchange;
(b) Denominator of Fraction:
(i) The fair market value of all entity assets on date of sale or exchange, regardless of how long entity has owned the assets.

b. Income from services performed in New York;

c. Income from intangible personal property, including annuities, dividends, interest, and gains from the disposition of intangible personal property, shall constitute income derived from New York sources only to the extent that such income is from property employed in a business, trade, profession, or

occupation carried on in this state.[98]

d. The distributive share of New York partnership income or gain under §632;

e. The share of New York estate or trust income or gain under §634;

f. Income from the disposition of intangible personal property shall also constitute income derived from New York sources to the extent such gains are from the sale, conveyance or other disposition of shares of stock in a cooperative housing corporation[99] in connection with the grant or transfer of a proprietary leasehold by the owner thereof. . .whether such shares are held by a partnership,

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[98] In general, New York source income excludes dividends or gains from the disposition of intangible property except if their receipt derives from property employed in a business, trade or profession carried on in New York. The disposition of stock in an entity that owns real estate in New York would not be considered as income from property employed in a business. The general rule, stated by the Supreme Court in *Safe Deposit Trust Co. of Baltimore v. Virginia*, is that intangible property "follows the fiction of *mobilia sequuntur personam* ["moveables follow the person"], but "*must yield to established fact of legal ownership, actual presence and control elsewhere*." If a nonresident trustee is the legal owner, the intangible would be sitused outside of New York. Prior to the change in law, a nonresident trustee selling an interest in a partnership owning income-producing New York real estate would not have New York source income. The statute illustrates the principle that a state has considerable latitude in how it defines nonresident source income.

[99] The New York legislature amended the Tax Law in 2004 to impose income tax on gains recognized by nonresidents on the disposition of shares in a New York cooperative apartment. (Tax Law §631(b)(2)). Note that while New York defines a coop as intangible property, the IRS considers coops real property for purposes of IRC §1031. This makes like kind exchanges an attractive alternative for nonresidents wishing to dispose of their New York coop shares.

trust or otherwise**.**

g. Income from a business, trade, profession carried on in New York State;

h. Income related to a business, trade, profession, or occupation previously carried on in New York State**,** whether or not as an employee, including but not limited to, covenants not to compete and termination agreements. Income received by nonresidents related to a business, trade, profession or occupation previously carried on partly within and partly without the state shall be allocated in accordance with the provisions of subsection (c) of this section**;**[100]

i. Income from a New York S corporation in which individual is shareholder, including (i) gain recognized on the receipt of payments from an installment obligation where the S corporation distributed an installment obligation under IRC § 453(h)(1)(A); (ii) gain recognized on the deemed asset sale where the S corporation has made an election under IRC §338(h)(10); and (iii) any income or gain recognized on the receipt of payments from an installment sale contract entered into when the S corporation was subject to tax in New York in a case where the S corporation terminates its taxable status in New York. See TSB-M-10(10)I.

j. Any gain recognized by the estate or trust for federal income tax purposes from the sale or transfer of a partnership interest, whether the sale or transfer is subject to the provisions of the IRC §1060 and occurred after April 10, 2017.

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[100] TSB-M-10(9)I provides that the amount of source income of a nonresident related to a business, trade, profession, or occupation previously carried on in New York is determined by applying a fraction to the total amount of income. If the business was carried on entirely in New York, the fraction is 1. If the business was carried on partly in New York, the fraction wouuld be based on the amount of compensation received in New York over the last three years, over the total amount of compensation.

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k. Lottery or gambling winnings in excess of $5,000;

l. A nonresident, other than a dealer holding property primarily for sale to customers in the ordinary course of his trade or business, shall not be deemed to carry on a business, trade, profession or occupation in this state solely by reason of the purchase and sale of property or the purchase, sale or writing of stock option contracts, or both, for his own account.

EXCLUSIONS FROM NONRESIDENT NEW YORK SOURCE INCOME

12. **New York Source Income Exclusions.** Tax Bulletin TB-IT-615 excludes the items listed below:

a. Income from pension plans described in Section 114 of Title 4 of the U.S. Code.
b. Income received as a shareholder in a C corporation;
c. Deductions with respect to capital losses, passive activity losses and net operating losses shall be based solely on income, gain, loss and deduction derived from or connected with New York sources, under regulations of the commissioner of taxation and finance, but otherwise shall be determined in the same manner as the corresponding federal deductions.
d. Income from annuities that meet the NYS definition of an annuity, unless the annuity is employed or used as an asset of a business, trade, profession, or occupation carried on in NYS;
e. Interest, dividends, or gains from the sale or exchange of intangible personal property, unless they are part of the income received from carrying on a

business, trade, or occupation in New York State;[101]

f. Gambling winnings, other than lottery winnings less than $5,000, unless engaged in the business of gambling and business is carried on in NYS;

g. Military compensation;

h. Income earned as the spouse of a person in the Military;

i. Compensation received from an interstate rail carrier, interstate motor carrier, or interstate motor private carrier for regularly assigned duties performed in more than one state;

j. Compensation received from an interstate air carrier if 50% or less of that compensation is earned in NYS;

k. Compensation paid if person is engaged on a vessel to perform assigned duties in more than one state as a pilot licensed under Section 7101 of Title 46 of the U.S. Code; or income earned from the performance of regularly assigned duties while engaged as a master, officer, or crewman on a vessel operating on the navigable waters of more than one state.

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[101] In *Estate of Evangelos Karayannides*, DTA No. 812811 (1997), New York issued a Notice of Deficiency reflecting a federal adjustment. The issue was whether dividends received by the widow were subject to New York tax. The Tax Appeals Tribunal "disagreed with the [ALJ's] conclusion and find that the Federal documents . . .do show that the dividend and long-term capital gain are attributable to intangible property." Since income from an intangible of a nonresident is New York source income "only to the extent that such income is from property employed in a business . . .in [New York], and there was no "contention or allegation" that the stock . ..or his ownership in such was itself employed in a business. . ." the dividend was not New York source income. (Emphasis in original).

13. Constitutional Limitations Imposed by the Commerce Clause. The Supreme Court has held that the Commerce Clause[102] does not bar two states from imposing tax on the same income.[103]In *Maryland v. Wynne*,[104]the Court invalidated a Maryland statute that (i) taxed nonresidents on income earned in Maryland and (ii) taxed Maryland residents on income earned in other states; but (iii) failed to provide a tax credit to Maryland residents who paid tax to another state on income earned in the other state. Taxing nonresidents on income while not providing a credit to its own residents paying tax in income earned in another state created an asymmetric statutory structure that lacked "internal consistency," and therefore violated the Commerce Clause. The Court found the "discriminatory double taxation of income earned out of state . . .created a powerful incentive to engage in intrastate rather than interstate activity."[105] Although the Commerce Clause is "framed as a positive grant of power to Congress," the "dormant Commerce Clause" prohibits certain state taxation when "Congress has failed to legislate on the subject."

a. "Internal Consistency" Test. If a taxing statute is internally consistent, then it does not violate the Commerce Clause. If it is not internally consistent, then

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102 The constitutionality of a tax under the Commerce Clause is determined by the following factors: Whether the tax (1) applies to an activity with a substantial nexus to the taxing state; (2) is fairly apportioned; (3) is non-discriminatory against interstate commerce and (4) fairly relates to services provided by the state. *Complete Auto Transit v. Brady*, 430 U.S. 274 (1977). Unlike the Due Process clause which considers the minimum contacts of the individual with the state, the Commerce Clause considers the effect of the tax on interstate commerce.

103 *Maryland v. Wynne*, 575 U.S. 542 (2015).

