Forbes

Robert W. Wood
THE TAX LAWYER

TAXES 11/27/2018

13.3% California Taxes Triggers Moves & Trusts To Avoid Taxes

California income taxes are high, up to 13.3%. Plenty of people try to avoid California taxes by moving shortly before a major income event. That is not a new idea, although there is more of it now than ever before. One added reason is the federal tax law's $10,000 cap on deducting state taxes. You might not feel the pain of that rule until you prepare your 2018 tax return, but that time is coming soon. Besides, many high tax state residents start thinking of moving right before a big income event. They might be selling a company, settling a lawsuit, or sitting on a mountain of Bitcoin. Done carefully, and with the right kind of income, a tax-motivated move can cut the sting of California's high 13.3% state tax.

Yet even *moving* to avoid California taxes can be tough. If you are dealing with the state's notoriously aggressive Franchise Tax Board you can still have problems. A related and newer approach that is still largely untested involves setting up a new type of trust in Nevada or Delaware. A 'NING' is a Nevada Incomplete Gift Non-Grantor Trust. A 'DING' is its Delaware sibling. There is even a 'WING,' from Wyoming. Let's say you can't move quite yet, so you wonder if a trust in another state might work? The usual grantor trust you form for estate planning doesn't help, since the grantor must include the income on his return.

Some sellers hold significant assets and move states before they sell. California may have a claim on some of the sales proceeds even if the move is well-timed, bona fide, and permanent. Indeed, California can also dispute the move, arguing that a move in March really was not a move until July. With a Nevada or Delaware Incomplete Gift Non-Grantor Trusts, the donor makes an incomplete gift to the trust, and the trust has an independent trustee. The idea is to keep the grantor involved but not technically as the owner. New York State changed its law to make the grantor taxable no matter what, but California has not yet done so. Thus, some marketers of NING and DING trusts offer it as an alternative or adjunct to the physical move. The idea is for the income and gain in the NING or DING trust not to be taxed until distributed. At that point, the distributees will hopefully no longer be in California. The chosen trustee must not be a resident of California.

Tax-deferred compounding can yield impressive results, even if it is only state income tax that is being sidestepped. If the NING or DING trust is being used to fund benefits for children and will grow for years, it may make even more sense. Parents frequently fund irrevocable trusts for children, and may not want the trust to make distributions for years. The parents might also remove future appreciation of trust assets from their estates. For tax purposes, most trusts are considered taxable where the trustee is situated. For NING and DING trusts, one common answer is an institutional trust company.

For trust investment and distribution committees, the committee members should also not be residents of California. Even if you jump through all the requisite hoops, the NING or DING trust may *still* pay some California tax. For example, if the trust has any California source income, it will still be taxable by California. Interest, dividends and gains from stock sales are intangibles, typically not California sourced. But gain from California rental properties or the sale of California real estate is sourced to California no matter what.

Outside of New York residents, the jury is out on NING and DING trusts. The facts, documents, and details matter. California tax lawyers know that the state rarely takes aggressive tax moves lying down. Still, California seems more likely to attack these trusts in audits rather than through legislation. Even so, state tax fights in California can be protracted and expensive. But if one is careful, willing to bear some risk, and there is sufficient money at stake, the calculated risks can make sense.

This is not legal advice. For tax alerts or tax advice, email me at Wood@WoodLLP.com.