Relocating Assets Out-of-State

How New Yorkers Can Take Advantage of Tax-free Trusts in New Hampshire

By Joseph F. McDonald III

Moving to New Hampshire has long held great appeal for many New York retirees, in part due to the state's year-round recreational activities, but perhaps even more for its favorable creditor protection laws and lack of any broad-based state income, sales, or estate tax. But recent enhancements to New Hampshire's trust and tax laws have enabled individuals living outside of the state to realize some of these same benefits by simply relocating assets into New Hampshire trusts.

The search for the best place to locate one's assets is nothing new among the wealthiest families. Several states—such as Delaware, which has similar trust laws to New Hampshire—have hosted many nonresident trusts for years. New Hampshire's recent changes provide wealthy families from the Northeast with a strong and relatively local alternative to other favored trust jurisdictions, including Delaware and South Dakota.

As trusted advisors to these families, New York CPAs should consider New Hampshire trusts when constructing their clients' wealth preservation strategies. Interest in reliable state income tax shelters has been piqued by recent changes that raised the combined state and municipal tax burden on New York City residents to more than 12%. New Hampshire, unlike New York and most other states, does not tax a non-grantor irrevocable trust's capital gains or taxable income that accumulates for distribution in future years to nonresident beneficiaries. Using New Hampshire's robust directed trust statutes, New York resident settlors can create trusts with a New Hampshire situs by using a New Hampshire–based administrative trustee that carries out the directions of the trust's investment or distribution fiduciaries (typically trust advisors, trust protectors, or committees). This directed trust structure enables advisors to maintain their primary roles and relationships with the families they serve, while simultaneously gaining access to New Hampshire's highly favorable trust laws.

Among other benefits, this can help individuals avoid some New York income taxation. Moreover, the directed trust structure enables New Hampshire–based administrative trustees to charge fees commensurate with the minimal risk that they undertake; this, in turn, leaves room for other advisors to charge their customary fees.

Moving Trusts from New York to New Hampshire

For newly created trusts, accessing New Hampshire's benefits is often as simple as arranging the appointment of a New Hampshire resident trustee in the trust agreement and requiring that New Hampshire law govern the trust's administration. On the other hand, successfully moving an existing New York irrevocable trust to New Hampshire can range from fast, simple, and inexpensive (for a discretionary living trust) to more difficult (for a testamentary trust supervised by a New York surrogate). Where any given trust falls in this spectrum will depend largely upon the trust's terms and other variables. The good news is that recent amendments made to New York's trust decanting statute now make it easier to relocate existing living trusts without obtaining court approval or beneficiary consents.

Advisors who assist in moving trusts must take care to avoid potential income and wealth transfer tax traps that might not be immediately apparent. Cooperation between qualified tax and trust counsel in both states at the outset is important to avoid these traps.

Avoiding New York State Income Tax

It is possible for New York residents who have relocated their assets to New Hampshire trusts to avoid New York State income tax on the trusts' income and capital gains, provided that the trust avoids certain contacts with New York that would invoke the state's taxing jurisdiction. The optimal candidate for a state income tax–motivated structure is a non-grantor trust that annually realizes large amounts of capital gains or historically refrains from distributing a larger percentage of its distributable net income to New York resident beneficiaries. To succeed, the trust must not own real or personal property located in New York, must not generate New York–source income, and must not have any New York resident trustees.

In the past, this simply required that all New York resident trustees resign and be replaced by a New Hampshire resident trustee that performs some minimal level of trust administration outside of New York. In 2004, however, a New York State Department of Taxation and Finance (DTF) Advisory Opinion, TSB-A-04(7), cast a shadow of uncertainty around certain structures and practices that were formerly assumed to place migrating New York resident trusts beyond the DTF's reach. This opinion questioned the domicile of a corporate trustee with New York–resident affiliates and questioned how broadly the concept of "trustee" extends to New York residents who play some role in the trust's administration—not, strictly speaking, as trustee, but rather as agent, advisor, co-fiduciary, or "quasi-" fiduciary. Again, careful planning from the outset can avoid even the broadest implications of this ruling.

