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Delaware's Income Tax Advantage for New York Residents

Help mitigate your state income tax liability with a personal trust administered in the First State

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Key points

- Personal trusts can be important vehicles for helping to mitigate a family's state income tax liability
- As New York is a high-tax state, there may be opportunities to reduce or eliminate state taxes on some of your income by establishing a new trust in Delaware or moving an existing trust to the First State
- For example, the potential New York state tax savings on a $1 million long-term capital gain in 2024 could be as high as $68,479; the savings may be even greater for New York City residents

How can this help me as a New York resident?

New York is a high tax state, regularly coming in as one of the highest in the country with a top marginal tax rate at 10.9%. New York City applies an additional income tax between 3.078% and 3.876%. Combined, these taxes may approach 15% for a resident of New York City.

Personal trusts can be important tools for helping to mitigate a family's state income tax liability. Holding family wealth inside a trust may limit the ability of New York state and New York City to tax the trust's income. The "location" of your family's assets (where your assets are held in trust) may be a significant driver of wealth by potentially reducing or eliminating the drag of state (and city) income taxes. This has been especially true since the effective repeal of the SALT (state and local tax) deduction in 2017, which capped the amount of state taxes that may be deducted against federal gross income.

How do I establish or move a trust to Delaware?

Regardless of your state of residence, you may create a new trust in Delaware and many existing irrevocable trusts may be moved into Delaware for ongoing administration. If you live in New York and created a trust, or you are the beneficiary of a trust, it may be as simple as changing from a trustee who is located in New York to one located in Delaware in order to potentially reduce the trust's state income tax burden.

Creating a new trust requires engaging an attorney who drafts the trust agreement to meet your specific planning goals. You select the beneficiaries of the trust, often your immediate family members, which could include a spouse, and determine when and how they may benefit from the assets held in trust. Finally, you select the assets to place in trust that you want to shield from New York state income tax. Importantly, while real estate located in New York and other assets that produce New York source income generally cannot escape New York tax, you should be able to shield most other assets, including certain marketable securities, from New York state taxes.

How New York's state tax laws create this planning opportunity

New York defines a "resident trust" as a trust established by a New York domiciliary. An "exempt resident trust" is a resident trust that has no New York trustees, assets, or source income. A nonresident trust is any trust that is not a resident trust. New York taxes all New York taxable income of resident trusts but only New York source income of nonresident trusts. Currently, New York applies a throwback tax on distributions of accumulated income to New York resident beneficiaries from exempt resident trusts. Consequently, creating an exempt resident trust, or converting an existing trust into an exempt resident trust, may be an opportunity for a New York resident to mitigate his or her New York income taxes by deferring or eliminating state and city taxes on income accumulated in trust.

There can be a significant tax savings opportunity for a New York resident when using a Delaware nongrantor trust, where the trust itself, and not the grantor, is taxed on income earned by the trust (Figure 1).

For example, a $1 million long-term capital gain accumulated in a New York resident trust would owe $107,102 in New York state and New York City income taxes in 2024. If the trust was structured so New York state and New York City taxes were not payable (e.g., an exempt resident trust), this $107,102 tax liability is eliminated.

Figure 1

2024 income tax due upon $1 million long-term capital gain accumulated in a nongrantor trust

Trust situs when gain realized	Federal Tax	+	NY State Tax	+	NY City Tax	=	Total Tax
Gain realized by trust resident in both NY state and NY City	$236,106	+	$68,479	+	$38,623	=	$343,208
Gain realized by trust resident in NY state (outside NY City)	$236,106	+	$68,479	+	$0	=	$304,585
Gain realized by NY exempt resident trust administered in DE	$236,106	+	$0	+	$0	=	$236,106
	Federal		**NY State**		**NY State and City**		
Potential tax savings by administering NY trust in DE	**$0**		**$68,479**		**$107,102**		

Note: The taxes due on the realized gains are calculated based on 2024 federal tax, New York state tax, and New York City tax rates.

Continued

How to mitigate state income tax using a Delaware personal trust

Delaware has a state fiduciary income tax on income accumulated in a nongrantor trust. However, there is a full exemption from Delaware tax if the income is accumulated for beneficiaries who are not current Delaware residents. Due to the fact that many trusts coming into Delaware have no other ties to the state, many trusts administered in Delaware are not subject to Delaware state income tax. Consequently, using Delaware as a trust planning jurisdiction is similar to using states that don't have any income tax but with the myriad other benefits afforded trusts under Delaware law. As a New Yorker, you may create a new trust in Delaware and many existing irrevocable trusts may be moved into Delaware for ongoing administration.

Trusts offer many tools to shield trust assets from income taxation in New York. The following strategies may provide opportunities for your family to mitigate state income taxes by making the First State the home state for your assets.

