

NEW YORK STATE BAR ASSOCIATION
REPORT ON
CERTAIN NEW YORK STATE RESIDENT TRUSTS
November 18, 2013

**New York State Bar Association Tax Section
Report on Certain New York State Resident Trusts**

This report (the “Report”)¹ responds to a request by the New York State Tax Reform and Fairness Commission (the “Commission”) for our views as to certain issues relating to the current exemption from income taxation of certain New York State resident trusts under Section 605(b)(3)(D) of New York State’s Tax Laws (“NYS Exempt Resident Trusts”). Specifically, the Commission asked us to (i) consider whether we continue to maintain the views set forth in our prior report (the “2010 Report”)² relating to a proposal made in 2010 relating to NYS Exempt Resident Trusts, (ii) provide recommendations as to how New York State could impose income tax on the accumulated income of NYS Exempt Resident Trusts, and (iii) provide recommendations as to how New York State could tax the income of certain NYS resident trusts that are commonly referred to as DING trusts.

This Report is divided into six parts. Part I is a summary of our principal recommendations. Part II provides background information relating to the Commission’s request for this Report. Part III provides background relating to the taxation of the types of trusts that are the subject of this report and greater background relating to the 2010 proposal. Part IV includes a discussion of the 2010 proposal. Part V provides a

¹ The principal drafter of this report was Joseph Septimus. Significant contributions were made by Mitchell M. Gans, Jeffrey N. Schwarz, Carlyn S. McCaffrey, Amy E. Heller, Stephen B. Land, Arthur R. Rosen, David H. Schnabel, Alan S. Halperin, Paul R. Comeau, Bryan C. Skarlatos and Henry Christensen III. This report reflects solely the views of the Tax Section of the New York State Bar Association and not those of its Executive Committee or House of Delegates.

² See New York State Bar Association Tax Section, *Report Commenting on the 2010-2011 New York State Executive Budget Proposal to Modify Income Taxation of New York Resident Trusts*, Report 1205, February 22, 2010. <http://www.nysba.org/tax/>.

recommendation for how the income of NYS Exempt Resident Trusts could be made subject to New York State income tax, if the Commission determines that it is appropriate to do so. Part VI discusses the taxation of Delaware Incomplete Non-Grantor Trusts (or “DING Trusts”) and includes three recommendations for how the income of such trusts could be taxed if the Commission determines that it is appropriate to do so.

I. Summary of Principal Recommendations

a. 2010 Proposal

Consistent with the 2010 Report, we continue to believe that the 2010 Proposal (defined below) raises serious constitutional issues based on the New York Court of Appeals’ decision in *Mercantile Safe Deposit & Trust Co. v. Murphy*, 203 N.E.2d 490 (N.Y. 1964), as well as certain practical considerations. Our concerns with respect to the constitutional issues are underscored by the decisions of two recent court cases in other jurisdictions that specifically raise constitutional issues arising out of both the Due Process Clause as well as the Commerce Clause, regarding a state’s income taxation of a trust with limited connections to the state.

b. Throwback Rules

Consistent with the 2010 Report, we recommend that, if the Commission determines that it is appropriate to tax the accumulated income of NYS Exempt Resident Trusts, the Commission consider a system of “throwback rules” pursuant to which New

York State residents who are beneficiaries of such trusts would be taxed at the time that they receive a distribution of accumulated income.³

c. Taxation of DING Trusts

We recommend that the Commission consider one of three approaches that would subject the income of DING Trusts to New York State income taxation. The first approach would specifically exclude DING Trusts from the definition of a NYS Exempt Resident Trust, thereby causing DING Trusts themselves to be subject to New York State income tax. The second approach would treat NYS resident DING Trusts as grantor trusts for New York State income tax purposes (even though they would not be treated as grantor trusts under Federal income tax principles), thereby subjecting NYS resident grantors to New York State income tax on all of the trusts' income on a current basis, including undistributed income. The third approach would combine the first two approaches in a manner that resolves certain issues that may be raised by each approach individually. Further, we recommend certain transitional rules for DING Trusts that are in existence on the effective date of any new legislation.

II. Background Relating to the Commission's Request for this Report

As discussed in greater detail below, New York State does not tax the undistributed income of a non-grantor resident trust⁴ if (i) all of the trustees are domiciled

³ We note that adopting this approach in lieu of taxing the NYS Exempt Resident Trust itself ultimately could result in greater revenue for New York State because, depending on the scope of the throwback tax, it could tax trust distributions received by New York State residents received from all trusts (resident and non-resident) to the extent the distributions reflect accumulated trust income that was not subject to state income taxation.

⁴ A New York State resident trust generally is a trust whose grantor was a domiciliary of New York at the time the trust became irrevocable.

outside of New York State, (ii) the trust has no New York State source income, and (iii) the trust has no real property or tangible personal property located in New York State.

In 2010, Governor Patterson's New York State Executive Budget contained a proposal that would have eliminated the exemption from income tax with respect to many, but not all, NYS Exempt Resident Trusts (the "2010 Proposal").⁵ Our 2010 Report was submitted in response and recommended that the 2010 Proposal be deleted from the draft budget because of serious Federal constitutional questions as well as certain practical considerations relating to the proposal.

Although the 2010 Proposal was ultimately removed from the final budget legislation, the New York State Department of Taxation and Finance Office of Tax Policy Analysis issued a statement that NYS Exempt Resident Trusts would be required to file New York State fiduciary income tax returns on a going forward basis, even though the trusts were exempt from New York State income tax liability.⁶ We understand that this reporting requirement was motivated, in part, by a desire to obtain a better understanding of the amount of income realized by NYS Exempt Resident Trusts.

⁵ Under the Proposal, all New York State resident trusts that were created during the grantor's lifetime would be subject to New York State taxation on a proportionate share of their undistributed income with the proportions determined based on the number of "ascertainable beneficiaries" resident in and out of New York. The Proposal contained no definition of "ascertainable beneficiary." Additionally, all trusts that were created under the will of a New York State domiciliary would be subject to New York State taxation on undistributed income even if there were no New York State ascertainable beneficiaries.

⁶ See Filing Requirement for Resident Trusts Not Subject to a Tax, TSB-M-10(5)(I), July 23, 2010. Prior to that announcement, it was the position of the New York State Department of Taxation and Finance that NYS Exempt Resident Trusts were not required to file fiduciary income tax returns. New York State fiduciary income taxes are reported on Form IT-205. The memorandum also requires resident trusts not subject to New York State income tax to file a new Form IT-205-C on an annual basis, on which the trustees confirm that the trust satisfies the applicable safeharbors that exempt the trust from income tax.

