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Nevada Incomplete Gift Non-Grantor Trusts (NINGs)

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A Nevada Incomplete Gift Non-Grantor Trust (NING) is an irrevocable trust designed to limit state income tax liability, preserve wealth, and protect trust assets using Nevada's laws. Clients who are high-income earners, have significant unrealized capital gains on the sale of an asset, such as a business, and live in a high-income tax state may benefit from using a NING.

What Exactly is a NING Trust?

A NING is a Nevada Trust where gifts are considered "incomplete " for gift and estate tax purposes. Incomplete gifts are so named because the grantor may retain control over or access to the contributed asset. NING trusts are non-grantor trusts, which means that the trust is the taxpayer for income tax purposes. This allows the income from trust assets to be taxed based on the residence of the trustee rather than that of the grantor. For grantors living in a high-income state, like California, this can offer significant tax savings. If, for example, the sale of a highly appreciated asset is anticipated, doing so through a NING could limit the capital gains tax which might be higher if done under the laws of the grantor's state of residence.

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How do NINGs Work?

A NING works exceptionally well if a client lives in a high-income tax jurisdiction and is either looking to eliminate state income taxes or is selling an asset with a significant capital gain.

Here's how a NING strategy works:

1. The grantor transfers an asset or brokerage account with income tax liability to a NING trust. This is often a portfolio of marketable securities or shares in a family business.
2. Once the transfer is complete, the grantor is no longer responsible for the income tax liability because a NING is non-grantor trust. As a non-grantor trust, the NING will be a separate entity for federal income tax purposes and will file a Form 1041 return.

3. The trust is responsible for the income tax, and since the trust is set up in Nevada, where there is no state income tax, the income earned on the assets in the NING trust is not subject to state income tax.

An experienced attorney should draft a NING trust to ensure it is a non-grantor trust per IRS regulations. Having a properly drafted NING is crucial to shift the income tax liability away from the grantor and to the trust.

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One of the key characteristics of a NING is the "Distribution Committee." A "Distribution Committee" is comprised of three adverse parties. To qualify as a non-grantor trust, these adverse parties must have discretion regarding distributions from the trust, and they must also be beneficiaries. In addition, the grantor must give up enough control to make the trust a non-grantor trust but not so much control that the trust becomes a completed gift.

Example NING Trust Scenario

Let's say you have a client who is a successful business owner in California and is looking to sell their business for a significant profit. The client has a basis of $500,000 in the business which is now worth $10 million. If the business owner were to sell the business, they would incur a capital gain of approximately $9.5 million.

Given that California has a state income tax rate of 13.3%, in this scenario, your client would be responsible for paying approximately $1.3 million in California state income taxes, not considering any other facts and circumstances. However, if you set up a NING trust for your client and transfer ownership to the trust, the trustee in Nevada could then sell the business, potentially avoiding the $1.3 million in state income taxes. Of course, federal income tax would be applicable whether the grantor or the trust sold the asset. However, significant state income tax savings are possible using an appropriately structured Nevada NING trust.

After the sale, the proceeds could be invested by your client's preferred financial advisor, and as long as the funds remain in the NING trust, there would be no state income tax liability. Additionally, if your client were to move to a state without state income taxes, they could avoid paying any state taxes on the trust distributions. Many clients set up a NING Trust with the intent of moving to a state without state income taxes before they start taking distributions from the trust. Others simply use the NING Trust as a legacy preservation vehicle for their children.

Ideal Candidate for a NING

The ideal candidate for a NING trust is someone who is looking to sell an asset with a significant capital gain and wants to eliminate or reduce state income taxes. This person may also be looking for asset protection and privacy and may be open to establishing a trust in Nevada to take advantage of the other benefits of Nevada's favorable trust laws, such as asset protection, perpetual trusts, and privacy. Additionally, the ideal candidate may be open to relocating to a state without a state income tax or is interested in using the trust as a legacy preservation vehicle for their heirs.

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Ultimately, the suitability of a NING trust will depend on the individual's unique financial and personal circumstances and should be evaluated with the help of legal, tax, and financial advisors familiar with this advanced planning technique.