104 *Id.*

105 Had Maryland not imposed tax on similar income earned by nonresidents working in Maryland, the tax would have been internally consistent, and Maryland's failure to provide a tax credit would created double taxation, but would not have violated the Commerce Clause.

a Commerce Clause violation occurs. The Maryland statute failed the internal consistency test, because it placed an additional burden on Maryland residents who earn income in another state. If every state adopted Maryland's tax scheme, interstate commerce would be taxed at a higher rate than intrastate commerce.

b. **Historical Rationale For Commerce Clause.** Justice Alito, writing for the majority, noted that the Commerce Clause was directed at a tendency toward "economic Balkinization" among the Colonies. Criticizing the "original intent" view of Justice Thomas, Justice Alito explained:

i. "[t]he Maryland tax scheme is tantamount to a tariff on work done out of State. . . .Justice Thomas refuses to accept the dormant Commerce Clause doctrine, and he suggests that the Constitution was ratified on the understanding that it would not prevent a State from doing what Maryland has done here. . .[and that according to Justice Thomas] 'it seems highly implausible that those who ratified the Commerce Clause understood it to conflict with the income tax laws of their States and nonetheless adopted it.' . . .[However,] [t]his argument is plainly unsound. . . .First because of the difficulty of interstate travel, the number of individuals who earned income out of State in 1787 was surely very small. (We are unaware of records showing, for example, that it was common in 1787 for workers to commute to Manhattan from New Jersey by rowboat or from Connecticut by stagecoach.")

c. **Double Taxation Inevitable.** Since states use variations of five factors to define resident trust, and then add differing taxing and exemption provisions to those resident trusts, situations will inevitably arise where two states tax the same trust, perhaps imposing different tax on different sources of income. Notably, the Constitution has not been held to not bar two states from imposing

tax on the same income.[106]As New York residents have learned, the resident tax credit is available only for tax that New York would itself impose on a nonresident on the same income.[107]The following two cases did not involve trusts. However, the principles articulated would apply to trusts as well. The first case, decided in 1998 in a matter appealed by the taxpayer to the Court of Appeals, involved a New Jersey resident who commuted to work in Manhattan. The second, decided in 2023, and now on appeal to the Appellate Division, involves a New York resident taxed by Connecticut on work performed there, and taxed by New York, based on the taxpayer's New York tax residency. Both involved the taxation of intangible interests, and both involved the denial by New York of a credit for tax paid to another state.

i. **Likelihood of Reversal on Appeal?** Some have suggested that the decision of the Tax Appeals Tribunal in the latter case may be reversed on appeal. In fairness to the petitioner, the decision does seem bereft of persuasive legal force, and seems to be little more than a transparent exercise advancing weak and confusing legal arguments in an effort to justify a result-oriented conclusion. That effort appears to have failed. Although the decision appears far from being "appeal-proof," it may nevertheless end up in the Court of Appeals. To prevail on appeal, the petitioner might only need establish that hedge fund partnership of which she was a partner, was not trading on its own account.

d. ***Tamagni v. Tax Appeals Tribunal*****,** 91 N.Y.2d 530, (1998). **Operation of Nonresident Tax Credit.** *Tamagni*, an investment banker and domiciliary of New Jersey, was also a statutory resident of New York by reason of his commuting to New York while also maintaining a permanent place of abode in

106 *Shaffer v. Carter,* 40 S.Ct. 221 (1920).

107 *Matter of Allison Greenberg*, Tax Appeals Tribunal, DTA No. 829737 (2023).

New York. *Tamagni* argued that the New York definition of "residence" as applied to him violated the Commerce Clause since it subjected him to multiple taxation on intangible income. The Court of Appeals explained why New York does not issue a credit for tax paid to New Jersey on intangible income:

i. "While residents are generally subject to income tax based upon their worldwide income, New York does provide a tax credit for income taxes paid by its residents to other States. . .[T]o qualify for this credit, [*48] the tax imposed by the other State must be on income "derived therefrom" --i.e., earned in the other State (Tax Law § 620[a]). . . [T]his provision protects residents actually engaged in interstate commerce from double taxation by ensuring that they are taxed only once upon income derived from interstate activities (see, 20 NYCRR 120.1[a][2]; 120.4[d] ["*the resident credit . . . is allowable for income tax imposed by another jurisdiction upon compensation for personal services performed in the other jurisdiction, income from a business, trade or profession carried on in the other jurisdiction, and income from real or tangible personal property situated in the other jurisdiction*"]). ***The credit is not generally available for intangible income because that income has no identifiable situs***. Intangible income generally is not derived, at least directly, from the taxpayer's efforts in any jurisdiction outside of New York, and cannot be traced to any jurisdiction outside New York. It is simply investment income, and under the long-recognized doctrine of *mobilia sequuntur personam* (["(m)ovables follow the * * * person"] . . . it is subject to taxation by New York as the State of residence. [citation omitted] *However, where the taxpayer can show that intangible income is in fact derived from the taxpayer's activities in a State other than New York, the taxpayer is entitled to the credit* (20 NYCRR 120.4[d] [credit allowed where the income is derived "from property employed in a business, trade or profession carried on in" another State])."

ii. Commerce Clause Challenge Not Viable. *While Tamagni commuted to New York daily as an investment banker, the Court noted the New York tax is based on the taxpayer's residence, without regard to any "specific or economic transaction."* Tamagni also argued that the tax is discriminatory because it subjects some statutory residents to potential double taxation which New York domiciliaries residing solely in New York do not face. The Court disagreed with the premise that the two are "similarly situated," noting that statutory residents of New York domiciled in another state enjoy the "privileges and protections" of the other state, in this case, New Jersey. The Court found that "the tax is not assessed against interstate labor market per se; it is based solely on the taxpayer's presence in New York." The Court could "conceive of no power more fundamental to the operation of a sovereign state than the power to tax its own residents." Tamagni appealed to the Supreme Court, which denied his request for Certiorari.[108]

e. ***Matter of Allison Greenberg*, Tax Appeals Tribunal**, DTA No. 829737 (2023). Greenberg, a New York resident taxpayer earned income in Connecticut and paid tax to both New York and Connecticut on that income. The Tax Appeals Tribunal, while finding some factual errors in the Determination of the Division of Tax Appeals, sustained the tax. New York does not impose tax on nonresidents who earn intangible income unrelated to a business in New York. Therefore, New York does not offer a credit to residents who earn intangible income unrelated to a business in another state. The ALJ determined that the intangible property at issue was not employed in a business. Rather, the partnership of which Greenberg was a partner traded intangible property for its own account. The ALJ rejected petitioner's argument that the income was compensation for her services as a partner.

i. Facts.

(1) Greenberg was Marketing Director for Hildene, an investment brokerage firm with offices in Manhattan, but which operated its

[108] 525 U.S. 931 (1998).

business in Stamford, Connecticut. Greenberg held a 6.5 percent profit-allocation interest as a member in a partnership, from which she received "flow through investment income" in the form of carried interest, consisting of interest income, dividends, capital gains, as well as ordinary business income and loss.

(2) **2004.** For the two years in issue, 2004 and 2005, Greenberg reported income from the partnership as reported on her K-1, some of which was reported as capital gain, and some which as ordinary income. In 2004, New York allowed a resident tax credit (RTC) on the ordinary income component only. Greenberg had $3.67M of total income. She received a credit of $2.14M on the ordinary income component, leaving a difference of $1.54M, attributable to her carried interest income (comprised of interest income, dividends, and capital gains) on which she paid tax.

(3) **2005.** In 2005, Greenberg had nearly $30M in carried interest income consisting of interest, income and capital gains, but also an reported an ordinary loss of $18.4M. While New York accepted the loss in computing her taxable income, the Department of Taxation disallowed the claimed RTC on the loss entirely "because no tax is paid on a loss." As a result, Greenberg received a deficiency notice of $839,932, plus interest. On exception, Greenberg (i) disputed the failure of New York to credit the carried interest income; and (ii) asserted her partnership interest was an asset employed in a business conducted in Connecticut.