We also understand from the Commission that the returns show that a significant amount of income has been reported by these trusts over the past two years.

In response to this information, the Commission asked us to (i) reconsider our recommendations regarding the 2010 Proposal and (ii) provide additional suggestions as to how New York State could tax the income of NYS Exempt Resident Trusts, in the event we maintain our view with respect to the 2010 Proposal. We understand that the Commission has two concerns with respect to accumulated income of NYS Exempt Resident Trusts not being subject to New York State income taxation.

The first is a specific concern relating to a certain kind of NYS Exempt Resident Trust that appears to be established for the primary purpose of avoiding New York State income tax on an individual's investment income. These trusts are often referred to as Delaware⁷ Incomplete Non-Grantor Trusts and appear to allow for the gift tax-free transfer of unlimited amounts of property to trusts that are treated as taxpayers separate from the grantor for Federal income tax purposes (and classified as a NYS Exempt Resident Trusts for New York income tax purposes).⁸

The second concern, which is more general, relates to situations in which many NYS Exempt Resident Trusts retain significant ties to New York State, yet are not subject to New York State taxation on undistributed trust income. For example, the

⁷ The jurisdiction in which these trusts may be organized is not limited to Delaware, but they are referred to as Delaware trusts because these trusts appear to have first been utilized in Delaware. In fact, the incomplete non-grantor trusts that have been the subject of the most recent IRS Private Letter Rulings appear to have been formed in Nevada, based upon the PLRs' description of local trust law.

⁸ As discussed in greater detail below, transfers to these trusts are treated as "incomplete" for Federal gift tax purposes. Accordingly, New York State resident grantors may fund these trusts without being subject to Federal gift tax.

undistributed income of a non-grantor trust that has a New York State grantor and New York State beneficiaries would not be subject to New York State income tax if the trust fulfills the requirements set forth in Tax Law Section 605(b)(3)(D).

III. New York State's Taxation of Resident Trusts and the 2010 Proposal

a. Income Taxation of Trusts

Unlike a corporation or limited liability company, a trust is not a separate legal entity under state law. Instead, a trust has been defined as “a fiduciary relationship with respect to property, arising from a manifestation of intention to create that relationship and subjecting [the trustee of] the property to duties to deal with it for the benefit of [beneficiaries].”⁹ Thus, a trust typically involves a legal relationship between three parties: the grantor (who may be deceased), the trustee and at least one beneficiary.

From an income tax perspective, income that is earned by a trust may be included in the income of the grantor (if living), the beneficiaries, or the trust itself, depending on the nature of the trust and distributions that are made by the trust. When the grantor of the trust retains or other persons are given certain interests in or powers over the trust such that the trust is classified as a “grantor trust” for income tax purposes, the grantor is required to include all of the trust’s income on his or her own income tax return.¹⁰ The income of a trust that is not classified as a grantor trust is included in the income of the

⁹ Restatement (Third) of Trusts § 2 (2003).

¹⁰ See §§ 671-678 of the Internal Revenue Code of 1986, as amended (the “Code”).

beneficiary, if trust income is distributed (or deemed distributed) to the beneficiary,¹¹ and is deductible by the trust. If trust income is not distributed (or deemed distributed) to a beneficiary, the income is taxable to the trust. Trust income that is not distributed to a beneficiary is often referred to as “undistributed income” or “accumulated income.”

Accordingly, New York State imposes an income tax directly on a trust only if the trust (i) is a non-grantor trust and (ii) has accumulated or undistributed income.

However, the New York State taxation of the accumulated income of such a trust depends in part on whether the trust is considered a “resident trust” and, if it is, whether it is considered a NYS Exempt Resident Trust.

Specifically, if a trust is considered a “resident trust” and it is not otherwise a NYS Exempt Resident Trust, New York State imposes an income tax upon all of the trust’s undistributed New York taxable income.¹² If a trust is a resident trust, but is a NYS Exempt Resident Trust, New York State does not impose any income tax upon the the undistributed New York taxable income of the trust. Finally, if a trust is not a New York resident trust, then New York State imposes an income tax only upon the New York source income of the trust.¹³

The definition of a “resident trust” for New York State income tax purposes focuses exclusively on the domicile of the grantor at the time that the trust became

¹¹ See §§ 641-661 of the Code.

¹² New York Tax Law § 601(c).

¹³ New York Tax Law § 601(e).

irrevocable.¹⁴ Thus, the definition of a resident trust does not take into account the locations of the trustee, trust administration, or beneficiaries of the trust.¹⁵ NYS Exempt Resident Trusts are not subject to New York State income tax, although they are characterized as resident trusts because of the domicile of their grantors when they became irrevocable. A resident trust is a NYS Exempt Resident Trust if (i) no trustee is domiciled in New York State, (ii) the entire trust corpus, to the extent it consists of real property and tangible personal property, is located outside of New York State, and (iii) all of the income of the trust is derived from sources outside of New York State.¹⁶

The exemption for NYS Exempt Resident Trusts was developed in response to the decision of the New York State Court of Appeals in *Mercantile* and the constitutional concerns it raised with imposing an income tax on a New York resident trust solely because the grantor was a resident of New York State. Without the exemption for NYS Exempt Resident Trusts, New York would purport to subject a resident to New York State income tax on all of its income, even though the trust has (i) no trustees, assets, or beneficiaries located in New York, and (ii) no New York source income. This raises constitutional issues.

¹⁴ Specifically, under New York Tax Law § 605(b)(3), a resident trust includes: (i) a trust or a portion of a trust consisting of property transferred by the will of a decedent who at his or her death was domiciled in New York State; (ii) a trust or portion of a trust consisting of the property of (a) a person domiciled in New York State at the time such property was transferred to the trust, if such trust or portion of a trust was then irrevocable, or if it was then revocable and has not subsequently become irrevocable or (b) a person domiciled in New York State at the time that the trust or portion of the trust became irrevocable, if it was revocable when such property was transferred to the trust but has subsequently become irrevocable.

¹⁵ New York is referred to as a “founder trust state,” due to its treatment of a trust as a resident trust based on the domicile of the grantor.

¹⁶ New York Tax Law §605(b)(3)(D).

