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# Can You Skip California Taxes Without Moving?

Not long ago, I wrote about people who seek to avoid California taxes by moving right before a major income event. They might be selling a company or settling a lawsuit. Done carefully, and with the right kind of income, it can work, cutting 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 approach 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.


*Credit: Shutterstock*

An emerging answer for the adventurous is a Nevada or Delaware Incomplete Gift Non-Grantor Trusts. The donor makes an incomplete gift—with strings attached—to the trust, and the trust has an independent trustee. The idea is to keep the grantor involved but not technically as the owner. York State has changed the law to make the grantor taxable no matter what.

California's Franchise Tax Board says it is studying the issue. 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.

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 it is distributed. At that point, the distributees will hopefully no longer be in California. The chosen trustee must not be a resident of California.

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 nearby Nevada has always loomed large for California sellers.

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 many years. The parents might also remove future appreciation of the 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 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 any California source income, it will still be taxable by California. Interest, dividend 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 moves that short the state lying down. Still, California seems more likely to attack these trusts in audits rather than through the legislature. 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.

*For alerts to future tax articles, email me at [Wood@WoodLLP.com](mailto:Wood@WoodLLP.com). This discussion is not legal advice.*