(4) **Issues and Law.** Tax Law §620(a) provides a tax credit to a New York resident against tax "otherwise due" for "any income tax imposed for the taxable year by another state" on income "both derived therefrom and subject to tax." The resident credit is allowable only to the extent that similar income to a nonresident of New York would be subject to tax under Tax Law § 631(a). Since New York does not tax intangible assets of nonresidents, a Commerce Clause violation is not likely. Reg. § 20 NYCRR 120.4 [d] provides:

(a) "[T]he resident credit against ordinary tax is allowable for income tax imposed by another jurisdiction upon compensation for personal services performed in the other jurisdiction, income from a business, trade or profession carried on in the other jurisdiction, and income from real or tangible personal property situated in the other jurisdiction. Conversely, the resident credit is not allowed for tax imposed by another jurisdiction upon income from intangibles, except where such income is from property employed in a business, trade, or profession carried on in the other jurisdiction. Thus, for example no resident credit is allowable for an income tax of another jurisdiction on dividend income not derived from property employed in a business, trade or profession carried on in such jurisdiction. (Emphasis added).

(5) Arguments on Exception by Petitioner. Petitioner argued first that the ALJ incorectly concluded that Greenberg was trading on her own account, since Hildene was an "active investment manager." She argued that her interest was an asset employed in a business in Connecticut, which generated the intangible income. Greenberg also cited a Connecticut case, *Sobel*, a "mirror image" of hers. In *Sobel*, the Connecticut court rejected the contention of Connecticut that *Sobel* was trading on his own account, and determined that he was providing investment management services. She was unlawfully subject to double tax, and that the difference in federal tax treatment of capital gain and ordinary income is "immaterial" since both are taxed at the same rate. The interpretation of the Division's regulation "distorts" its meaning and lacks a rational basis. Finally, the Division's allowing the resident tax credit for petitioner's ordinary income but not for her carried income interest is "illogical" since both forms of income were "compensatory in nature."

(6) Arguments on Exception by Division. The Division of Taxation argued that the ALJ "properly determined that the intangible

interests at issue was not employed in a business and therefore was not derived from Connecticut sources." The Division also observed that "if carried interest can be properly sourced to other states for the purposes of the resident tax credit as petitioner contends, then it could be considered New York source income for New York nonresidents, contrary to the Division's current interpretation of the Tax law." The Division argued that the New York statute was "internally consistent," and did not violate the Commerce Clause.

(7) **Tax Appeals Tribunal Opinion.** The Tribunal first determined that the ALJ erred in not finding that Hildene conducted its operations exclusively in Connecticut during the audit period. The Tribunal then noted that each item of partnership income distributed by Hildene as ordinary income, capital gain, interest and dividends retained its character. The question then turned to whether the income at issue was "derived from" Connecticut.

(a) **Resident Tax Credit.** The term "derived from sources within another state" is construed to be in accord with definition of the term "derived from or connected with New York sources[109]. . . in relation to the New York source income of a nonresident individual."[110] Therefore, the resident tax credit is allowable only to the extent that similar income would be subject to tax in New York under Tax Law §631(a). The regulations add that "the resident tax credit is not allowed for tax imposed by another jurisdiction upon income from intangibles, *except where such income is from property employed in a business, trade or profession carried on in the other jurisdiction."*

(b) The Tribunal then found that "[t]he assets of the Hildene

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109 Tax Law § 631(a).

110 20 NYCRR 120.4[d].

funds that generated the interest income, dividends, and capital gains in issue were *intangible property*; and that such *intangible personal property not employed in carrying on of any business is "deemed located at the owner's domicile*."

(c) The "property" that must be "employed in a business, [etc.], must be the very same intangible property . . . from which the income is derived." Consistency with *Matter of Epstein*, 89 AD2d 256 (1982) requires that *the intangible personal property that must be employed in a business in Connecticut in order for petitioner's intangible income to qualify for the resident tax credit* is the property that generated the income at issue. It *must be the assets of the Hildene Funds from which petitioner's interest income, dividends and capital gains derived.* The Tribunal rejected Petitioner's contention that her partnership interest in Hildene was the intangible personal property employed in Connecticut that generated the intangible income at issue.

(d) Since Greenberg failed to show that the intangible assets of Hilden funds were employed in the conduct of Hilden's business, she failed to meet her burden of establishing clear entitlement to the resident credit. The Tribunal determined that the partnership owned the funds and was trading for its own account and that Greenberg had failed to show otherwise. The Tribunal acknowledged that "Petitioner['s] contention that Hidene was an active investment manager for third party investors. . . may well be the case, but there is insufficient evidence in the record to support such a finding."

(e) Greenberg failed to show that Hilden was not trading on its own account. This "failure of proof stands in contrast to the evidence presented in *Sobel v. Commr. of Revenue Serv.*, upon which petitioner relies." The Tribunal also found that Greenberg had failed to provide evidence in

support of her contention that she was not trading for her own account, and cited the *Epstein* case for the proposition that exceptions to tax laws are to be narrowly construed and that Notices of Deficiency are presumed to be correct.

(f) The Tribunal rejected Petitioner's argument that since her ordinary income and incentive income were both "compensatory in nature," they should receive like tax treatment. It noted also that when considering whether a double tax violates the Commerce Clause, only the laws of New York are considered. Since New York does not tax nonresidents on intangible income of a nonresident not employed in a trade or business, no double taxation issue arises.

(8) Appellate Division Appeal. Greenberg appealed determination the to the Appellate Division, Third Department, and filed a brief on January 30, 2025.

f. Governing Law.

i. Uniform Trust Code. The Uniform Trust Code[111] provides that law of the jurisdiction provided by the trust determines the governing law unless that law is contrary to a strong public policy of the jurisdiction having the most significant relationship to the matter at issue.

ii. NY EPTL §7-1.10. The EPTL provides that in the case of trust created by a person not domiciled in New York, a provision stating that the trust shall be governed by New York law controls with respect to (i) any property situated in New York at the time the trust is created; and (ii) personal property, wherever situated, if the trustee is a person residing, incorporated, or authorized to do business in New York. When a person

[111] The Uniform Trust Code has been adopted by 35 states. New York has not adopted the UTC.

does not indicate which state law governs, the law of the jurisdiction with the most significant contacts controls.[112]

14. Former Tax Planning Strategies Still Relevant. Some strategies have been rendered ineffective by a change in tax law, but may remain relevant. For example, placing real property into an LLC or partnership will still convert the asset into an intangible and may enable a trust to qualify as an exempt resident trust, but gains from the sale of the entity itself may result in taxable gains disqualifying the trust from exempt resident status. Nonresident trusts have similarly been hampered in using this technique, for the same reason: The sale of an interest in the entity may result in New York source income. Another tax strategy made ineffective by New York may have use in another context today. New York enacted a law decreeing that income of a nongrantor Nevada trust would be treated as if the trust were a grantor trust for New York purposes. A variation of this technique consists of making completed gifts to Nevada nongrantor trusts. This technique may be attractive because of its ability to fuse the advantages provided by the high federal gift tax exclusion and the lack of a New York tax on gifts made with respect to which the donor survives for at least three years. Another example involves the tax on "throwback" distributions of accumulated trust income. Knowing how the throwback tax works may enable the trustee to lessen its effect.

[112] NY Jur trusts §25.

a. 2014: Incomplete Gift Nongrantor Trusts. The doctrine of federalism does not require New York to follow federal tax law. Nevertheless, the federal tax law as stated in the Internal Revenue Code is a model for most states, including New York. In 2013 the IRS published several rulings[113] that caused Albany to "decouple" from federal tax law. The rulings opined that certain "incomplete gift nongrantor trusts" established in Nevada would be respected under federal tax law.[114] That determination resulted in the Nevada fiduciary being responsible for the tax. Nevada has no state income tax. Tax planners began to implement trusts in Nevada that qualified as "incomplete gift nongrantor trusts" (NINGs). Delaware followed suit.