Under the Due Process Clause, a state may impose a tax only if it has sufficient contact with either the person or property upon which the state seeks to impose a tax. In *Mercantile*, a New York domiciliary created an *inter vivos* trust which was fully revocable by the grantor. Income was payable to the grantor during his lifetime. The trust became irrevocable at the grantor's death. The trustee of the trust was domiciled in Maryland and the trust property was located in Maryland. After the grantor's death, the trustee accumulated the trust's income and did not pay New York State income tax. New York State asserted that the trust was a resident trust and it therefore had the right to impose tax on all of the trust's income. The New York Court of Appeals held that New York cannot tax the undistributed income of the trust because New York "lacked the power to levy taxes beyond its border." By imposing an income tax on the trust, New York would "extend [its] taxing power beyond the jurisdiction of the State of New York in violation of due process." The court arrived at this conclusion even though the only current beneficiary of the trust was the grantor's spouse, who was a New York State resident.

b. The 2010 Proposal

In 2010, as a result of perceived changes in jurisprudence under the Due Process Clause, the New York State Executive Budget contained a proposal that would have eliminated the exemption with respect to many NYS Exempt Resident Trusts, and consequently the undistributed income of these trusts would become subject to New York State income tax, in a manner inconsistent with the New York Court of Appeals decision

in *Mercantile*.¹⁷ The legislative memorandum justified the departure from *Mercantile* as follows:

The three part test under Tax Law § 605(b)(3)(d)(i) was enacted in 2003 in order to codify the rule originally set forth by the New York courts in *Mercantile*...and then set forth in the personal income tax regulations. However, recent state and Federal appellate decisions have upheld the constitutionality of taxing a percentage of trust income in cases where the trust grantor is a state resident according to the percentage of trust beneficiaries who are state residents.¹⁸

The principal cases to which the memorandum was likely referring are *Chase Manhattan Bank v. Gavin*, 733 A.2d 782 (Conn. 1999) and *District of Columbia v. Chase Manhattan Bank*, 689 A.2d 539 (D.C. 1997). These cases were premised on the notion that the standards under which a state may impose tax under the Due Process Clause were relaxed by the Supreme Court's decision in *Quill Corp. v. North Dakota*.¹⁹ In the 2010 Report, we noted that (i) it was unclear whether the New York Court of Appeals would be willing to depart from *Mercantile* and adopt the views of these two courts and (ii) in any case, specific aspects of the 2010 Proposal were materially distinguishable from the facts of *Gavin* and *District of Columbia*.²⁰ The final budget did not include the 2010 Proposal.

¹⁷ A full description and analysis of the 2010 Proposal is set forth in the 2010 Report.

¹⁸ See 2010-11 New York State Executive Budget Revenue Article VII Legislation Memorandum in Support at 14.

¹⁹ *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

²⁰ Specifically, in *Gavin*, the sole beneficiary of the *inter vivos* trust at issue was a domiciliary of Connecticut (the state that sought to impose the tax), all of the trust's undistributed income was going to be distributed to the sole beneficiary upon reaching the age of forty-eight, and the beneficiary had a testamentary power of appointment over the trust's assets. The 2010 Proposal, on the other hand, would have taxed a resident trust that merely had a contingent New York State resident beneficiary. The *District of Columbia* case involved a testamentary trust, which could be viewed as having significantly closer nexus to the state in which the decedent's last will and testament was admitted to probate than the state in which a grantor was domiciled when creating an *inter vivos* trust, as the trust established under the will would be subject to ongoing supervision of the probate court, including the involvement of that court in issuing certificates evidencing the appointment and continuation in office of the trustee(s).

c. Subsequent Cases

More recently, there have been two additional state court cases (one in New Jersey and one in Pennsylvania) that are consistent with *Mercantile*. In *Residuary Trust v. Director Division of Taxation*,²¹ a decedent's will had established a trust that, for the year 2006, had a trustee who was not a resident of New Jersey. The trust did not make any distributions of income during 2006. On its New Jersey fiduciary income tax return for that year, the trust did not include non-New Jersey source income. On audit, the New Jersey Division of Taxation asserted that the trust was subject to New Jersey tax on all of its income, including non-New Jersey source income. On appeal, the Trust argued that two New Jersey precedents (*Potter*²² and *Pennoyer*²³) precluded New Jersey from taxing the non-New Jersey source income under the Fourteenth Amendment. The analysis in *Potter* and *Pennoyer* is substantially similar to the New York State Court of Appeals' analysis in *Mercantile*. The New Jersey Division of Taxation, however, urged the New Jersey Tax Court to depart from *Potter* and *Pennoyer*, in light of the *Gavin* and *District of Columbia* decisions, and in light of the general evolution of the Fourteenth Amendment jurisprudence.

The New Jersey Tax Court refused to depart from its prior decisions. It held that

²¹ *Residuary Trust A v. Dir., Div. of Taxation*, 27 N.J. Tax 68 (2013).

²² *Potter v. Taxation Div. Dir.*, 5 N.J. Tax 399 (Tax 1983) (holding that New Jersey could not impose an income tax on an *inter vivos* trust funded by New Jersey domiciliaries when the only continuing contact was that contingent beneficiaries resided in New Jersey).

²³ *Pennoyer v. Taxation Div. Dir.*, 5 N.J. Tax 386 (1983) (holding that New Jersey could not impose an income tax on a testamentary trust created by a New Jersey domiciliary that was administered outside of New Jersey and when the trustee, trust assets, and beneficiaries were located outside of New Jersey, notwithstanding that letters appointing the trustee were issued by a New Jersey court, the trustee was amenable to service of process in New Jersey, and the New Jersey courts were available to resolve disputes relating to the trust).

The Pennoyer decision does not leave room for a contrary interpretation of due process as it applies to this case. Despite the Director's insistence that the law has evolved following Pennoyer, the District of Columbia and Gavin cases have no precedent value in New Jersey and directly conflict with New Jersey Court's rulings in Pennoyer and Potter. Moreover, the Director has not set forth compelling reasons why this court should disregard New Jersey's own case law in favor of contrary out of state authority. To do so would be a drastic step this court finds inappropriate under the circumstances.

