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Using Nevada Trusts for California Residents: 'Do's, Don't's, and 'Don't Even Think About It'

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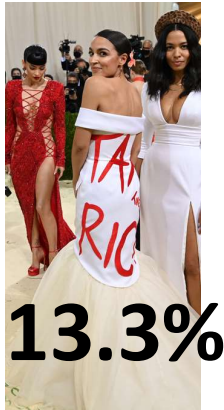
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Part One: The Departing Resident



- Retirees (sometimes with substantial gains from the sale of their California real estate) are headed for Texas, Arizona, Nevada, and Oregon.
- The out-migration is so significant that it is affecting real estate prices in those states, and causing demographic rifts with the locals.



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What makes a resident a Nonresident?

FTB Publication 1031 include:

- Amount of time you spend in California versus amount of time you spend outside California.*
- Location of your spouse/RDP and children.
- Location of your principal residence.**
- State that issued your driver's license.
- State where your vehicles are registered.
- State where you maintain your professional licenses.



* Presence test usually met if > 6 months in CA RTC 17016; but see *Appeal of Edgar Montillon Wolley* (SBE, 7/19 1951)

** Aka "permanent abode"

*** Presumption is of residency – there is no "presumption of nonresidency"



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What makes a resident a Nonresident?

- State where you are registered to vote.
- Location of the banks where you maintain accounts.
- The origination point of your financial transactions.
- Location of your medical professionals and other healthcare providers (doctors, dentists etc.), accountants, and attorneys.
- Location of your social ties, such as your place of worship, professional associations, or social and country clubs of which you are a member.*
- Location of your **real property** and investments.
- Permanence of your work assignments in California**



* Assemble affidavits of friends, employers, business associated verifying the temporary nature of your stay

** Note RTC 17014(d) – depart CA w/min written empl. Contract for 546 days



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What makes a resident a Nonresident?

What about establishing a new Taxpayer outside of CA?

- A Trust is a resident of the State:
 - In which the trustee(s) resides
 - In which a beneficiary resides
 - In which the grantor resides?



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Place of Administration/Residence of Trustee	Grantor Domicile	Grantor Domicile Plus	Beneficiary Residency	States with No Income Tax on Trusts
Trust is a resident if administered in the state or if trustee is a resident of the state	Trust is a resident if the grantor was domiciled in the state at the time the trust became irrevocable	Trust is a resident if the grantor was domiciled in the state when the trust became irrevocable and there is some other connection with the state	Trust taxed as a resident if it is held for the benefit of a resident of the state	State does not impose income tax on trusts
Arizona, California, Colorado, Hawaii, Idaho, Indiana, Iowa, Kansas, Louisiana, Minnesota (pre-1996 trusts), Mississippi, Montana, New Mexico, North Dakota, Oregon, South Carolina, Utah, Virginia, Wisconsin (pre-October 28, 1999 trusts)	District of Columbia, Illinois,** Maine, Minnesota (post-1995 trusts),** Nebraska, Oklahoma, Vermont, Virginia, West Virginia, Wisconsin (post-October 28, 1999 trusts)	Alabama, Arkansas, Connecticut, Delaware, Iowa, Maryland, Massachusetts, Michigan, Missouri, Montana, New Jersey, New York State, New York City, Ohio, Pennsylvania, Rhode Island	California, Georgia, North Carolina**	Alaska, Florida, Nevada, New Hampshire, South Dakota, Texas, Washington, Wyoming

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When to “not even think about it”

- TP (or TP’s beneficiaries, if establishing a Trust) live here and plan to do so indefinitely
- TP’s kids go to school here
- TP’s **real property is here (or mostly CA source income)**
- TP (or your beneficiaries) work here (or TP’s business is situated here and not planning to sell)
- TP has creditor issues (UVTA)



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The decision has been made to leave. Now what?

To do:

- ___ Change drivers License
- ___ Cancel old library card and obtain a new one
- ___ Cancel old voter registration and register in new State
- ___ Bills:
 - ___ Credit card – change to new State
 - ___ Cellphone/telephone: use land line in new State
- ___ Individual bank account w/address of residence in New State
- ___ Entity/trust bank accounts with address of business in New State
- ___ Video Rental Card (whoa, this is old!)
- ___ Cable subscription and Netflix/Amazon Orders



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To do (cont.):

- ___ Health club membership
- ___ Cancel car registration and re-register in new State
 - ___ Or sell the car and buy a new one outside CA
- ___ Sell (or indefinitely rent) residence – creates source income
- ___ Cancel social and country club memberships
- ___ Find new church, synagogue, mosque, temple, etc. in new State.
 - ___ Register in the new Parish
- ___ Move medical records to new doctor in new State; change primary care physician



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To do (cont.):

___ Use Nevada (or Washington, etc.) office of law firm and tax preparer to communicate with lawyer and accountant. (Use Fox Rothschild LLP Las Vegas Nevada office if working with Peter's team)

___ Reduce (or eliminate) expenses while in California to those in which a temporary visitor or tourist would make



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Part Two: Structuring Succession Planning for the *Departing* Business Owner

"I am thinking about leaving California."