Change your trustee to save state taxes. It may be as simple as changing from a trustee located in New York to a trustee in Delaware in order to potentially reduce the trust's state income tax burden. For convenience or cost savings, most trusts use an individual family member, trusted advisor, or local financial institution as the initial trustee to get the structure up and running. Consequently, you may not have considered the New York tax burden that the trustee's location in New York has on the trust's ongoing administration and the impact on your family's overall wealth. In many cases, changing the location of the trustee to Delaware may be sufficient for the trust to eliminate or defer paying state taxes on income accumulated in the trust. Keep in mind that careful consideration must be given to whom you appoint as trustee, and it's important to consult with your advisors on this matter.

Appoint a successor trustee in Delaware. During your lifetime, some trusts are best administered by you or other family members. Common examples are an irrevocable life insurance trust (ILIT) used to remove a life insurance policy's death benefit from the taxable estate, or a revocable lifetime trust used to avoid the probate process at death. These are typically grantor trusts where the trust's income is taxed to the person who created the trust, so the location of the trustee has no impact on the tax burden. However, these trusts generally become their own taxpayer (or a non-grantor trust) following the grantor's death. At this same time, the trust may receive significant value from the death benefit of a life insurance policy or significant, complex assets requiring ongoing administration following settlement of the estate. Appointing a successor corporate trustee in a tax-friendly state such as Delaware may offer professional management of these assets at the same time New York taxes may be eliminated or deferred on income accumulated in the trust.

Turn off grantor trust status. When making a gift into an irrevocable trust, it is common for the trust to be structured as a grantor trust so you continue to make tax-free gifts by paying the income tax burden on the trust for the benefit of your heirs. Although the gift into trust is complete for gift tax purposes, the trust is structured so you are still the owner for income tax purposes. This allows the trust's assets to grow income tax-free since you, as the grantor, are picking up the tax bill. However, the grantor trust feature can generally be turned off so the trust becomes its own taxpayer. If the trust is administered in a tax-friendly state such as Delaware, it may be possible to turn off payment of New York taxes on the trust's income by simply making the trust responsible for the taxes instead of you.

Additional estate planning advantages of a Delaware trust

With the increased use of Delaware trusts seeking to meet income tax planning goals, it's also important to understand the additional estate planning benefits and flexible administrative tools that can be incorporated into your trust structure. Some of the trust features available to you under Delaware law are the ability to: (i) create a perpetual trust that serves as a family endowment through multiple generations (New York restricts the duration of a trust), (ii) potentially protect trust assets from your creditors (New York law does not provide asset protection to self-settled trusts), (iii) potentially protect trust assets from your beneficiaries' creditors, (iv) determine when or how beneficiaries receive information regarding their interests in the trust by making your trust a "quiet trust" (New York does not sanction restrictions on providing information to trust beneficiaries), and (v) retain control over investment or distribution decisions through a directed trustee structure (New York does not have an adviser statute to support a directed trustee structure).

Wilmington Trust has advised affluent families for generations. We can work with you regarding the techniques available that seek to meet your estate, tax, and wealth transfer planning needs. Working with your comprehensive Wealth Management team can help you implement a tax-efficient plan.

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As part of the Wilmington Trust Emerald Family Office & Advisory® team, Jeff is responsible for developing trust planning strategies for successful individuals and families throughout the United States and abroad. He works closely with his clients' legal, tax, and investment advisors to construct and implement appropriate trust structures that take advantage of the state of Delaware's unique trust and tax laws. Jeff earned his JD (summa cum laude) and MBA (with honors) from Syracuse University and holds a bachelor's degree in economics from Northwestern University, where he was a member of Phi Beta Kappa. He is a frequent lecturer on topics involving the use of Delaware trusts for asset protection, state income tax minimization, and investment management for unique trust assets.

Jeff is a recipient of the Wilmington Trust Chairman's Club award. He is a member of the Estates and Trusts Section of the Delaware State Bar Association and the Real Property, Trust & Estate Section of the American Bar Association.

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As part of the Wilmington Trust Emerald Family Office & Advisory® team, Matt is responsible for developing customized wealth management strategies and financial plans for high-net-worth individuals, families, and business owners in the Tri-State area that includes New York City, Westchester, Long Island, Connecticut, and northern New Jersey. Matt holds a JD from Northeastern University School of Law, where he was a member of the Law Journal, and is a graduate of Bowdoin College with a bachelor's degree in history.

He is a member of the New York State and New York City Bar Associations and previously held a leadership role with the Boston Philanthropic Advisors Roundtable in Boston.

Data sources: www.irs.gov; www.tax.ny.gov