The second recent case that considered this issue is *McNeil v. Commonwealth of Pennsylvania*.²⁴ In *McNeil*, a Pennsylvania resident settled a Delaware trust. All of the trust's discretionary beneficiaries were located in Pennsylvania, but the trustees were (i) located outside of Pennsylvania and (ii) did not conduct any trust affairs inside Pennsylvania. The trust had no Pennsylvania source income and no trust assets were located in Pennsylvania for the year at issue. Finally, the trust made no distributions in the year at issue. The Pennsylvania Department of Revenue asserted that the trust was subject to Pennsylvania income tax, as it was a resident trust under Pennsylvania law. The trust argued that imposing Pennsylvania income tax would violate the Commerce Clause and Due Process Clauses of the United States Constitution. The court held that Pennsylvania's attempt to tax the trust violated the Commerce Clause.²⁵ The court stated that it was not addressing the trust's argument under the Due Process Clause, as it was able to decide the case under the Commerce Clause.

²⁴ *McNeil v. Com.*, 67 A.3d 185 (Pa. Commw. Ct. 2013).

²⁵ *McNeil* cited *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977) for the proposition that for a state tax to withstand Commerce Clause scrutiny, the following four conditions must be satisfied: (i) the taxpayer must have a substantial nexus to the taxing jurisdiction, (ii) the tax must be fairly apportioned, (iii) the tax being imposed upon the taxpayer must be fairly related to the benefits being conferred by the taxing jurisdiction, and (iv) the tax may not discriminate against interstate commerce. *McNeil* applied three of these factors to the trust at issue, as follows: (i) the presence of discretionary beneficiaries and the trust's grantor do not, on their own, constitute a substantial nexus between the trust and Pennsylvania; (ii) the imposition of tax by Pennsylvania on all of the trust's income was "plainly out of proportion to the Trust's business activities in Pennsylvania" (internal quotations omitted); and (iii) the trust did not derive any benefit from Pennsylvania and therefore taxing the trust's entire income was not reasonably related to the benefits provided by Pennsylvania to the trust.

IV. Consideration of the 2010 Proposal

For the reasons discussed in the 2010 Report, we continue to believe that the 2010 Proposal raises serious Federal constitutional questions under the Due Process Clause of the United States Constitution. These concerns were precisely the basis of the holding in *Residuary Trust*. Moreover, *McNeil* casts further doubt on the constitutionality of the 2010 Proposal under the Commerce Clause of the United States Constitution, although this argument has not yet been considered by the New York Court of Appeals.

Accordingly, we recommend that the Commission not propose legislation similar to the 2010 Proposal.

V. Taxation of Undistributed Income of NYS Exempt Resident Trusts

a. NYS Exempt Resident Trusts

In determining whether the undistributed income of NYS Exempt Resident Trusts should be subject to New York State income taxation, through throwback rules or otherwise, we note that, other than state tax planning specifically related to DING Trusts, state income taxation is generally only one of many reasons why a grantor who is a New York domiciliary would establish a trust outside of New York State. Practitioners may recommend to their clients trusts governed by the laws of other states with out-of-state trustees for many non-income tax reasons such as (i) the ability to potentially create a self-settled asset protection trust, (ii) the ability to create so-called “dynasty trusts” by choosing to establish the trust in a state that has abolished the rule against perpetuities, (iii) relaxed trustee accounting rules, (iv) the ability to utilize a trust protector that is not bound by fiduciary duties, (v) the ability to create a so-called “quiet trust”

that limits the information about the trust that is required to be provided to the beneficiaries, (vi) the ability to create a directed trust, which requires trustees to retain certain assets (such as a family business), and (vii) the ability to bifurcate trustee responsibilities, so that different persons can have responsibility for trust investments, trust distributions, and trust administration. Moreover, in practice, the overwhelming majority of *inter vivos* trusts are created as grantor trusts for estate planning purposes.²⁶ Consequently, the typical estate planning trust offers no state income tax benefit until the death of the grantor.²⁷

Nevertheless, if the Commission determines that all or a portion of the undistributed income of a NYS Exempt Resident Trust should be subject to New York State income tax, we continue to recommend consideration of a system of throwback rules as a constitutionally permissible mechanism to achieve this result with respect to accumulated income that is distributed to trust beneficiaries who are resident in New York State. Such a system of taxation also could be applied to non-resident trusts, if the Commission determines that it would be appropriate.

b. Throwback Rules

Very generally, throwback rules would tax the trust's accumulated income at the point in time that the income is distributed to a trust beneficiary who is a New York State resident. The income tax would be imposed on the beneficiary as opposed to the trust

²⁶ There are several significant benefits for an estate planning trust to be characterized as a grantor trust. Among the benefits are that grantor trust status allows the grantor to (i) pay tax on the trust's income, which is the equivalent of a tax free gift to the trust and (ii) engage in transactions with the trust on an income tax free basis, such as selling assets with potential for future appreciation to the trust.

²⁷ That said, at the death of the grantor, the trust will no longer be a grantor trust and state income tax could be avoided at that point in time. Moreover, testamentary trusts are never characterized as grantor trusts, and thus state income tax could be avoided from inception. Nevertheless, as noted, there are numerous non-tax reasons why a settlor or testator would decide to domicile a trust outside of New York State.

itself, which should avoid concerns under the Due Process Clause and the Commerce Clause, as the trust beneficiary is a resident of New York State.²⁸

Throwback rules have been used by California to tax the accumulated income of trusts that would otherwise be subject to California tax and have withstood constitutional challenge in state courts.²⁹ Throwback rules were also enacted as part of the Internal Revenue Code of 1954, to address concerns of taxpayers shifting income to non-grantor trusts that were in a lower tax bracket than the settlor of the trust. The Federal throwback rules were ultimately repealed with respect to domestic trusts in 1997,³⁰ when income shifting concerns were significantly mitigated by the compression of the tax rate schedules for trusts,³¹ but they are still applicable to accumulation distributions that are made from foreign non-grantor trusts to United States beneficiaries.³²

²⁸ The 2010 Report provides more detailed background to the throwback rules.

²⁹ See *McCulloch v. Franchise Tax Board*, 61 Cal.2d 186 (1964) (see, Joseph W. Balckburn, Grantor Trusts, Trust Throwback Rules, and Their Application—or Not—by the States, JOURNAL OF MULTISTATE TAXATION AND INCENTIVES (Aug. 2006) (noting that *McCulloch* was the first case applying and upholding the California throwback tax).

³⁰ See Section 665(c) of the Code, which excludes most domestic trusts from the Federal throwback rules.

³¹ In 2013, trusts are subject to the marginal 39.6% income tax rate on all income in excess of \$11,950. See Section 1(e) of the Code and Rev. Proc. 2013-15.