What do we want to know:



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Part Two: Structuring Succession Planning for the *Departing Business Owner*

“I am thinking about leaving California and seek State tax advice.”

What do we want to know:

- When; what does “thinking about” mean?
- To which State? (Hawaii, New Jersey and New York are similar to CA)
- Who is to Control wealth?
- CA source? Passive or active income?



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Part Two: Structuring Succession Planning for the *Departing Business Owner*

Example 1: Seller (“Bob”)

- CEO and majority shareholder in ABC Widgets, a California C corporation.
- Bob is planning to move to Arizona
- Bob is planning to sell his stock “soon,” but there is no enforceable contract in place

Other possible points of consideration to be included in a \$5M buyout are:

- Deferred compensation
- Covenant not to compete
- Consulting income



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Part Two: Structuring Succession Planning for the Departing Business Owner

Type of income	Taxable or not?
Real property located in California	Taxable
Real property located outside California:	Not taxable
Income from tangible personal property located in California	Taxable
Income from tangible personal property located outside California	Not taxable
Gain on the sale of real property or tangible personal property located in California	Taxable
Interest and dividends	Not taxable (unless it had a business or taxable situs in California (R&TC §17952) or unless the intangible income is from an installment sale that occurred while the taxpayer was a resident (18 Cal. Code Regs. §17952))
Payment for services performed in California	Taxable
Payment for services performed outside California for a California business, trade, or profession	Not taxable (until recently - <i>Bindley</i>)
A nonresident's pension accrued during California residency from services performed in California	Not Taxable
Income from a stock option exercised after taxpayer becomes a nonresident but where services between grant date and exercise date were performed while taxpayer was a resident	Taxable (18 Cal. Code Regs. §17952)
Income from California S corporation	Taxable
Gain on sale of partnership interest (or other intangible)	Not taxable. Appeal of <i>Amyas Ames, et al.</i> (June 17, 1987) 87-SBE-042
Income from royalties and for the privilege of using patents, copyrights, secret processes and formulas, goodwill, trademarks, trade brands, franchises, etc., that have a business situs in California	Taxable



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Bindley - SERVICES

(Unitary) Testing Grounds: *Appeal of Blair S. Bindley*

- In *Appeal of Blair S. Bindley*, the taxpayer was a self-employed screenplay writer and **Arizona resident**. Bindley contracted with LLCs headquartered in California to provide film and TV production services. He performed all of the services at issue **while in Arizona**. The FTB assessed tax on Bindley's income from the California LLCs under *FTB Regulation 17951-4* and Bindley appealed.
- After determining that Bindley was conducting business as a sole proprietorship **within and without** California, the OTA turned to the question of a unitary business. The OTA held that Bindley's services, which only he controlled and managed, were "one interrelated and interdependent business employing and consuming the same resources." The OTA next applied the FTB's cascading rules for sourcing sales of services to determine where **the benefit** of Bindley's services was **received**. The contracts did not specify the location where either LLC received the benefit of Bindley's services; therefore, the OTA reasonably approximated the location to be California based on the facts that the LLC customers were registered and located in the state, and Bindley's contracts with the LLCs both listed California addresses.

- See also, FTB Regulation 17951-4 and *Appeal of Christopher Wood*, 2019-OTA-264 (July 8, 2019) (nonprecedential)



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Part Three: The Non-Resident (NV) Trust

- *NING*. Nevada Incomplete Gift Non-Grantor Trust
 - IRS no longer issuing PLR’s on these
- *Spousal Limited-Access Non-Grantor Trust (“SLANT”)*. The trust creator has relinquished benefits from and control over trust to their spouse, who is a discretionary income beneficiary
 - Spouse cannot receive income “without the consent of an adverse party.” See *IRC 677(a)(1)*
 - The gift is “completed,” however. *Kaestner* may come into play.
- Third-Party Non-Grantor Trust (e.g., a Dynasty Trust)



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Part Three: The Non-Resident (NV) Trust