New York objected to the use of this tax strategy, which it claimed was costing New York to lose hundreds of millions of dollars in tax revenue. New York quickly shut it down by enacting legislation decreeing that income of these trusts would be "taken into account" for New York tax purposes as if the trust were a grantor trust under federal tax law.[115] However, ***complete*** gifts to Nevada nongrantor trusts may useful today. Nevada However, *completed gifts to nongrantor trusts* may be useful since such gifts utilize both the federal lifetime transfer tax exemption and the favorable New York tax treatment of lifetime gifts.[116]Such a gift would remove both the asset and its future appreciation from both the federal and New York taxable estates. Since the gift will not be included in the grantor's estate, it will not receive a step-up in basis.

b. 2014: Accumulation Distributions. Legislation was enacted in 2014 taxing

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113 PLRs 20130002-20130006

114 No completed gift was made for transfer tax purposes because sufficient "strings" had been retained by the grantor to prevent a transfer for transfer tax purposes; but yet a completed transfer occurred for income tax purposes, since no grantor trust provision operated to impose tax on the grantor.

115 Tax on income of the trust reverts back to the grantor under a bespoke provision of the New York law that treats the income of such a nongrantor trust as grantor trust income for New York income tax purposes.

116 For 2025, the lifetime gift limit is $13.61 million for individuals and $27.22 million for couples. The gift will be include in the grantor's estate if the grantor does not survive for at least 3 years after making the gift.

beneficiaries residing in New York and over the age of 21 on "accumulation distributions."[117]Throwback does not arise if a trust distributes all DNI annually to beneficiaries. Throwback only arises when income is accumulated and later distributed. The tax does not impose an interest penalty, and the beneficiary is allowed a resident tax credit (RTC) for taxes already paid.

i. **Rationale For Imposition of Tax.** If a trust makes a distribution to a New York beneficiary over the age of 21 out of distributable net income (DNI), New York taxes the resident beneficiary on the distribution carried out on Schedule K-1. If the trust makes no distributions, then the fiduciary pays the tax imposed on the trust. If the trust qualifies as an exempt resident trust, then no tax is imposed even if the trust makes no distributions, due to its exempt status. This will cause distributions to accumulate to succeeding tax year or years. Before the statutory change, exempt resident trusts could accumulate income and in a subsequent year distribute the accumulated income. To the extent the accumulated income exceeded the current year's DNI, the distribution would escape tax. To remedy this perceived loophole, New York looked to federal tax law. Under federal tax law, a complex trust under IRC §§ 661 and 662 that does not distribute all of its DNI in a taxable year will have "undistributed net income" (UNI) under IRC §665(a).[118]

ii. **Mechanics of Throwback Rules.** "[T]hrowback" occurs where a trust makes an "accumulation distribution"of undistributed net income (UNI) from earlier tax years. Tax Law §612(b)(40) applies the "throwback" tax to "accumulated" income of an exempt trust distributed to a New York resident beneficiary[119]over the age of 21 not previously taxed. An accumulation distribution will generally occur when required and discretionary distributions in a taxable year exceed DNI for that year. Beneficiaries receiving "accumulation distributions" are taxed on those

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117 2014 NY Laws 59, Pt. I, §1, §6 (2014).

118 See *Taxation of Foreign Nongrantor Trusts: Throwback Rule*; Tax News & Comment; D. Silverman, (August, 2014).

119 The tax does not apply to non-New York beneficiaries, or New York beneficiaries under the age of 21.

distributions, even if they exceed trust DNI.[120] A New York beneficiary who receives an accumulation distribution is required to include the distribution in income unless the distribution is "thrown back" to a year before the beneficiary reached the age of 21. A resident tax credit (RTC) is allowed for (i) taxes paid on income already included in the beneficiary's gross income; and (ii) taxes paid to other states. Exempt trusts are subject to reporting requirements for tax years in which accumulation distributions are made; the exempt resident trust must file a Schedule J for any tax year in which an accumulation distribution is made to a New York resident beneficiary.

iii. Harshness of Tax Mitigated. Several factors mitigate against the harshness of the tax: First, it applies only to beneficiaries who reside in New York and are over the age of 21. Second, undistributed net income (UNI) can be minimized by the trust investing in assets that principally produce income consisting of capital gains. Capital gains are not by default included in DNI and accordingly, the retention by the trust of income derived from capital gains will not become subject to the throwback rule when the income is later distributed.[121] However, if capital gains are "paid, credited, or required to be distributed" to a beneficiary, they are required to be included in DNI.[122] It is not clear whether the favorable treatment accorded capital gains was intentional or the result of a statutory oversight.

iv. Allocating Capital Gains to DNI. Throwback can be avoided by the trust distributing all DNI to beneficiaries currently. The trustee could also allocate capital gains to DNI. Since capital gains are not included in "undistributed net income" (UNI), to the extent trust income is allocated to capital gains, the throwback tax will not apply. This will divert more income to beneficiaries, and may work to the detriment of ultimate trust beneficiaries. Another approach is for the trustee to invest a greater portion of the trust in assets producing capital gains. The power

120 Tax Law § 658(f)(2).

121 Tax Law § 605(b)(3)(D).

122 IRC §643(a)(3); Treas. Reg. § 1.643(a)-3(a).

of the trustee to take these actions may be provided for in the trust instrument. Even if they are not specifically provided, they may be within the general powers granted to the trustee. The trustee is under an obligation to administer the trust in an efficient manner, and to act with fairness to the existing and future trust beneficiaries. Reducing the incidence of tax is consistent with the obligations of the trustee.[123]

(1) Decanting. Various other exceptions may permit allocation of capital gains to DNI.[124] If the trust does not authorize allocating capital gains to DNI, the trustee may consider decanting the assets to a trust with provisions that do allow allocation of capital gain to DNI. Other factors, such as the loss of asset protection, or fairness to ultimate beneficiaries must be considered. The trustee has a fiduciary duty to reduce taxes but at the same must be fair to all beneficiaries, both present and future.

15. New York Trust Tax Planning.

a. In General. A fundamental consideration involves avoiding the possible application of another state's income tax to a New York resident trust. Careful planning may help eliminate the possibility of a double tax when a New York resident trust has assets, trustees, or beneficiaries in other states. The complexity of trust income taxation may at times obscure the fact that tax savings may be possible by taking actions not readily apparent yet not difficult. For example, at times replacing a New York trustee with an out-of-state trustee may eliminate source income, or even qualify a resident trust as exempt.

Trust planning begins with the trust itself. It is important that provisions allowing division of the trust, decanting of trust assets, powers conferred on the trustee to accomplish those and other ends, and a procedure for replacing a trustee, be in place when the trust is implemented. If toggling is desired, the

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123 See Nenno, supra, p. 6, *"trustees in more than half the states have a statutory duty to ensure that trusts are placed in suitable jurisdictions. In other states, that duty might exist under common law*."

124 See *Removing Capital Gains From Trusts*, Andrew L. Whitehair, CPA/PFS, The Tax Adviser, (2014).

procedure to accomplish that should also be in the trust instrument. It is difficult to amend an irrevocable trust to contain provisions not initially present in the trust, but it is not impossible. Some powers inhere in the trust, even if not specifically enumerated. The power to decant is one example of a provision likely benefitting from an explicit provision, but many trusts can be decanted even without an explicit provision.

b. Replacing a New York Trustee. Tax Law§ 631(b)(2) provides that income from intangible personal property constitutes income derived from New York sources only to the extent that such income is from property employed in a business, trade, profession, or occupation carried on in New York. Since a trustee is considered the legal owner of a trust, intangibles "follow" the trustee. Therefore, replacing a New York trustee with a non-New York domiciliary trustee may eliminate New York source income of intangible interests in brokerage account and, depending on other trust assets, may enable the trust to qualify as an exempt resident trust.[125] In the case of a testamentary trust, changing the trustee to an out-of-state trustee may be advisable, if it would cause the trust to become an exempt resident trust.[126] However, for purposes of qualifying as an exempt trust, the presence of a trustee in New York will cause the intangible interest to have a situs in New York. Therefore, all trustees must be removed from New York. However, when doing so, the fiduciarymust ensure that the state in which the new trustee will be domciled will not cause source income of the trust to be taxed based on the residency of the trustee in that state. Some states tax trusts based on the residence of a trustee. California is one such state.

i. Inter Vivos Trustees. Replacing the trustee of an irrevocable inter vivos nongrantor trust does not generally require court approval. However, since the Division has such litigated cases, documenting the change should be clear and unassailable. Any procedure provided for in the trust

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125 One commentator astutely notes "[t]he disadvantage to the certainty provided by the safe harbor is less ability to challenge the application of the tax if the trust comes within the terms of the taxing statute."*, State Income Tax Issues With Trusts*, Charles A. Redd, *2011 Estate Planning Teleconference Series*.