³² The Federal throwback rules applicable to domestic trusts that have been repealed could be used for implementing New York State throwback rules, under New York's current income tax forms. The instructions to Form IT-201 provide a mechanism for a New York State resident to include accumulated distributions from foreign trusts as follows:

If you filed federal Form 4970, Tax on Accumulation Distribution of Trusts, the income you reported on line 1 of Form 4970 is not included on line 11 of Form IT-201 because the IRC considers the distribution part of federal gross income. You must therefore include on line 23 the amount of income you reported on Form 4970, line 1, less any interest income on state and local bonds and obligations of New York State and its local governments (that was included on Form 4970, line 5). Be sure to identify the source of this income as Form 4970 income in the Identify area.

IRS Form 4970 generally applies only to foreign trusts and to trusts that at one time were foreign trusts. As a starting point, a New York State tax on accumulated distributions could be implemented by

We suggest that the Commission should take into account the following issues when it considers recommending throwback rules:

Tax Credit. California allows a resident beneficiary who is subject to tax upon the distribution of income from a trust to take a tax credit for income taxes paid by the trust to another state.³³ California's allowance for this tax credit appears to have been based upon constitutional concerns that a state throwback tax on income previously taxed by another state could constitute a form of double taxation that unduly burdens interstate commerce.³⁴ The Commission should therefore consider the allowance of a tax credit for taxes paid by a trust to other states, when considering throwback rules.

Interest Charge. Under the Federal throwback rules applicable to foreign trusts, an interest charge is imposed with respect to the deferred income.³⁵ We note that California does not impose an interest charge with respect to its throwback rules, and neither did the Federal throwback rules relating to domestic trusts.³⁶ We also note that an interest charge would create administrative complexity, as it would require the

amending Tax Law Section 612 so that New York adjusted gross income includes an amount that an individual would have included on line 5 for Federal Form 4970, if the Federal tax on accumulated distributions had not been repealed. Adjustments would have to be made to take into account determinations that the Commission makes with respect to exit tax, interest charge, whether the throwback tax should apply to non-resident trusts, and whether it should apply to income accumulated prior to a beneficiary becoming a resident of New York State.

³³ See Cal. Rev. & Tax. Code § 18005.

³⁴ Blackburn, *supra* note 29 at 33 (analyzing certain aspect of California's throwback tax and noting that "[t]he Commerce Clause prohibition against multiple taxation was satisfied by allowing the beneficiary a credit for taxes paid by the trustee to its state of residence").

³⁵ Section 668 of the Code.

³⁶ It would seem, however, that there was less of need for an interest charge under the Federal throwback rules for domestic trusts, as Federal income tax would have been paid by the trust itself at the time the income was earned, but at a lower rate.

beneficiary to determine the exact period in which the trust earned the income. Without an interest charge, however, trust beneficiaries could benefit from deferral of income.

Exit Tax. The Commission should consider whether it would be appropriate to subject a New York State resident beneficiary of a trust to an “exit tax” at the point in time that the beneficiary is no longer a New York State resident. In other words, should a beneficiary be treated as if he or she received a distribution equal to an allocable share of the trust’s accumulated income upon giving up New York State residency, even though there was no distribution of income. Without an exit tax, the throwback rules could be avoided by delaying a distribution to a beneficiary until a point in time that the beneficiary is no longer a New York State resident. On the other hand, an exit tax could raise a variety of issues, including how to determine a discretionary beneficiary’s share of the trust’s accumulated income.³⁷ As an alternative, California’s less aggressive method of dealing with this issue could be considered. Under California’s throwback rule, if a beneficiary who is subject to the throwback rule leaves the state within twelve months prior to a distribution and returns to the state within twelve months after the distribution, it is presumed that the beneficiary remained a California resident at the time of the distribution.³⁸

Distributions Received from Non-resident Trusts. The Commission may also consider whether a throwback tax should apply to distributions received by New York

³⁷ We also note that in certain contexts taxpayers have raised constitutional concerns relating to taxes imposed as a result of exiting a state. *See, e.g., Kuhnen v. Musolf*, 420 N.W.2d 401 (Wis. 1988), which held that a Wisconsin statute that denied deferral of gain on the sale of a residence when the replacement residence was located out of state was equivalent to a “migration or exit tax,” which in that context violated the Privileges and Immunity Clause of the Constitution.

³⁸ *See* Cal. Rev. & Tax. Code § 17745(e).

State resident beneficiaries from non-resident trusts. If the Commission decides to suggest a throwback tax with respect to distributions from all trusts, resident and non-resident, it has the potential to raise more revenue than the 2010 Proposal, as it would apply to non-resident trusts as well, although only when distributions are actually made.

Beneficiaries who Become New York Residents. The Commission would need to consider whether the throwback rule should apply to trust income that was accumulated while the beneficiary was not a resident of New York State, but the distribution of such accumulated income was made after the beneficiary became a New York State resident. If the Commission determines that the throwback rule should apply in this situation, it would also need to consider whether the distribution should be taxed at the current year's tax rate and whether an interest charge should not apply (if the Commission determines that an interest charge is otherwise appropriate).

If the Commission determines that throwback rules with respect to New York resident exempt trusts are appropriate, we would be happy to submit a more detailed report as to how such rules may work.

VI. New York Taxation of Delaware Incomplete Non-Grantor Trusts

a. Incomplete Non-Grantor Trusts, in General

The Commission asked us to suggest alternatives that would subject DING Trusts created by New York State grantors to New York State income taxation, in the event that the Report does not endorse legislation similar to the 2010 Proposal. We agree with the Commission's view that DING Trusts created by New York State grantors should be

subject to New York State income tax, given that DING Trusts appear to be primarily established to avoid state income taxation.³⁹

A DING Trust created by a New York State domiciliary must have several features for its accumulated income not to be subject to state income taxation. First, the trust must be a NYS Exempt Resident Trust. Second, its trustee must not be domiciled or resident in a state that imposes income tax on a trust based on the resident or domiciliary status of its trustee. Third, the trust must not be administered in a state that imposes income tax on a trust based on the location of the trust's administration. Fourth, the trust cannot be classified as a grantor trust for income tax purposes, because the deemed owner would be required to include the trust's income on his or her own income tax return for each year; thus DING Trusts are structured specifically to avoid grantor trust status under Sections 671 through 678 of the Code. Grantor trust status is somewhat difficult to avoid when the grantor is either a discretionary beneficiary of the trust or otherwise has certain powers with respect to distribution of trust property, both of which are important features of the DING Trust. Nevertheless, based on several Internal Revenue Service ("IRS") private letter rulings ("PLRs"),⁴⁰ grantor trust status can be avoided by imposing

³⁹ See, e.g., Pulsifer & Flubacher, Eliminate a Trust's Income Tax, 145 Tr. & Est. 30 (May 2006) (suggesting the use of DING Trusts to avoid state income taxation). Some will argue that a non-tax purpose of the DING Trust is that it permits the grantor to transfer funds to an asset protection trust of which he or she is a beneficiary, which would otherwise not be possible if the trust was created under New York State law. While that is an undeniable benefit of a DING Trust, the same asset protection planning could be achieved by removing the "NG" (non-grantor) from the DING. Meaning, a New York resident can still settle a Delaware incomplete gift trust and reap the same asset protection benefits without including the features that made it a non-grantor trust. As noted below, the state income tax benefits are achieved only if the trust is a non-grantor trust for tax purposes.