- *NINGs*, *SLANTs* and NV Dynasty Trusts all require “situs” in NV
- NV Trustees are usually the basis for situs
 - NV has “directed trustee statutes” (the trustee is an administrative trustee, who is directed in investments and distributions by other trustees or “advisers”)
 - There are several NV trustees who seek out this business:
 - Alliance Trust Company of Nevada ((775) 297-4000)
 - Dunham Trust Company ((775) 826-7900)
 - Premier (Las Vegas: 702.507.0750 | Reno: 775.473.2200)
 - Icon ((702) 998-3700)
 - Preservation Trust Company ((702) 784-5114)
 - Crawford Trust Company (Dayton – (775) 499-8900)



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Part Three: CA Taxing the Non-Resident Trust – Key Concepts

- *Grantor Trust*. Trust where the grantor is treated as the owner of the assets of the trust.
- *Non-Grantor Trust (NGT)*. The trust creator has relinquished benefits from and control over trust.
- *Fiduciary accounting income (FAI)*. Fiduciary accounting income is income as defined under the governing trust instrument and applicable state law.
- *Taxable Income (TI)*. Taxable income is income to be reported on a tax return as ordinary income or capital gain



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Key Concepts

- *Simple trust*. A simple trust is any trust that is required to distribute all income, that is not required to, and does not in fact, distribute any principal, and that makes no charitable distributions.
- *Complex trust*. A complex trust is any trust that is not a simple trust in the year for which the determination is being made. It is sometimes called an accumulation trust, because trust income may be accumulated within the trust and added to trust corpus.



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Key Concepts

- *Distributable net income (DNI)*. Distributable net income equals the trust's tentative taxable income plus the personal exemption plus tax-exempt income less capital gains, unless such capital gains are allocated to fiduciary accounting income or are distributed to beneficiaries, plus capital losses to the extent of capital gains included in DNI.



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Non-Grantor Trusts as a Taxpayer or Conduit

- A NGT can be treated either or both as a conduit and as a true taxpayer for income tax purposes.
 - If NGT is required to distribute income or, if not required, actually distributes income to beneficiaries in the same tax year the income is earned (or up to 65 days thereafter under IRC §663(b)), the NGT functions mostly as a conduit.
 - The income is taxed to the beneficiaries and the NGT is allowed an “income distribution deduction” for the portion of the gross income that is distributed (or currently distributable) to the beneficiaries. IRC §§651, 661.
 - The income retains the same character in the beneficiaries' hands as it had in the hands of the NGT. IRC §§652(b), 662(b).



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Key Concepts



Or, if it is distributed, it is deducted at the Trust level and taxed here:



- *Distributable net income (DNI)*. Distributable net income equals the trust's tentative taxable income plus the personal exemption plus tax-exempt income less capital gains, unless such capital gains are allocated to fiduciary accounting income or are distributed to beneficiaries, plus capital losses to the extent of capital gains included in DNI.



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NGT as a Taxpayer or Conduit

- If the NGT accumulates income for future distribution (it is a complex trust) or does not distribute a particular form of income (e.g., capital gains income, imputed income, etc.), the NGT itself is liable for the payment of income tax. See IRC §641.



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Trust Income Tax Rates - 2021

Taxable Income	Tax Rate
\$0 to \$2,650	10 percent
\$2,650 to \$9,550	\$265 plus 24 percent of amount over \$2,650
\$9,550 to \$13,050	\$1,921 plus 35 percent of amount over \$9,550
over \$13,050	\$3,146 plus 37 percent of amount over \$13,050



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California Trust Income Tax Rates - 2021

Taxable Income	Tax Rate
\$0 to \$8,932	1.0 percent
\$8,933 to \$21,175	\$89.32 plus 2% of the amount over \$8,932
\$21,176 to \$33,421	\$334.18 plus 4% of the amount over \$21,175
\$33,422 to \$46,394	\$824.02 plus 6% of the amount over \$33,421
\$46,395 to \$58,634	\$1,602.40 plus 8% of the amount over \$46,394
\$58,635 to \$299,508	\$2,581.60 plus 9.3% of the amount over \$58,634
\$299,509 to \$359,407	\$24,982.88 plus 10.3% of the amount over \$299,508
\$359,408 to \$599,012	\$31,152.48 plus 11.3% of the amount over \$359,407
\$599,013 and over	\$58,227.85 plus 12.3% of the amount over \$599,012
\$1,000,000 and over	\$107,549.37 plus 13.3% of the amount over \$1,000,000



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Important Trust Income Tax Concepts Regarding Capital Assets

