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NING Trusts: Eliminating State Income Tax and Protecting Your Assets From Creditors

by Tara M. Walsh

A Nevada Incomplete-Gift Non-Grantor Trust, or NING Trust, is an estate planning tool used to eliminate state income tax liability while providing asset-protection features for assets transferred to the trust. NING Trusts are particularly effective for individuals with significant income or capital gains who reside in high-income-tax-rate jurisdictions, such as California or New Jersey.

By transferring assets to a NING Trust, the settlor (i.e., creator of the trust) also transfers the income tax liability with respect to such assets to the NING Trust. Accordingly, after the transfer, the settlor is no longer responsible for the income tax generated by the transferred assets, and because Nevada does not impose an income tax, the assets in the NING Trust avoid state income tax altogether.[1]

The NING Trust must appoint a Nevada resident trustee (many times this will be a Nevada trust company). The NING Trust should not appoint any trustees who reside in the jurisdiction in which the trust seeks to avoid state income tax.

The fundamental planning concepts of a NING Trust include:

1. **Incomplete Gift** – The NING Trust should be drafted in a manner such that the settlor's transfer of assets to the trust is an incomplete gift for Federal Gift Tax purposes, thereby avoiding the need to use the settlor's Federal Gift Tax Exemption Amount.[2]

   While this feature of a NING Trust preserves the settlor's Federal Gift Tax Exemption Amount during his or her lifetime, it is important to note that the assets transferred to the NING Trust will not be removed from the settlor's estate for Federal Estate Tax purposes. The objective of the NING Trust is not to reduce the settlor's taxable estate for Federal Estate Tax purposes but instead to reduce or eliminate state income tax liability during the settlor's lifetime. Since the assets transferred to the NING Trust are not removed from the settlor's estate for Federal Estate Tax purposes, such assets will receive a step-up in basis at the time of settlor's death.

   In order to ensure that the transfer to the NING Trust is an incomplete gift, the trust instrument will provide the settlor with a lifetime non-general power of appointment that gives the settlor the power to direct the distribution of the trust assets to certain beneficiaries of the trust (other than the settlor) for their health, education, maintenance or support. The NING Trust will also provide a similar non-general power of appointment that will be effective upon the settlor's death.

2. **Non-Grantor Trust** – Under a "grantor trust," the settlor retains certain powers that result in the settlor being treated as the owner of the trust assets for income tax purposes.

Therefore, the NING Trust must be carefully drafted to qualify as a "non-grantor" trust so that the trust is its own separate legal entity, and therefore income from the assets transferred to the trust is taxed to the trust. This feature of the NING Trust is critical in shifting the income tax burden from the settlor to the trust.

The NING Trust typically appoints a distribution committee composed of the settlor and several other beneficiaries that control the amounts and recipients of trust distributions, subject to various limitations. For example, any distributions to the settlor must require the consent of the other beneficiaries. This condition ensures that adverse parties acquiesce in any distribution decisions for the benefit of the settlor, which in turn ensures that the trust is not treated as a grantor trust for income tax purposes.

3. **Asset Protection Trust –** A Domestic Asset Protection Trust is a domestic trust that allows the settlor to be a discretionary beneficiary of the trust while simultaneously protecting the trust assets from the settlor's creditors. In order for an Incomplete-Gift Non-Grantor Trust (such as a NING Trust) to avoid grantor-trust status, the settlor's creditors must be prohibited from attaching or accessing the trust assets. As a result, an Incomplete-Gift Non-Grantor Trust must be established in a jurisdiction that provides asset protection laws, such as Nevada. This feature of a NING Trust offers the added benefit of protecting the trust assets from the settlor's creditors while making them available to the settlor under certain circumstances.

Summary

Under appropriate circumstances, a NING Trust can provide significant state income tax savings while simultaneously protecting trust assets from creditors. You may benefit from a NING Trust if you meet the following criteria:

1. You are living in a high-income-tax-rate jurisdiction, such as California or New Jersey.

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2. You have intangible assets (e.g., marketable securities) with significant tax exposure.

3. You are willing to transfer significant intangible assets to the NING Trust, recognizing that such transfer will limit your access to such assets and may reduce your available cash flow.

4. Your income is currently subject to the top Federal Income Tax rates and would continue to be subject to such top rates following the transfer of a portion of your assets to the NING Trust.

If you believe a NING Trust may be a beneficial part of your estate and financial plan, please contact any of the attorneys in our Trusts and Estates practice group to discuss your particular circumstances and how we may best serve you.

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[1] A NING Trust does not seek to reduce or eliminate *Federal* Income Tax.

[2] A distribution from a NING Trust to a beneficiary other than the settlor will be considered a completed gift, which will require the filing of a Federal Gift Tax Return if such distribution does not fall within the Annual Gift Tax Exclusion.