⁴⁰ Although there are no published IRS rulings on point, several PLRs have held that the DING Trusts that were the subject of the rulings were non-grantor trusts.

carefully tailored limitations on the grantor's ability to (i) receive distributions and (ii) make decisions with respect to distributions.⁴¹

The DING Trust is also designed so that the grantor's transfer of property to the trust is an incomplete gift. Because the grantor's gift to the trust is incomplete, the grantor may fund the trust without using lifetime exemption (which is currently \$5,250,000, reduced by prior taxable gifts) or otherwise incurring Federal gift tax liability. Generally, a transfer to a trust is a taxable transfer for gift tax purposes,⁴² unless the transfer to the trust is "incomplete." A gift to a trust is incomplete if the grantor retains "dominion and control" over the trust property.⁴³ The provisions of the DING Trust are carefully drafted so that that the grantor retains "dominion and control" over the trust assets for gift tax purposes. At the same time, many of the retained powers that would cause transfers to a trust to be incomplete for gift tax purposes also, generally, would cause the trust to be a grantor trust for income tax purposes.⁴⁴ Yet, as noted above, the DING Trust would not achieve the desired state income tax avoidance if it were characterized as a grantor trust. Accordingly, the incomplete gift and non-grantor

⁴¹ These limitations limit the grantor's access to the trust assets in certain ways on a going forward basis. For example, once the assets are contributed to the DING Trust, trust distributions cannot be made to the grantor, without the consent of others.

⁴² See Treas. Reg. § 25.2511-1(a) ("the gift tax applies to a transfer by way of gift whether the transfer is in trust or otherwise").

⁴³ See Treas. Reg. § 25.22511-2(b) ("if upon a transfer of property (whether in trust or otherwise) the donor reserves any power of its disposition, the gift may be wholly incomplete, or may be partially incomplete and partially complete, depending on all the facts in the particular case.").

⁴⁴ For example, the grantor of a DING Trust is typically given the power to consent to trust distributions, and this power is relied upon to cause the gift to the trust to be incomplete under Treas. Reg. § 25.2511-2(e). At the same time, this power could generally cause the trust to be treated as a grantor trust under Section 674 of the Code, which provides that a trust is a grantor trust if the grantor has the power to control beneficial enjoyment of trust property. Grantor trust status is avoided by requiring the consent of an "adverse party" prior to making a distribution from the trust.

trust provisions of the DING Trust need to be carefully crafted to navigate between incomplete gift and non-grantor trust status.⁴⁵ While it may seem somewhat inconsistent for a grantor who retained sufficient control over property to be treated as not having made a completed gift of that property and, at the same time, to be treated as having retained insufficient control over the transferred property to be treated as the owner of that property for income tax purposes, that is the result purportedly accomplished by the DING Trust.

Until 2007, the IRS issued a series of private letter rulings which held that DING Trusts were not grantor trusts for income tax purposes and that transfers to DING Trusts were not completed gifts for gift tax purposes.⁴⁶ Given the intricate nature of these trusts, it is understandable why a taxpayer would incur the expense to obtain a PLR, particularly with respect to the status of transfers to the trust as incomplete gifts, as the gift tax liability that could result if the transfer is treated as a completed gift could be crippling. On July 9, 2007, the IRS announced that it was reconsidering a critical aspect of DING

⁴⁵ An example of a carefully drafted DING Trust provision that is drafted to allow a transfer to the trust to be treated as an incomplete gift, but still avoids grantor trust status is the grantor's retention of the ability to distribute trust principal to trust beneficiaries for their health, education, maintenance and support ("HEMS") in a non-fiduciary capacity. Under Treas. Reg. § 25.2511-2(c), a gift is incomplete if "a reserved power gives the donor the power to . . . change the interest of the beneficiaries as between themselves unless the power is a fiduciary power limited by a fixed or ascertainable power." The retained power by the grantor over trust principal is intended to cause transfers to the trust to be incomplete even though it is limited by a fixed or ascertainable power (*i.e.*, HEMS), because the trust agreement provides that the power is held in a non-fiduciary capacity. The provision is intended not to cause the trust to be treated as a grantor trust, however, because under Section 674(b)(5), a trust is not a grantor trust if the grantor retains the power to distribute trust corpus to a beneficiary if the power to distribute is limited by a reasonable ascertainable standard in the trust instrument (such as HEMS), but the Section 674(b)(5) exception does not require the grantor to retain this power in a fiduciary capacity. Thus, the provision that allows the grantor to make distributions of trust principal for HEMS is intended to cause transfers to the trust to be incomplete gifts, yet it is also intended to avoid grantor trust status.

⁴⁶ *See, e.g.*, Internal Revenue Service PLRs 200148028 (Nov. 30, 2001), 200247013 (Nov. 22, 2001), 200502014 (Jan. 14, 2005), 200612002 (Mar. 24, 2006), 200637025 (Sep. 15, 2006), 200647001 (Nov. 24, 2006) and 200715005 (Apr. 13, 2007).

Trust PLRs.⁴⁷ More recently, an IRS Chief Counsel Advisory⁴⁸ indirectly called into question the DING Trust PLRs' analysis that the initial gifts to the trusts were incomplete because of a limited power of appointment over the trust assets retained by the grantor.⁴⁹ Despite these adverse indications from the IRS, it seems that people were using DING Trusts planning without the protection of a private letter ruling.⁵⁰

In 2013, the IRS resumed issuing favorable DING Trust PLRs.⁵¹ As a result, domiciliaries of New York State (and other states with significant income taxes that do not tax trusts with characteristics of a DING Trust) can once again avoid tax on investment income by creating a DING Trust, with the protection of an IRS private letter ruling as to the gift tax and non-grantor trust status of the trust.

