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Accredited Investor Markets (AIMkts)™

# Eliminating Income Tax and Protecting Assets With a NING Trust

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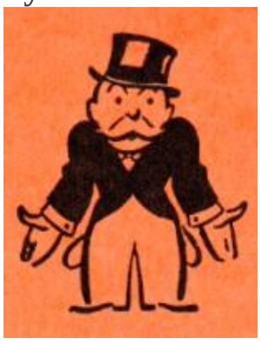

A great deal of discussion lately has surrounded the use of the NING Trust, aka a Nevada Incomplete Non-Grantor Trust. The NING is an exceptional tool to avoid state income taxes, with potential other benefits such as asset protection. By eliminating state income taxes that would otherwise have to be paid to the taxpayer's state of residence, the net rate of return on investment is increased.

For instance, in the case of California, which imposes a maximum 12.3 percent income tax and an additional 1 percent surcharge for incomes over $1 million, the elimination of state tax can mean a huge savings and corresponding increase in the net return on investment. It can also mean an extraordinary savings upon the disposition of highly appreciated securities and other intangible investments. Even better news—this powerful tax planning tool has actually been approved in several recent private-letter rulings by the IRS.

This is not to say that all Californians or residents of other states with a serious income tax problem can benefit from the NING Trust. Care must be exercised in structuring it. To begin with, the trustee needs to be in Nevada, or another state with a well-designed asset protection trust statute. If the NING is not created in a state with a statute authorizing self-settled asset protection trusts, the grantor's creditors are able to reach the trust assets and the income is taxed to the grantor—thereby undoing the very purpose of this planning technique. In addition, distributions to resident beneficiaries will commonly be taxed. So the NING is for those prepared to accumulate income over some period of time. Of course, by accumulating income free of state tax year after year, this has a cascading effect on the growth of the accumulated amount.

Another limiting factor relates to the character of the assets—the NING is for investors who own intangibles like stocks, bonds, mutual funds or other securities. If, for example, the NING holds California real estate or tangible property like works of art situated in the state, the state income tax cannot be avoided. But even this is hardly an insurmountable obstacle. These tangible assets can be owned by an entity the shares or units of which, being intangible, could be owned in turn by the NING. By converting the tangible into an intangible, the benefits of the NING become available at little or no additional cost. Note that intangibles received as stock option compensation would not be appropriate for a NING, since all compensation can be taxed when and where it's earned.

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A final limiting factor relates to the grantor's loss of control over the assets placed in trust. Although the grantor of the trust cannot exercise direct control over the assets, this does not mean that the grantor is without access or must surrender total say in the eventual disposition and investment. For example, the grantor can be a discretionary beneficiary. Furthermore, through careful design of powers, the grantor can exercise considerable influence over who gets what when distributions are ultimately made. With respect to investment decisions, the grantor's involvement can be even more direct.

Let's look at an illustration to demonstrate just how powerful the NING is for certain taxpayers using California as an example. Assume the Cal Investor owns shares in a corporation and the shares he owns have a low basis. The corporation might be a tech startup and the Cal Investor might originally have put up some minimal capital. The company has taken off and is now being wooed by a number of mega Silicon Valley suitors. Let's suppose that this actually occurs and our investor will be receiving $50 million above his basis in payment for his shares. If the shares are held by a NING, there will only be federal tax on the gain realized and recognized. There will be no California income tax. On the other hand, if Cal Investor owns the shares directly, his additional income tax will be in the range of $6,650,000, assuming he is already in the maximum 39.6 percent federal income tax bracket due to other income he reports in the year of the transaction.

Depending on the particular taxpayer, this amount of tax savings may be somewhat overstated. There are a number of reasons for this. First, there will likely be an offsetting federal deduction for the state taxes paid. However, this benefit may not be available if the taxpayer is subject to alternative minimum tax, as the calculation of that tax does not allow a deduction for state income taxes. Another reason that there may be some reduction in benefits from the NING is due to the low level of taxable income of a trust at which the maximum marginal rate of taxation for the federal income tax and the net investment income tax come into play. An individual does not hit the maximum bracket until the taxpayer has much more taxable income. On the other hand, if the taxpayer is already in the 39.6 percent bracket due to other sources of income during the year, the rate differential between trusts and individuals will not be a factor.

In the case of the Cal Investor, let's assume a net $6 million savings on the sale of the stock, after taking into account various offsets. This is not the end of the story. Assume the proceeds from the sale are accumulated in trust for 15 years. Assume further an annual return, net of federal tax, of 4 percent. In this scenario, that original $6 million savings due to use of the NING, will equal $10,805,661. Without the NING, this significant sum would not be available for the ultimate benefit of the taxpayer and his family or other intended beneficiaries.

The foregoing "big hit" example is not the only instance in which the NING Trust may prove appealing. Suppose the Cal Investor's brother, LA Larry, who is single and earns $450,000 per year, contributes $10 million worth of securities, which he inherited, to a NING. The securities average an 8 percent return each year, or $800,000. The trust will accumulate this income for 15 years. Each year's income will incur roughly $80,000 in California income tax, based on the 2014 rate table, which is adjusted for inflation. Assuming a net return after federal tax of 5 percent on these taxes saved annually, this means at the end of 15 years, there will be an accumulated sum due to annual state tax savings of $2 million that otherwise would not exist. The NING enables this result and does so without requiring LA Larry to surrender any real access to the assets should he need them.

As the "Big Hit" and "Steady Accretion" examples demonstrate, the NING Trust is a tremendously powerful vehicle not only for preserving wealth, but for increasing it, especially for people who are subject to the exceptionally high rates of income tax in states such as California. Every situation differs and a particularized analysis is required before choosing the NING route. Still, for many tax-burdened individuals, the NING Trust may be the perfect remedy.

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Schoenblum oversees the administration of trust accounts for high-net worth clients. He is responsible for providing expert advice and counsel to clients and administering accounts in a manner that ensures compliance with legal requirements and business policies and procedures. Prior to joining First American Trust in 2014, Schoenblum was Senior Trust Officer at Provident Trust Group in Las Vegas, and an attorney with the international law firm of King & Spalding. He has authored or co-authored articles featured in publications including Probate & Property, Estate Planning, Oxford Journals' Trusts & Trustees, CCH Estate Planning Review, Los Angeles Lawyer, Practical Tax Strategies, and CCH Financial and Estate Planning. He has been quoted in Forbes, the Wall Street Journal, the Chicago Tribune, and CBS News online.

Schoenblum is currently serving as the Vice President of the Southern Nevada Estate Planning Council. He also is the Founding Chair of the Nevada Chapter of the worldwide Society of Trust and Estate Practitioners (STEP). Additionally, Neil previously served as the ABA Young Lawyers Division's Vice Chair to the Committee on Real Property, Probate and Trust Law.

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