126 See *Matter of John Heifer Trust*, DTA 820351 (2006).

should be meticulously followed. If the trust is silent, court approval may be required or advisable unless the trustee obtains the written approval of all interested parties. If minors are involved, guardians ad litem may need to be appointed. In general, beneficiaries and co-trustees have the right and power to replace a trustee.

(1) Trust Protectors. To some extent, the grantor may be able to retain a continuing power over a trust if the trust has named a trust protector. A trust protector represents the interest of the settlor and may make decisions concerning amending distributions provisions, adding new beneficiaries, or replacing trustees. For purposes of determining the domicile of the trustee, a trust protector or advisor is considered a trustee. Therefore, if resident trust exempt status is sought, all fiduciaries who could conceivably be considered as having powers of advice or removal, should be located out of New York.

(2) Inter vivos grantor trusts. The grantor maintains substantially greater retained rights and powers with a revocable inter vivos grantor[127] trust than with an irrevocable inter vivos nongrantor trust. For example, the grantor of an inter vivos grantor trust may retain the right to substitute assets of equal value, or to borrow from the trust without adequate security. These retained powers cause transfers to the trust to be incomplete for income tax purposes and result in the trust being ignored for federal income tax purposes. In such cases, the tax liability of the trust assets would be reported by the grantor. The revocation by the grantor of a revocable grantor trust would have no federal tax consequences.[128] However, since New York does not recognize

[127] A grantor trust may be revocable or irrevocable. Similarly, a nongrantor trust may be revocable or irrevocable.

[128] However, New York does not recognize Revenue Ruling 85-13, which allows for sales between a grantor and a trust without income tax consequences. Accordingly, it is not inconceivable that there might be New York tax consequences if a revocable inter vivos grantor trust is revoked.

Revenue Ruling 85-13[129], the revocation of a grantor trust might have New York tax consequences.

c. Qualify As Exempt Resident Trust. Trustees are arguably under a fiduciary obligation to take measures to reduce tax as part of their duty to preserve trust property.[130]A New York resident trust will be exempt if it has no New York trustees, no New York income, and no New York assets.

i. No New York Trustees. Meeting the first requirement, replacing a New York trustee is fairly straightforward and need not in require court approval or involvement in most cases. In cases where a court must approve of a change in trustee, provided the beneficiaries are in accord, problems should not arise. Care must be taken to ensure that no fiduciaries remain in New York, as they are considered to be trustees by the Department of Taxation.

ii. No New York Assets. The second requirement, that the trust have no New York assets, involves the disposition of existing real and personal property, either by sale or by conversion to intangible property. Disposing of an intangible interests in certain property, as a result of a statutory change, may produce New York source income, which would defeat exempt trust status. Tangible personal property can be physically removed New York, or sold. If a sale of low basis property is contemplated, dividing the trust into two, and then decanting the low basis assets into a single trust might enable the other trust to qualify as an exempt resident trust. If the low basis assets are decanted into a trust in another state, it may be possible to eliminate New York tax liability

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129 Revenue Ruling 85-13 stated that for federal income tax purposes, a sale between a grantor trust and its grantor have no income tax consequences. The Second Circuit, in *Rothstein v. United States*, 735 F.2d 704 (2nd Cir. 1984) reached the same conclusion, but on different grounds. Decisions of the Second Circuit would likely trump Rulings issued by the IRS for New York tax purposes.

130 *Proposed New York Fiduciary Income Tax Changes: Let My Trustees Go!,* Richard W. Nenno and Howard Zaritsky, Esq., 35 Tax Mgm't Est., Gifts and Tr. J. 147 (May, 2010).

in that trust.

The statutory term "no New York assets" in the definition of an exempt resident trust would appear to admit of no exception for non income-producing property. This could be significant: Assume no New York trustees, no New York source income, but the existence of non income-producing real property in New York. If the non income-producing real property precludes exempt resident status, the trust will be taxable on the assets out of state producing source income. On the other hand, if the non income-producing property were ignored, then the trust would be an exempt resident trust.

iii. **No New York Source Income.** Brokerage accounts will generally not produce New York source income. Other intangible property will produce New York source income if it derives from business activities in New York. Under a special rule in the New York Constitution, the existence of a New York trustee will cause intangible property to sitused in New York. Therefore, any New York trustee should be replaced with an out-of-state trustee. Generally, under the maxim *mobilia sequuantur personam*, "moveables follow the person," ownership of the intangible will "follow" the trustee.[131] Note that income from a brokerage account attributable to publicly traded partnerships issuing a K-1 will be included in New York source income, despite the situs of the asset at the domicile of the trustee. This is because income from a partnership is expressly included as source income of a nonresident. As discussed earlier, sales of intangible interests in real property are a source income land mine, and one must be exceedingly careful when making a sale of such an interest, since it can result in an exempt resident trust becoming

[131] See TSB-A-00(2)(I) – (2000). Where the trust consists of intangible assets, those assets are deemed to be located at the domicile of the trustee. None of the assets was employed in a business in New York. Since all three exemption conditions were met, the trust would be taxed as an exempt resident trust.

non-exempt.[132]

d. Converting Real Property to an Intangible. Real property may be converted into an intangible interest in property by transferring the property into a partnership or LLC. After doing so, an election may be made for the entity to be taxed as an S or C Corporation. However, selling an interest in the property, even if it is not income-producing and not used in a business, may cause tax problems for both exempt resident trusts and resident trusts not exempt. Even if achieving exempt resident status is not possible, converting the asset into an intangible will reduce source income of a resident or nonresident trust.

e. Reduce Source Income by Decanting. New York source income may be reduced by dividing the trust into two trusts, and segregating assets producing source income and assets not producing source income into separate trusts with the objective of qualifying one trust as an exempt resident trust. Decanting also has many other uses not involving income tax.[133] Decanting may be within the powers not required to be expressly granted to the trustee. New York statute specifically provides rules for decanting. The objective in some cases would be to qualify one of the two trusts as an exempt resident trust, or to segregate low-basis assets requiring in a separate trust not subject to New York tax. As with decanting, in most cases, the power of the trustee to divide the trust into two

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132 TSB-M-09-(5)I warns that

> "[a] resident trust that is not currently subject to New York State personal income tax because the trust meets the conditions under section 605(b)(3)(D) of the Tax Law may become subject to tax based on the sale or exchange of its interest in an entity that owns real property in New York State if the gain or loss from the sale or exchange is considered to be New York source income under section 631(b)(1)(A)(1) of the Tax Law."

133 Decanting a trust can be used to (i) clarify trust ambiguities; (ii) merge trusts or separate trusts from a single trust; (iii) achieve asset protection objectives; (iv) protect assets used to provide for a special needs child in a supplemental needs trust; (v) change the governing law of a trust; or (vi) change the situs of a trust.

separate trusts is also specifically is conferred upon the trustee in the trust instrument.

i. Decant Assets Into Newly Formed Trust in Delaware. Decanting involves transferring trust assets to another trust in New York, if the trust is a New York resident trust, or into a trust whose situs is in any other state. The trustee of a New York resident trust might decant trust assets into a second New York trust or into a Nevada[134] or Delaware trust. The power of a trustee to decant trust assets may be an inherent attribute of trustees under common law. New York was the first state to enact a decanting statute.