⁴⁷ See Chief Counsel Seeking Comment on Gift Tax Consequences of Trusts Employing Distribution Committee, IR-2007-127 (July 9, 2007). The request for comment called into question whether members of the DING Trusts distribution committee should be treated as possessing a general power of appointment over the assets of the trust, which would result in adverse estate and gift tax consequences to the members of that committee. The New York State Bar Association Tax Section responded to this request for comments in Report No. 1134, on October 11, 2007 (the "2007 Report"). The report concluded that, contrary to the PLRs, the distribution committee members did possess general powers of appointment. See New York State Bar Association Tax Section, *Report Responding to IR-2007-127, Request for Comments Regarding General Powers of Appointment Under IRC Section 2514*, Report 1134, October 11, 2007. <http://www.nysba.org/tax/>. The more recently issued Private Letter Rulings cited to in footnote 51 held that the committee members are not treated as having a general power of appointment and the rulings do not indicate how the IRS resolved the issue it raised in IR-2007-127.

⁴⁸ See IRS CCA 201208026 (September 28, 2012). Although the subject of the CCA is not a DING Trust, it holds that the retention of a testamentary limited power of appointment over trust assets caused the gift of the remainder interest in the trust to be incomplete, but the transfer of the present interest was a complete for gift tax purposes. With respect to the DING Trust, one of the features relied upon by the PLRs in holding that the transfers were incomplete gifts, was the retention of a limited power of appointment by the grantor. Thus, the CCA called the analysis of the DING Trust PLRs into question.

⁴⁹ The 2007 Report raised this issue to the IRS. See the 2007 Report at pg. 19-22.

⁵⁰ For example, former Section 2511(c) of the Code would have foreclosed DING Trusts from being formed for the year 2010, by treating gifts to non-grantor trusts as completed gifts for gift tax purposes. The Wilmington Trust Company wrote a letter to the IRS asking them to issue regulations that exclude DING Trusts from this legislation. The clear implication of this letter is that DING Trusts were still being formed in 2010, despite the fact that the IRS was not issuing private letter rulings.

⁵¹ See IRS PLR 201310002 and IRS PLR 201310006, both issued on March 8, 2013.

The state tax avoidance that can be accomplished through a DING Trust was analyzed by two practitioners in the example set forth below, highlighting that a New York State grantor is a primary candidate for such planning:

A simple example illustrates the power of a Delaware non-grantor/incomplete gift trust. Let's say a couple residing in New York City has a sizeable portfolio of marketable securities and other intangible assets. These two are concerned about liability to potential future creditors. They are in the highest federal income tax bracket and pay combined state and city income tax at an 11 percent rate. They don't want to make a completed gift because they don't want to pay gift tax or use any of their gift tax exclusion amount. Within their portfolio of securities, they have \$2 million of assets that they essentially hold for the benefit of their children because they don't foresee any circumstance (other than a catastrophic lawsuit or similar financial setback) in which they would expend that money during their lifetimes given the magnitude of their other assets.

A Delaware non-grantor/incomplete gift trust could be a powerful planning tool for this couple. As settlors of such a trust, they could retain the right to receive discretionary distributions of income and principal from the trust (subject to the consent or direction of a distribution committee comprised of their children who are also potential discretionary beneficiaries). This would provide the couple with a safety net against the possibility of a major financial setback. The trust also will provide creditor protection for the trust assets. At the same time, the trust's income will not be subject to New York state or city income taxation. The federal income tax imposed on the trust's assets would be about the same in the trust as it would be if the couple owned the assets outright.

Had the couple retained this \$2 million in their own names and achieved an enviable 10 percent annual rate of return before taxes, the \$2 million would grow to about \$8.6 million in 20 years, assuming the earnings are comprised entirely of qualified dividends and realized capital gains. The effective rate of tax on these investment assets would be 24.35 percent (15 percent federal rate on capital gains and dividends; 11 percent New York state and city tax on all income; New York taxes deducted in computing federal taxes). By contrast, contributing the \$2 million to a Delaware non-grantor/incomplete gift trust means the effective rate of tax is reduced to 15 percent, and the trust grows to about \$10.225 million in the same time with the same rate of return. Thus, merely by creating the trust, the couple would obtain asset protection for the trust property during the entire 20-

year trust period and, at the end, the value of the property would be \$1.6 million greater.⁵²

In the foregoing example, only future income that is at best speculative is transferred to the DING Trust. Taxpayers may attempt more aggressive DING Trust planning by transferring appreciated assets (*e.g.*, securities or interests in a trade or business) to a DING Trust. For example, suppose a New York resident owns all the outstanding shares of a C corporation, which owns a New York based trade or business that has a fair market value of \$20 million, but the taxpayer has very low basis in the stock of the C corporation. If the taxpayer is considering selling the business, the taxpayer could transfer the C corporation stock to a DING Trust, and allow the DING Trust to sell the shares of the C corporation. If the analysis in the IRS Private Letter Rulings is correct, no gift tax would be owed upon the contribution of the shares of the corporation to the DING Trust and no New York State tax income tax would be imposed upon the sale of the shares by the DING Trust.⁵³

b. Discussion and Recommendation

The Commission could consider proposing legislation that would make the income of a DING Trust settled by a grantor who is a New York State domiciliary subject to New York state income tax, under one of three approaches.

i. First approach

⁵² Pulsifer & Flubacher, Eliminate a Trust's Income Tax, 145 Tr. & Est. 30 (May 2006).

⁵³ In this example, if the transfer to the DING Trust takes place very close in time to the sale of the shares, it could raise separate issues of assignment of income, which we do not discuss in this Report.

Our first approach would be to recommend legislation that amends the New York Tax Law such that it would specifically exclude DING Trusts from the definition of a NYS Exempt Resident Trust. Specifically, the Commission could recommend legislation that would add the following to Section 605(b)(3)(D)(i):

(IV) each transfer of property to the trust was a completed gift under section two thousand five hundred and eleven of the internal revenue code, provided, however, that the requirement of this clause (IV) shall apply only for as long as any person who transferred the property to the trust is alive and domiciled in this state.

