780 Third Avenue
New York, NY 10017

TWENTY-FIRST
SECURITIES
CORPORATION

Phone: 212-418-6000
Fax: 212-418-6038
www.twenty-first.com

NINGs Get Dinged in New York

June 1 deadline to save 2014 taxes

Over the last few years we've been asked on numerous occasions about the state tax benefits of holding your investments in a trust situated in a state that has no income tax on trusts like Nevada or Delaware.

This might sound very much akin to the activity that's causing a lot bellyaching in Washington about US corporates not paying tax on the income they make outside the US. Well it's just like that but for you and me. At least it was until April Fool's day 2014.

Since 2001 attorneys have pointed out that trusts set up in a very specific manner could achieve state tax savings by moving the taxable income out of your home state and instead into the trust's home state. As a report from New York State put it, these Incomplete Gift Trusts "are treated as grantor trusts under federal gift tax law, so that the transfer is not subject to gift tax, but as non-grantor trusts for federal income tax purposes, so that the trust is a separate taxpayer from the grantor".

If the state that the trust was in had no taxes like Nevada or Delaware then there would be no state taxes on the income. You still pay taxes on the income at the federal level just for the trust not for you. This did not work in all states; I've read that this arrangement was not respected in Connecticut, Ohio or the District of Columbia but could work in others such as New York, New Jersey, Kentucky, Massachusetts, Michigan and Missouri.

The most written about trusts were trusts that went by the acronyms DING-Delaware Incomplete Non-grantor Gift Trust or NING-Nevada Incomplete Non-grantor Gift Trust; although I'm told that many were set up in Alaska.

This idea gained great momentum last year when the federal government issued a series of rulings (PLRs 201310002-201310006 released March 8, 2013) that "condoned" such a trust. There was doubt in the community until then as to whether such a trust would indeed be respected.

The other states that were losing out, as you might imagine, have never liked this concept and have at times tried to fight the result in court or in legislation. These efforts have been rebuffed on constitutional grounds. Indeed in 2010 New York State proposed to eliminate the benefit in such a manner and it did not pass.

The New York State Tax Reform and Fairness Commission reported in November 2013 that this proposed change would bring in $150,000,000 a year into the state's coffer. At the current New York State tax rate that means that over $1.5 billion a year In INCOME is earned outside the state by New York residents in these special type of trusts. That's not $1.5 billion in assets outside New York, its $1.5 billion in income that would have been taxed. Who knows what the asset base is that throws off that much taxable income.

Through *Part I of Chapter 59 of the Laws of 2014*, passed April 1st of this year, New York State will, on a going forward basis, treat these incomplete gift trusts as grantor trusts and thus the income will be taxable to the NY resident as the grantor rather than taxable to the trust itself. This applies to income earned after January 1, 2014. There is a transition relief rule for trusts liquidated before June 1st, 2014 (two weeks from now). If the trust is liquidated in time, the income that is earned between January 1 and June 1, 2014 would be exempt from New York state taxes. If you don't liquidate by then, all of 2014's income will be taxed by New York.

Bottom line: if you are a New York resident and took a giant capital gain this year in one of these trusts, hurry up and liquidate. For those who went down this path the good news is that past years are not being looked at for a claw back so the strategy worked - bad news is the game is up. Let's see if other states follow suit.