<i>Type of Capital Asset</i>	<i>Tax Rate</i>
Long-Term Capital Gain	20 percent (federal) + NIIT
Qualified Dividend – on US stock held > 60 days	20 percent (federal) + NIIT
Section 1231 capital asset	OI for first (5-year net) 1231 losses, then LTCG @ 20%
Section 1245 capital asset	OI for recaptured depreciation, then LTCG @ 20%
Section 1250 capital asset	OI for “excess depreciation,” then LTCG @ 25%

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Creating a non-California Taxpayer

A nongrantor trust can be “situated” outside California (e.g., Nevada)

- Most advisers form in a State which does not tax income earned by trusts
- Establish “situs” (use a trustee that is a resident of that State, ideally holding property within that State)
 - Example: an NV trust company holds bank accounts and stock certificates
- Bank accounts and stock certificates are intangible personal property, generally deemed situated where the accountholder/shareholder resides.

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California Taxation of Trusts

A nongrantor trust is subject to California income tax if any one of the following is true:

- One or more fiduciaries are California residents.
- One or more "noncontingent" beneficiaries are California residents.
- The trust has California source income.

[Rev & T C §17742\(a\)](#)

=> Notably, the settlor's residence is irrelevant.



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Non-Resident Trusts

- Accumulation of income in NRT's (e.g., out-of-state 3rd-party trusts with nonresident beneficiaries, "NINGs") can defer California income tax
- "Throwback rules." When the LTCG is distributed out.
 - You don't entirely escape California income tax if the beneficiaries remain in CA. 5 years "income averaging" helps
- No matter what, CA-source income always subject to CA income tax. 17951.
 - What is C corp stock in a California situated corp?



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What about multiple trustees or benes?

- “Proportionate” number rule applies:
- CA taxes the trust income based on the proportion of resident and nonresident fiduciaries
- Same rule for noncontingent beneficiaries (proportion of benes who are CA residents ÷ total benes).
 - R&TC 17743 & 17744



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What about an NRT's CA-taxation when there are contingent beneficiaries?

- If distributions to the California beneficiaries are subject to the trustee's discretion, then they are “contingent beneficiaries” and the trust is not subject to California income tax on non-California source income.
- California beneficiaries are taxable on any distributions made.
 - If, in a later year, the beneficiary moves to a nontax jurisdiction, however, distributions to the beneficiary should no longer be subject to California income tax.
 - Ideally they are gone for the 546 day safe harbor under RTC 17014(d)



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Examples

- “SLANT”
 - Normally a “SLAT” is a grantor trust. 677(a): if the spouse may withdraw discretionary income without the consent of an “adverse party.”
 - If we add an adverse party (a remainder beneficiary, such as a child) who is a nonresident (okay, a brother or sister) whose consent is required for a discretionary distribution, we can make our SLAT a non-grantor trust.
 - Why? Because we can defer or avoid California tax by setting up the SLAT in Nevada as a non-grantor trust – a “SLANT”
 - This requires extremely careful drafting, and risk of the nonresident beneficiary making a claim for a discretionary distribution



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AB 310 – California’s “Wealth Tax”

Under AB 310, the wealth tax would apply to all California residents, part-year residents, and temporary residents who meet the wealth thresholds identified above. For purposes of the tax, temporary residents are individuals who spend more than 60 days in California during the current taxable year and have spent either at least 120 days in the state over the prior two taxable years or at least 150 days in the state over the prior four taxable years. The tax also would apply to certain former residents (i.e., non-residents), specifically individuals who were subject to the tax in one of the preceding four years but who now are nonresidents with no expectation of returning to the state to reside.



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LEGISLATIVE PROPOSAL C – California’s “ING Tax”

EXECUTIVE SUMMARY

Title

Taxation of Income from an Incomplete Gift Non-Grantor (ING) Trust

Problem

ING trusts are generally treated as taxable trusts. A California resident grantor is able to establish an ING trust with a nonresident trustee and transfer assets to that trust. By doing so, the taxable income of the ING trust, generally intangible income, is sourced to the commercial domicile of the nonresident trustee for California income tax purposes. (Revenue and Taxation Code (R&TC) sections 17742, 17743, and 17744.) This allows a California resident to transfer assets to an ING trust, with an out-of-state trustee in a jurisdiction that does not have a state income tax, and not pay California state income taxes.

Proposed Solution

Amend Personal Income Tax Laws (PITL) to require that the net income derived from an ING trust’s assets, be included in the grantor’s gross income and subject to California income tax. This proposal would mitigate a developing tax strategy of shifting income to a state with more favorable tax treatment. New York had a similar issue and resolved the problem by amending their PITL. Our proposal suggests a similar approach. This would eliminate a tax planning strategy while providing consistent and fair treatment of ING net income for similarly situated taxpayers.