We note, however, that this approach may still leave the constitutional issues open to challenge.⁵⁴

ii. Second Approach

Under the second approach, proposed legislation could directly include the income of a NYS resident DING Trust in the income of its grantor for New York State income tax purposes, so long as the grantor continued to possess sufficient control over or interest in the trust property to prevent his or her transfers to the trust from being treated as completed gifts.⁵⁵ Specifically, the proposed legislation might add the

⁵⁴ On one hand, it seems that a state should be treated as having significant constitutional nexus to a trust over which the grantor retains sufficient control to treat a transfer to the trust as an incomplete gift. Nevertheless, an argument could be made that the trust's non-grantor trust status demonstrates that the grantor relinquished significant rights with respect to the trust, which could call the state's nexus to the trust into question.

⁵⁵ This recommendation is similar in scope and objective to former Section 2511(c) of the Code, in terms of attempting to achieve consistency for gift and income tax purposes. Section 2511(c) of the Code was enacted as part of the Economic Growth and Tax Relief Reconciliation Act of 2001, and was applicable for the year 2010. It provided, in substance, that a transfer of assets by a taxpayer to a non-grantor trust will be treated as a completed gift for gift tax purposes, notwithstanding any other provision of Section 2511. Section 2511(c) appears to have been enacted out of concern that taxpayers in a high income tax bracket would shift income to taxpayers in a lower income tax bracket by making incomplete gifts to non-grantor trust. If such taxpayers would not have to pay gift tax on these transfers, there would be no limitation on the amount that could be transferred to achieve a lower tax rate. Section 2511(c) addressed this concern by treating transfers to non-grantor trusts as completed gifts, and thus making them subject to gift tax, even if they were otherwise structured as incomplete gifts.

following paragraph to Section 612(b) of New York State's Tax Laws, so that it would read as follows:⁵⁶

There shall be added to federal adjusted gross income . . . In the case of a taxpayer who transferred property to an "incomplete non-grantor trust," the income of such trust. For purposes of this paragraph, an "incomplete gift non-grantor trust" means a resident trust that is not treated as a grantor trust under section six hundred and seventy-one through six hundred and seventy-eight of the internal revenue code, to the extent that the grantor's transfer of assets to the trust is treated as an incomplete gift under section twenty five hundred eleven of the internal revenue code, and the regulations thereunder.⁵⁷

This approach is significantly different from our first approach which would tax the DING Trust itself. In contrast, this approach would treat the DING Trust as a grantor trust, and therefore tax the grantor. This approach, however, likely would be more administratively complex than the first approach because it creates an additional variation between New York State and Federal adjusted gross income.

iii. Third Approach

Our final recommendation combines approaches one and two and by so doing should resolve the concerns raised by those approaches. Specifically, under the third

⁵⁶ New York Tax Law Section 612(a) provides that "[t]he New York adjusted gross income of a resident individual means his federal adjusted gross income as defined in the laws of the United States for the taxation year, with the modifications specified in this section." Section 612(b) provides the modifications.

⁵⁷ A similar provision would need to be added with respect to deductions, under Tax Law Section 612(c) (relating to New York State modifications that reduce Federal adjusted gross income) and an additional provision would need to be added to the Tax Law to provide that the grantor benefits from the DING Trust's tax credits. We note that this approach would technically apply in the case of a resident trust that did not qualify as a NYS Exempt Resident Trust for a taxable year because, for example, it had New York State source income. A provision would need to be added to prevent the trust from being subject to tax in this circumstance, as the income would already be included in the grantor's income. We also note that this approach is limited to New York State resident trusts and as such would not apply to a non-domiciliary who forms a DING Trust and who subsequently becomes a New York State domiciliary. If the Commission determines that it is appropriate for the second approach to apply in the foregoing situation, it could do so by replacing the term "resident trust" with "trust" in the definition of an "incomplete non-grantor trust."

approach, the trustee of the DING Trust would, at the outset, have the ability to affirmatively elect to subject the trust to New York state income tax.⁵⁸ If the trustee makes this election, the trust would be subject to New York State income tax while the grantor would not be subject to tax on the trust's income. If the trustee fails to make the election, the trust would be treated as a grantor trust for New York State income tax purposes, and the trust itself would not be subject to New York State income tax. This approach has the benefit of allowing the trustee to select an approach that is administratively simpler than forcing the trust to be treated as a grantor trust for New York State income tax purposes and as a non-grantor trust for Federal income tax purposes. Moreover, we believe that there would be no constitutional issue under the Due Process Clause or Commerce Clause with taxing the trust when the trustee affirmatively elects to subject the trust to New York State income tax.⁵⁹

iv. Effective date

If the Commission decides to recommend one of these three approaches, it should further consider the appropriate effective date of the legislation. Specifically, the Commission should consider whether it is appropriate to grandfather DING Trusts that were created prior to the enactment of the new legislation. Because the primary purpose of creating DING Trusts appears to be state income tax avoidance, a grandfathering rule is arguably not appropriate.

⁵⁸ Making the election to subject the trust to New York State income tax should not cause fiduciary concerns for the Trustee, as the election would remove the income tax burden from the grantor, who is typically a beneficiary of the DING Trust.

⁵⁹ It is worth noting that once either of these approaches is implemented, New York state resident grantors of DING Trusts are likely to wind up their structures, as there would no longer be an income tax benefit.

We do, however, recommend the following two alternatives to give DING Trusts a meaningful opportunity to be unwound. First, we recommend that the new legislation should not apply to trusts that are liquidated before the close of the tax year in which the legislation is enacted or, if later, at the end of a six (6) month period after enactment. This will provide an opportunity to wind up DING Trust structures without additional tax reporting. Second, we recommend that the new legislation not apply to DING Trusts when either (i) the original transfer to the trust becomes a completed gift⁶⁰ or (ii) the trust becomes a grantor trust, in the year that the legislation is enacted.

Finally, the Commission might consider applying limited throwback rules as a means of imposing income tax on income that has been shifted to a DING Trust in prior tax years and on which no New York income tax would be paid without the imposition of some form of throwback tax. If the Commission decides to propose throwback rules that would apply to a broad category of trusts, there would be no need to impose specific throwback rules with respect to DING Trusts. If, however, the Commission decides not to propose throwback rules with respect to a broad category of trusts, it may consider proposing throwback rules that would specifically apply to the receipt by the grantor of a DING Trust of a distribution of accumulated income, as that income would not have been subject to New York State income tax in prior periods.

⁶⁰ A grantor could accomplish this by releasing the powers he or she retained in the trust agreement that caused the transfer to be an incomplete gift. For example, the grantor could release a retained power such as the ability to distribute trust corpus for a beneficiary's health, education, maintenance and support, which was one of the retained powers that caused the transfer to the trust to be incomplete in PLR 201310002.