(1) Under EPTL §10-6.6(b), if the trustee has unlimited discretion to invade trust principal in favor of "current beneficiaries," the decanting statute allows the trust into which the assets are decanted, the "appointed trust," to benefit one or more beneficiaries to the exclusion of other beneficiaries – the rationale being that if the trustee has unlimited discretion to invade principal in favor of a single beneficiary, appointing all of the trust assets into a new trust which benefits only that person is essentially the same.

(2) Under EPTL §10-6.6(c), if the trustee has only limited discretion to invade principal, the appointed trust must have identical current and remainder beneficiaries as the invaded trust. Furthermore, the standard which guides the trustee in the appointed trust must be identical to that in the invaded trust for the duration of the original trust term. For example, if the invaded trust provided for principal distributions for the beneficiaries' "health, education, maintenance and support" (i.e.,

134 Nevada is preferable to Delaware since it allows decanting from a trust with an ascertainable standard to a discretionary trust. Delaware does not. Nevada also ranks above Delaware as a jurisdiction to create a domestic asset protection trust. Delaware however, boasts a judicial structure without parallel and should not be discounted where its few limitations are not relevant.

the "HEMS" standard), the appointed trust must also follow this directive.

(3) A trustee might seek to utilize EPTL §10-6.6 to accomplish any of the following objectives: (i) to extend the termination date of the trust; (ii) to add or modify spendthrift provisions; (iii) to create a supplemental needs trust for a beneficiary who is or has become disabled; (iv) to consolidate multiple trusts; (v) to modify trustee provisions; (vi) to change trust situs; (vii) to correct drafting errors; (viii) to modify trust provisions to reflect new law; (ix) to reduce state income tax imposed on trust assets; (x) to vary investment strategies for beneficiaries; (xi) to create marital and non-marital trusts; (x) to achieve asset protection objectives; or to (xi) change the governing law or situs of the trust to a different state.

ii. Although no trust may be invaded if it would be contrary to the intent of the creator, that intent would presumably be required to be evidenced in the trust instrument itself. Although beneficiaries have the right to notice of the intention to decant, their approval is not required. Decanting must not violate public policy. Although decanting is generally not a recognition event for income tax purposes, it may have other income tax consequences. For example, it will carry out DNI from the decanting trust to the receiving trust.

iii. **Example.** Trust A, a New York resident trust, with a New York fiduciary, authorizes a trustee to decant trust assets pursuant to EPTL §10-6.6(b). The New York trustee has the absolute power to invade to principal. The trust provides that the trustee may make distributions to two current beneficiaries, with the remainder to issue of the current beneficiaries. The trustee has unreviewable discretion to distribute as much or as little of trust income and principal as determined by the trustee, even if means distributing all assets and terminating the trust.

(1) The New York resident trust also holds title to property in California. The trust consists of low basis assets currently producing New York source income, a brokerage account in New

York, and the real property in California. Trustee decants the low-basis assets and the brokerage account into a Delaware trust with a Delaware trustee. Before transferring the assets, the New York trustee resigns and is replaced by a Delaware trustee, pursuant to a provision in the trust instrument.

(2) Result. The requirements for decanting are met. The recipient trust will now hold low basis assets which it can sell without producing New York source income. The brokerage account follows the trustee to Delaware. Since the trust now owns only the California, it appears to meet the requirement for an exempt resident trust.

iv. Decanting Cannot Convert Resident Trust to Nonresident Trust. Decanting cannot be used to change the settlor of a New York resident trust for purposes of the residency rules. The decanting statute provides: *"An exercise of the power to invade trust principal . . . shall be considered the exercise of a special power of appointment*." The holder of a special power is the grantor of the original appointive trust. This dooms any attempt to use the decanting statute to avoid New York resident trust classification. However, in the example, the trust qualifies as an exempt resident trust. Even though resident trust status cannot be altered by decanting, other income tax benefits may be achieved. In addition, administering the trust in Delaware or Nevada, for example, may be far easier than in New York. Those states also provide significant asset protection, which New York does not. Nevada and Delaware, in addition to sixteen other states, also permit "self-settled" spendthrift trusts. New York generally abhors self-settled spending thrift trusts as against public policy.[135]

f. Change Trust Situs and Governing Law. It may be possible to establish a new trust situs in another state. If the trust itself provides for a change in situs, it may be possible to accomplish under the terms of the trust instrument. If the

[135] The only instance in which New York appears to recognize self-settled spendthrift trusts to a limited extent is where a disabled minor self-settles a "first person" special needs trust.

trust does not expressly provide for a change in situs, it may be possible to accomplish essentially the same objective by decanting assets into a new trust in another state. Since the domicile of the trustee is a major factor in determining the situs of the trust, replacing a New York trustee with the trustee in the desired situs for the trust should also be effectuated. Other factors relevant to a change in situs include where the trust is administered, which may be where the trustee is domiciled, where the beneficiaries reside, the domicile of the settlor, or where real property held by the trust is located.

i. **New York May Not Recognize Change in Situs.** Since a New York resident trust status is immutable, formally changing the situs of a trust or its governing law to Florida, for example, while leaving trust assets or businesses in New York might result in New York not recognizing the change for income tax purposes. If an inter vivos trust were involved, New York would have less nexus with the trust to tax assets not producing New York source income, if the trust contained New York source income and also New York source income as defined under the New York statute.[136] If a change in situs is made, and contacts with New York are severed, due process may preclude New York from continuing to tax the trust.

(1) **Defending a Change in Situs.** The claim by New York to tax all income of a trust based on the settlor's domicile once the settlor has no longer lived in New York for a period of time raises constitutional issues under due process. The due process concern is higher, and the legal footing of the trustee stronger, if the trust is an inter vivos, rather than a testamentary trust. If the New York resident trust contains no assets in New York, then it may qualify as an exempt resident trust, mooting the issue. If the trust has some assets in New York and some beneficiaries, then the argument of New York for continuing taxation becomes stronger. The presence of New York beneficiaries will also present a risk whether or not New York immediately challenges the situs

136 See *Matter of The Amauris Trust,* DTA Nos. 821369 & 821497 (2008)**,** *supra.*

change, since New York could seek to tax a distribution years later as an accumulation distribution, if the distribution was made to New York beneficiaries who were over the age of 21 when the income was accumulated.

(2) **Conclusion.** Changing the situs of a trust is not a simple decision for the trustee. Ideally, the trust should contain explicit provisions for a change in situs, as well as a change in governing law. Testamentary trusts are more likely to be problematic than inter vivos trusts. The longer the former New York domiciliary is away from New York, the stronger the case becomes that the change in situs will be respected. Extra caution should be exercised where most beneficiaries are in New York, and some assets remain there.

(3) **Changing Situs of California Trust Easier.** By comparison, the changing the taxable situs of states that define their resident trust by reference to the domicile of the trustee or the place of administration, presents fewer constraints than states that defines resident trust by the domicile of the settlor, as does New York. Since California is among the states that include the domicile of an in-state trustee in its definition of a resident trust, it would appear possible for the trustee of a California trust to convert a California resident trust to a resident trust in another state. Although the same option is not available in New York, since the domicile of the trustee is irrelevant for purposes of determining whether the trust is a resident trust, due process arguments can be made by the trustee of a New York resident trust seeking to prevent New York from imposing tax on a trust with few contact with the state. However, the Department is free to disagree with such an assertion.

