Forbes

Robert W. Wood

THE TAX LAWYER

TAXES 06/18/2018

Bitcoin Trusts Avoid Taxes, Including $10,000 SALT Deduction Cap

The IRS treats bitcoin and other crypto as property. That means each transfer can trigger taxes. There may be tax to the recipient, plus tax to the transferor. The latter catches many people by surprise. A key tax question on each transfer is the market value on transfer. With the wild swings in value, that can be frightening. Some crypto investors use legal entities such as corporations, LLCs or partnerships. They can face the same transfer issues, but it is often possible to contribute the crypto to the entity without triggering taxes.

Another avenue now being considered is a crypto trust. This is really just a trust that holds crypto assets. Trusts can be taxed in several different ways, depending on their type. There are living trusts that people usually use for estate planning, and they are not separately taxed. If you transfer Bitcoin to your living trust, it usually isn't a taxable transfer, since your living trust isn't really a separate taxpayer. It is still you. The trust is not separately taxable, typically until you or your spouse die.

There are also non-grantor trusts, where the transferor is not taxed on them. These are separately taxed, and they file a separate trust tax return.
The trust *itself* pays taxes, and there can be another tax on the distribution to beneficiaries. But leaving distribution issues aside, *where* does the trust pay taxes? Some trusts are foreign, set up outside the U.S. Those rules are complex, but if you are U.S. person, you should not assume that you can avoid U.S. tax with a foreign trust.

What about state taxes? Some trusts are being set up with an eye to reducing or avoiding *state* taxes. Remember, there's a new federal tax deduction cap of $10,000. Say you are in California and don't want to move to Nevada before you sell your Bitcoin. You want to cut the sting of California's high 13.3% state tax, but you aren't willing to move, at least not yet. You could consider 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. Some marketers of NING and DING trusts offer it as an alternative or adjunct to a physical move. The idea is for the income and gain in the NING or DING trust not to be taxed until it is distributed. At that point, the distributees will hopefully no longer be in California.

Let's say you can't move quite yet, so you wonder if a trust in another state might work? The idea of a Nevada or Delaware Incomplete Gift Non-Grantor Trust is for the donor to make an incomplete gift, with strings attached. The trust has an independent trustee outside of California. When this was tried in New York, New York lawmakers changed the law to make the grantor taxable no matter what. California's Franchise Tax Board has not yet ruled on the issue.

If the NING or DING trust is formed to facilitate a business sale and the proceeds will be capital gain, there is the federal tax of up to 20%. Then, there is also the 3.8% Obamacare tax on net investment income. It makes the current federal tax burden on capital gain up to 23.8%. California taxes all income at up to 13.3%, and there is no lower rate for long term capital gain. It is one reason Nevada, Texas, Washington, Florida and other no tax states may be tempting for California sellers.

Most non-grantor trusts are considered taxable where the trustee is situated. For NING and DING trusts, one common answer is an institutional trust company in Delaware or South Dakota. 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 California source income, it will still be taxable by California. 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 still out on NING and DING trusts. The facts, documents, and details matter. California rarely takes moves that short the state lying down. 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 may be worth considering.

For alerts to future tax articles, email me at Wood@WoodLLP.com. This discussion is not legal advice.