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# The Advisor

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## Out-of-State Domicile Can Save Estate Taxes

In addition to the lure of sunshine, many people consider moving to Florida for tax advantages. States like New York and New Jersey have relatively high income and estate taxes. Yet Florida does not impose a state level income or estate tax and a person can enjoy substantial tax savings by moving to Florida.

New York and New Jersey, however, are becoming increasingly aggressive about asserting tax jurisdiction over people who maintain significant ties to these states. In an estate tax context, it is important to establish "domicile" in the state of choice.

"Domicile" for estate tax purposes means the place where a person has his or her permanent home. It requires both physical presence and the intent to have one's domicile in that state. Note that the concept of "domicile" for estate tax purposes is different than the concept of "residence" for income tax purposes. Residence is often based on a number of days in a particular state, but domicile is not and may be established as soon as both physical presence and the intention to create a domicile are present.

Courts in New Jersey typically evaluate the facts and circumstances of a case to determine where a decedent was domiciled at his or her death, and therefore whether New Jersey transfer taxes apply. For example, in a case where it was established that the decedent was unable to live alone, moved to be near her closest relatives in Florida, executed a Florida declaration of domicile, rented a Florida safe deposit box and opened Florida bank and brokerage accounts, the court found that the decedent was a Florida (and not New Jersey) domiciliary, even though she had only lived in Florida for two months.

Individuals who intend to affirmatively establish domicile in Florida or another state should consider the following steps: acquiring a driver's license and registering vehicles in the state of choice; voting in the state of choice; filing resident tax returns from the state of choice and filing nonresident returns for other states, using the address in the state of choice as the primary address; filing an affidavit of domicile in the county of domicile; opening bank accounts, securities accounts and safety deposit boxes in the state of choice; keeping objects of sentimental value in the new residence; being active in places of worship and politics in the state of choice, and furnishing and improving the residence in the state of choice. Another substantial step is to sell and/or transfer the residence in New York or New Jersey which would greatly diminish New York or New Jersey's case.

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## IRS Issues Pro-Taxpayer Revenue Ruling on Power to Substitute Assets

The news from the IRS is not always bad. In Revenue Ruling 2008-22, the IRS held that one of the common grantor trust switches – the grantor's power to substitute assets of equivalent value – will not cause the trust assets to be included in the grantor's estate under Code §2036 or §2038.

This is a pro-taxpayer ruling that will provide comfort to planners and clients who utilize grantor trusts. Prior to this ruling, a number of commentators felt there was a risk that using a power to substitute assets as a way to make a trust a grantor trust could cause inclusion of the trust assets in the grantor's estate. They argued that the power to substitute assets could be found to be a retained interest under Code §2036 or a power to revoke the trust under Code §2038. The IRS had previously issued several private letter rulings holding that such a power did not cause estate inclusion, but of course private letter rulings have no precedential value, and it was still considered a potential risk. Following the Revenue Ruling, the risk of estate inclusion is, for practical purposes, eliminated.

In the ruling, the IRS held that the trust assets will not be includible provided (1) the trustee has a fiduciary obligation under local law or the trust instrument to ensure the grantor's compliance with the terms of the power by satisfying itself that the properties acquired and substituted by the grantor are in fact of equivalent value, and (2) the substitution power cannot be exercised in a manner that can shift benefits among the trust beneficiaries.

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## Case Study – Buying a $60 million chateau in France

Your assistant hands you a message: Your celebrity clients, A and B, called. They are buying a $60 million chateau in the south of France so that they and their 6 children (some natural born, some adopted), can have a "normal" life. They ask if there are any estate planning issues to consider regarding their move. Your advice?

Here are some ideas A and B might consider:

1. Double taxation? As US citizens, A and B are subject to estate tax on assets they own anywhere in the world, so the chateau will be taxed in their estates. The chateau is also likely to be subject to estate tax in France. However, Internal Revenue Code §2014 helps mitigate double taxation by allowing a foreign tax credit for estate or succession taxes paid to a foreign country with respect to property situated in that country and included in the decedent's gross estate. The US-France Estate Tax Treaty, ratified in 1980, also may alleviate double taxation and should be consulted.

2. Living trusts. Living trusts are not used extensively in New Jersey, are used more frequently in New York, and would very likely be appropriate here. If the property is owned in a living trust, it should avoid the need for a French probate proceeding to transfer title at the later of A and B's deaths (to be confirmed by French counsel, of course). Use of a living trust also avoids publicity since a Will filed for probate is a public document but a living trust is not.

3. Definition of "heirs" or "descendants." As the definition of family continues to change and the trend toward multigenerational trusts continues, the definition of heirs, descendants or issue becomes more important. There are cases every year where a stepchild or adopted child sues to be included in an inheritance. A and B's estate planning documents should clearly state their intentions as to how they wish to treat their adopted children. In addition, their families' estate planning documents should be evaluated as well.

4. Reducing estate tax exposure. A Qualified Personal Residence Interest Trust ("QPRIT") will not be effective in this case primarily because the gift of the remainder interest would almost certainly trigger a large gift and gift tax liability. While QPRITs are effective tax reduction tools in more modest taxable estates, they generally do not provide significant savings in very large estates.

   It is also unlikely that A and B could own their new chateau in a family limited partnership or similar structure as their personal use of the property would likely cause all of its value to be included in their estates. See Strangi and related cases.

If A and B's children have wealth in their own names, a joint purchase using a PRT may be worth considering. If effective, each of A and B and their 6 children could own a fractional share of the property and much of the value and appreciation could be removed from A and B's taxable estates.

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