(a) **Note on Trusts Constricted Appeal Rights:** Administrative tax tribunals are generally averse to considering constitutional arguments. That puts taxpayers in a catch-11, since in order to preserve appeal rights, the constitutional issue must nevertheless be raised by the

Trustee in administrative hearings. Under recently, the Commissioner was unable to appeal determinations made by the Tax Appeals Tribunal. As a result of a legislative amendment, the Commissioner may now take appeals to the Appellate Division in some cases, assertions of constitutional issues being one. Even though the case may not have been decided by the Tax Appeals Tribunal on constitutional grounds, the raising of the issue by the trustee may ultimately benefit the Commissioner, and accord the Commissioner appeal grounds that might now have otherwise existed. Without question, granting the Commissioner appeals rights from determinations made by the Tax Appeals Tribunal has further impaired the already constricted rights of the taxpayer to litigate Department determinations.

g. New York Definition of Resident Trusts May Appeal to Nonresidents. Since New York requires that the settlor of a New York resident trust be a New York domiciliary, residents of states having little or no contact with New York may ironically find New York an attractive place to settle a trust in some circumstances. A trust established by nondomiciliary[137] of New York with no New York source income or assets, would have no source income for New York upon which the state could impose. The presence of a New York trustee would not cause the trust to be taxable on all income, since the trust would not be a resident trust. A nonresident trust may only be taxed on New York source income.[138] Although only a resident trust qualifies as an exempt resident trust, the trust would essentially be taxed in the same manner, except it would not be required to file certifications required for resident trusts, since it is would not

[137] Since a statutory resident of New York for tax purposes is not invariably a New York domiciliary, a trust created by that person would not be a New York resident trust. Rather, it would be a nonresident trust, taxable only on its New York source income. For a New York resident trust to exist, the statute requires that it be funded by a New York domiciliary.

[138] See "*Choosing and Rechoosing the Jurisdiction of a Trust,"* Nenno, 40 *University of Miami School of Law Philip E. Heckerling Institute on Estate Planning* (2006).

be a resident trust. The situs of the trust might be New York, the trust might provide that it be administered pursuant to New York law, and the trustee might be domiciled in New York, but still the trust would be a nonresident trust taxable only on its New York source income. If it had none, it would incur no tax.[139] New York historically was an attractive place for nonresidents to implement trusts, and attracted the wealth of many industrialists.

i. **Advantages of New York as Trust Situs.** New York has an established body of trust law, a predictable court system, and a wealth of legal and banking services. New York was the first state to enact a decanting statute, and if decanting trust assets may be a trust objective, New York would be an ideal situs for a trust. Provided there were no New York assets or source income, the trust would not incur New York tax. As a center of commerce, New York has historically welcomed trust established by nonresidents. Of course, there are many reasons why a nonresident would prefer to implement a new trust in a state whose laws cater to nonresidents.

h. **Use Trusts to Neutralize SALT.** TCJA amended IRC §164 to limit the deduction for state and local income and property taxes to $10,000 per year. President Trump stated during the presidential campaign that he would "get SALT back." According a recent report in *The Wall Street Journal,* while the cap will likely be raised, the amount is uncertain. Full repeal appears unlikely.[140] Several planning strategies exist:

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139 Whether or not such a trust is denominated an exempt resident trust is immaterial, since a trust established by a nonresident having no New York source income, no New York trustees, and no New York assets would not be taxable in any case.

140 "The SALT cap can be adjusted in several ways. . . Some have proposed full repeal of the cap, which even supporters concede is politically unlikely. Rep. Mike Lawler (R., N.Y.) has proposed a new $100,000 level for individuals and $200,000 for married couples. . .Congress also could set an income limit for the deduction to prevent the highest earners from benefitting. . .Raising the cap for married couples to $20,000 for married couples would be a $225 billion tax cut over a decade, compared with keeping the $10,000 limit, according to the Tax Policy Center, with about 75% of the benefits going to the top 10% of households by income. Full

i. **Grantor Trusts Less Desirable.** One of the features of asset sales to grantor trust lay in the ability of the grantor to pay the income tax liability of the trust, thereby permitting the trust assets to grow without the imposition of income tax. This feature may not be as important today, since New York essentially has no gift tax and the federal exemption is extraordinarily high. If a grantor trust is employed, then the income and deductions are reported by the grantor. The SALT deduction is unaffected by the payment of the grantor of the trust tax liability. However, with several advantages previously associated with the use of grantor trusts not as compelling today, the opportunity cost of using a grantor trust versus a nongrantor trust, especially where real property is involved, may tilt the scales in favor of a nongrantor trust.

ii. **Nongrantor Trusts and SALT.** Since a nongrantor trust is a separate legal entity, it is entitled to its own $10,000 deduction. If a trust owns multiple pieces of real estate, it might be possible to structure the ownership such that each trust owns a separate piece of real estate, thereby multiplying the deduction by the number of trusts. Note that under IRC §643(f), the IRS may treat multiple trusts as a single trust if they have "substantially the same grantor or grantors and substantially the same primary beneficiary or beneficiaries," and the principle purpose is to avoid tax.[141]

i. **IRC §199A.** Section 199A, enacted in 2017 along with the SALT limitations, provides a 20 percent deduction for "qualified business income" for non-corporate taxpayers, including trusts. Income from a "specified service trade," which includes businesses such as legal or accounting, is limited to $157,500. Above that amount, the deduction is phased out.[142]

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repeal would lower revenue by more than $1 trillion." *The $10,000 SALT Cap Is Likely dead. What Will the New Cap Be?* The Wall Street Journal, January 17, 2025.

141 See *Use of Trusts to Bypass Limit on State and Local Tax Deduction*, Jonathan G. Blattmachr *et al*, Estate Planning, April 2018

142 IRC §199A(d)(2).

j. Inter Vivos Trusts May be Preferable to Testamentary Trusts. Revocable inter vivos trusts that become revocable at death allow a grantor to be sole trustee.[143] For this reason, such trusts have for some testators become a useful adjunct to a "pourover" will. These trusts often contain a provision to change trust situs. A settlor who creates a revocable inter vivos trust – and transfers property into the trust – but is not a New York domiciliary when the trust becomes irrevocable, will not have not created a New York resident trust. However, if the individual dies before becoming a non-domiciliary, then it will be a resident trust, since it becomes irrevocable at death.[144]

i. Due Process Considerations Favor Inter Vivos Trust. In *District of Columbia v. Chase Manhattan Bank*, 689 A.D.2d 539 (DC App. 1997), the court, referring to inter vivos trusts noted "[i]n 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." Under this principle, a New York resident trust created by an inter vivos trust becoming irrevocable even while the settlor was still domiciled in New York, might be able to argue that under due process, New York may not continue to tax all income of the trust once the settlor has changed domicile to another state.

k. "Toggle" Trust Status. Grantor trusts have been formative in tax and estate planning over the last quarter-century.[145] Still, there are occasions when grantor

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143 NY EPTL § 7-1.1.

144 Tax Law §605(b)((3) provides that a resident trust is "a trust or portion of a trust, consisting of the property of:. . .a person domiciled in New York State at the time such property was transferred to the trust . . . if a person domiciled in New York 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."

145 An example is the use of assets sales to "defective" grantor trusts. These arrangements allow the grantor to transfer assets out of the estate for transfer tax purposes, while retaining the obligation to pay tax on trust income (sometimes with the right of reimbursement), thus allowing trust assets to grow without the imposition of income tax, and taking further

trust status is no longer desirable.[146] Trusts may be drafted to "toggle" between grantor trust and nongrantor trust tax status. (In a sense, New York automatically "toggles" trusts taxed for federal purposes as incomplete gift nongrantor trusts to grantor trusts for New York State tax purposes.)[147] This can be accomplished by the grantor releasing the trust power that caused the trust to be taxed as a grantor trust.[148] Converting a nongrantor trust to a grantor trust is more complicated. A nongrantor trust containing the dormant powers to "toogle" to a grantor trust should also contain explict trust language describing when such toggling may occur. Toggling is essentially amending the trust, so

appreciation out of the estate. Another benefit of which grantor trusts may be imbued is the ability to "swap" higher basis assets with lower basis assets. This will reduce capital gain should the trust sell the assets. The trust may provide for the reimbursement to the grantor of income taxes paid on behalf of the trust. However, the grantor may not have a right to demand reimbursement.

146 An Advisory Opinion issued in 2014 stated that transfer between grantor and grantor trust was a transfer for consideration. Since New York imposes sales tax on sales of tangible personal property, the sale by grantor of an interest in a SMLLC holding tangible personal property would be subject to sales tax if sold to a grantor trust in exchange for a note. [TSB-A-11(1)(M). Another arrow was taken out of the quiver of sales to grantor trusts in 2023, when the IRS issued Revenue Ruling 2023-2 which stated that assets held in an irrevocable grantor trust do not receive a step-up in basis at the grantor's death. Although not surprising, this issue had been debated for years.