Here are some questions you may want to ask your client to see if a NING strategy makes sense for their situation:

- ✓ Are you a high-income earner in the top tax brackets and live in a state with a high-income tax environment like California, Massachusetts, or New Jersey?
- ✓ Do you have intangible assets with an embedded large capital gain that you would want to sell?
- ✓ Do you plan on moving to a state with no state income tax? Do your beneficiaries reside in a state with no state income tax?
- ✓ Have you done any estate tax planning? (Assets transferred to a NING trust are still includible in the grantor's estate at death because the gift is "incomplete" for estate and gift tax purposes.)

Considerations for Establishing a NING

A NING works well if it owns intangible assets, such as shares in a business or a brokerage account. However, a NING trust cannot own tangible assets or assets sourced to the state in which the taxpayer resides. For example, if the asset is physically located in a high-income tax state (source income), the strategy will not work. Sometimes, tangible assets can be converted to intangible assets, but this requires additional careful planning with the help of specialized legal and tax advice.

A NING trust may not work for your client, depending on the state in which your client resides and how that state views the taxation of a trust. New York, for example, has enacted a law to negate the use of the NING trust strategy. Other states automatically impose a state income tax if the grantor is a state resident when the trust is established. Therefore, consulting knowledgeable tax and legal advisors is critical to determine whether the NING trust strategy will work for your client.

NINGs are complex trust structures that must be drafted according to specific rules to achieve the planning benefits. Therefore, working with a qualified attorney with experience creating such complex trusts is critical.

Talk to a Trust Expert

Have a question about an advanced planning technique?

Ready to submit a trust document for review?

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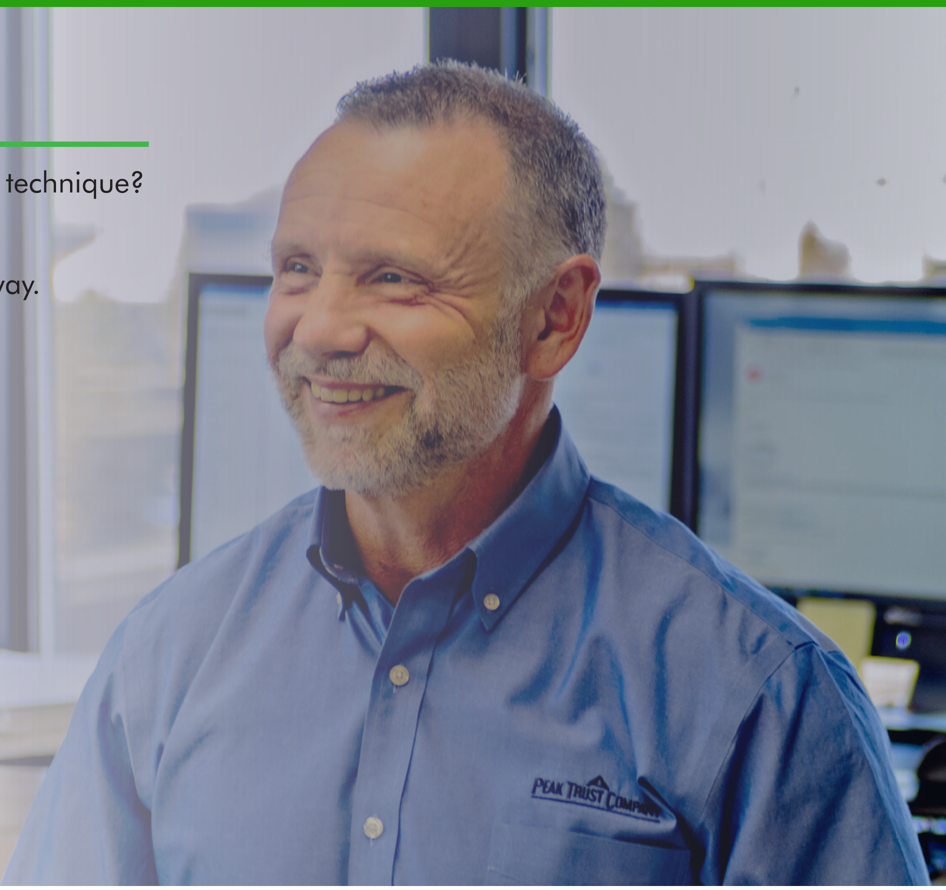

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