To stay outside of New York's taxing jurisdiction, a trust's governance structure should—at minimum—ensure that legal ownership of the trust assets and the execution of any New York resident party's instructions occur exclusively in New Hampshire by the directed trustee. Using a New Hampshire special purpose entity—such as an LLC, rather than an individual who is a New York resident—to serve as the trust advisor or protector might further hedge any residual risk. Cautious structuring to avoid giving the DTF any defensible basis for asserting its continuing taxing authority is particularly imperative in light of New York's ongoing fiscal challenges and the DTF's mandate to conduct additional residency audits of individuals and entities—as well as a July 2010 announcement that any trust purporting to move out of state must continue to file Form IT-205 and attach to it a completed Form IT-205-C, *New York Resident Trust Nontaxable Certification*.

Case Studies

The following sections present two examples of New York residents who might use New Hampshire trusts as state and local income tax shelters.

Shifting proceeds of an impending liquidity event to a New Hampshire asset protection trust. John, a business owner residing in Brooklyn, is considering selling the stock of his closely held company to a strategic buyer. If John does nothing, his sale of the stock would create significant capital gains, with a city and state tax liability of more than 12%. John might be able to avoid a portion of those taxes, however, if he first transfers a portion of his stock into a specially designed trust with a New Hampshire–based directed trustee.

The trust would be drafted to satisfy all of the requirements applicable to trusts eligible to receive a qualified disposition in trust under New Hampshire's self-settled Asset Protection Trust (APT) statute. Special provisions for the appointment of a "distribution committee" of "adverse persons" should result in the trust being treated as a non-grantor trust, even though John is eligible to receive distributions of the trust's net income and principal at the trustee's discretion. John's retention of a power to direct the distribution of the trust assets remaining at his death should prevent his transfer of the stock from being treated as a completed gift for federal gift tax purposes and should cause any assets held in the trust at John's death to be included in his gross estate for federal estate tax purposes. Because the trust is a non-grantor trust with no New York resident trustees, there should be no New York State taxable capital gain when, at a later date, the New Hampshire trustee sells the APT's stock.

There are several caveats for those interested in this strategy, however. The APT's funding should be accomplished as early as possible—in this case, certainly before John has signed a purchase and sale agreement committing him to sell the stock. This should avoid the DTF's imputation of the trust's gain back to John under the assignment of income doctrine. Care also must be taken to draft around some technical issues recently raised in IRS announcements relating to the gift tax consequences of this strategy.

New Hampshire directed trust advised by New Hampshire LLC and managed by New York resident. George is a New York State resident and the beneficiary of his deceased father's irrevocable dynasty trust. The trust has large holdings of marketable securities and has paid significant New York income taxes over the years because it has made little or no annual distribution to George or the other beneficiaries. George's longtime accountant, Bob, is also the current trustee who administers the trust from his Manhattan office. Bob advises George that moving the trust to New Hampshire can avoid continuing New York State income taxation and can also result in other benefits. George is willing to consider it—as long as the move will not require that Bob cede his control over trust distributions and investments to a New Hampshire resident trustee that George does not know or trust.

George learns that achieving those objectives is possible by decanting the trust's assets into a New Hampshire–directed trust. George's New York estate planning attorney prepares the trust, with the assistance of New Hampshire counsel. The new trust's governance structure contemplates a directed trustee arrangement. Bob is named as the fiduciary investment and distribution advisor.

As an excluded fiduciary under New Hampshire law, the New Hampshire directed trustee will not be required to monitor or question Bob's directions as the investment and distribution advisor. As needed, distributions will be declared by Bob and will run through the trust's New Hampshire bank account. The New Hampshire directed trustee charges a modest fee that reflects its diminished liabilities; thus, Bob can charge for his services as investment and distribution advisor without burdening the trust with significant additional fiduciary fees. The New Hampshire trustee files a final tax return in New York, and it pays no New Hampshire interest and dividends tax because the trust has no New Hampshire resident beneficiaries.

An Opportunity for Great Value

Because not all potential trust situs jurisdictions are created equal, trust situs selection is emerging as an important decision for high-net-worth individuals. As an important member of a high-net-worth family's team of advisors, a CPA typically knows the intricacies and complexities of a client's financial picture better than anyone. This makes a CPA uniquely qualified to advise high-net-worth individuals on the substantial benefits they can achieve through careful trust situs selection.

New Hampshire's continuing efforts to enact and fine-tune some of the most favorable tax and trust laws in the nation, combined with its geographic proximity to New York, make it a very strong contender among the competing jurisdictions that New York CPAs might consider recommending to their clients. ❑

Joseph F. McDonald III, a fellow of the American College of Trust & Estate Counsel, is a founder of Concord Trust Company, Concord, N.H.