147 In legislatively mandating that nongrantor trusts under federal tax law would be taxed as if they were grantor trusts under federal tax law, New York "decoupled" its trust income tax regime from the federal regime. Since TCJA, some states have structured its tax laws such that its residents would be less affected by SALT rules.

148 The trust instrument may contain this provision if the desirability of this feature was contemplated when the trust was implemented. If the trust does not contain this power, it may be amended to include the provision enabling the grantor to exercise the power. Beneficiary consent might be required for the trust amendment, but not for the decanting itself. Courts are becoming more receptive to a reduction in fiduciary tax as a rationale for changing the terms of a trust.

the laws of the state must also be considered.[149]

i. **Advantages of Grantor Trust Remain.** In some cases the grantor may wish to pay the income tax liability of the trust, and shift the tax burden from the fiduciary to the grantor. Causing a nongrantor trust to be taxed as a grantor trust would shift the tax liability, but would not change the residence or situs of the trust. A grantor paying the tax of a grantor trust will constitute a tax-free gift of the tax liability to the trust. The conversion of a nongrantor trusts would result from the grantor exercising the power to "swap" trust assets under IRC §675(4)(C). This swap power can also be used for estate planning purposes; assets with a low basis may be swapped for high basis assets if a sale is contemplated.

l. **Effect of Settlor Becoming Domiciled in Another State.** The resident trust of a settlor who irrevocably transferred property to a trust while a New York domiciliary will have created a New York resident trust, unless the trust became irrevocable when the settlor was domiciled elsewhere. If the individual establishes residency and domicile in Florida, the an irrevocable trust funded while a domicile of New York will continue to be subject to tax on all trust income. If the resident trust has no New York assets or source income, and no New York trustee, it will qualify as an exempt resident trust. Even if it does not so qualify, due process may limit the taxing power of New York to New York source income.

If the trust has no New York source income, due process may prevent

[149] Toggling to change a grantor trust to a nongrantor trust is more difficult than toggling to change a nongrantor trust to a grantor trust. The latter involves the grantor exercising a retained power, whereas the former, creating a nongrantor trust, changes more rights and obligations of the trustee and beneficiaries.

New York from imposing tax on the trust.[150] However, should New York impose tax on the resident trust in questionable circumstances, challenging the imposition of tax by New York will be difficult in the Division of Tax Appeals, which are disinclined to hear Constitutional arguments. The Tax Appeals Tribunal has shown less disinclination. An alternative path exists to challenge determinations that violate due process or the Commerce Clause. The fiduciary may commence an action in New York State Supreme Court alleging constitutional violations in certain circumstances. Thus, relief may be sought if the state has acted in an unconstitutional manner by seeking to impose tax by alleging that the statute is unconstitutional, that the statute does not apply to the fiduciary, or that the Department exceeded its jurisdiction in imposing the tax.[151]Although it is said that the taxpayer must "exhaust administrative remedies," if the matter is one that would cause immediate and irreparable harm to the trust or beneficiaries, then seeking injunctive or declaratory relief or a temporary restraining order may be sought before administrative remedies are exhausted.

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150 Tax Law §3030(a)(4). See also *Let's Jiggle the Door Handle to Federal Court for SALT Disputes*, 95 Tax Notes State 473, 474 (Feb. 10, 2020); Robert P. Merten, III & Nicholas J. Kump. The articles states:

> "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."

151 According to the *2023 Annual Report of the New York State Tax Appeals*, 42 percent of cases were settled before hearing. Of the 58 percent, or 144 cases that went to hearing, 92 percent were sustained, 7 percent were modified, and 1 percent (2 cases) were cancelled. While the odds are higher on appeals taken to the Third Department, litigants still have only a 5 to 25 percent change of prevailing. A recent change raises the bar even further against the taxpayer: The Division of Taxation is now allowed to appeal adverse Tax Appeals Tribunal determination to the Appellate Division.

16. Testamentary Planning. The use of an testamentary trust may allow the trustee to remove trust assets from New York so that they are not part of the taxable estate. While real property in New York will be included in the decedent's estate, intangible property will not.

a. TSB-A-10(1)M – (2010). The decedent was a Florida domiciliary who owned various minority interests in New York LLCs through a revocable trust. The issue was whether the decedent's interest was subject to estate tax. This depended upon whether the interest in the revocable trust was an intangible. The New York LLCs owned property in New York. Since the LLCs had elected to be taxed as a partnership, and since a partnership under the IRC has an existence separate from its owner, the interest of the revocable trust in the LLC constituted an intangible.

i. Tax Law § 960(a) provides that tax is imposed on the transfer at death of a non-New York domiciliary of real and tangible personal having an actual situs in New York State and is includable in his or her federal gross estate. Therefore, converting real property to an intangible interest in a partnership or corporation as described above may result in estate tax savings if held by an out-of-state trustee. The advisory concluded that (1) an interest in a S corporation owning New York real property is considered an intangible and is not included in a non-resident decedent's New York gross estate unless the S corporation is not entitled to recognition under the Moline Properties test (*Moline Props. v. Commissioner of Internal Revenue*, 319 U.S. 436, 438-439 [1943])[152]; and (2) an interest in an SMLLC owning New York real property is also considered an intangible and is not included in the nonresident

[152] *Moline Properties* held that the corporation created by the taxpayer was "clearly not [the taxpayer's] alter ego. . .It was then as much a separate entity as if its stock had been transferred to third persons." The advisory noted that "[i]ts separate existence must be recognized for tax purposes so long as [its] purpose is the equivalent of business activity or is followed by the carrying on of business by the corporation." Therefore, its existence should not be disregarded. The "mere fact of the existence of a corporation with one or several stockholders, regardless of the corporation's business activities, does not make the corporation an agent of its stockholders." *Moline Properties v. Com'r*, 63 S.Ct. 1132 (1943).

decedent's New York gross estate as long as the SMLLC elects to be treated as a corporation under the "check-the box" regulations (Treas. Reg. §§301.7701-1 through 301.7701-3).

ii. **TSB-A-00(2)(I) – (2000)**. Where trust consists of intangible assets, those assets are deemed to be located at the domicile of the trustee. None of the assets was employed as a business in New York. Since all three exemption conditions were met, the trust would be taxed as an Exempt Resident Trust.

iii. **TSB-A-15(1)M.** An Advisory Opinion was requested by a New York resident who planned to establish residency in another state. For estate planning purposes, the taxpayer contemplated deeding a New York condominium to a single-member LLC established in Delaware.

(1) **Analysis.** Estate tax is imposed on the estate of a non-resident decedent of real property and tangible personal property located in New York. Condominiums are real property the interest of which, if held by a corporation, partnership or trust, is intangible property. Tax Law §951-a(1) excludes stocks, bonds, notes, shares of stock, evidences of indebtedness, or choses in action, generally. The New York Constitution prohibits the imposition of estate tax on a nonresident's intangible property, provided it is not used in carrying on any business within the state by the owner, even if located in New York. However, as the taxpayer requesting the advice learned, since a single-member LLC is disregarded, the SMLLC must elect to be taxed as a partnership or corporation (or add another member) to accomplish its goal.

17. Chart Indicating Resident Trust Criteria

18. *Safe Deposit Trust Co of Baltimore v. Virginia* (1929)

19. *Mercantile Safe Deposit & Trust v. Murphy* (1964)

20. *Taylor v. State Tax Commission* (1981)

21. *Epstein v. NYS Tax Commission* (1987)

22. TSB-M-09(5)I. Amendment of Definition of New York Source Income of a Nonresident Individual (2009)

23. *Tamagni v. Tax Appeals Tribunal* (1998)

24. *Petition of Allison Greenberg* (2023)