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November 18, 2013

The Honorable H. Carl McCall
Co-Chair, New York State Tax
Reform and Fairness Commission
State Capitol
Albany, NY 12224

The Honorable Peter J. Solomon
Co-Chair, New York State Tax
Reform and Fairness Commission
State Capitol
Albany, NY 12224

Re: Report on Certain New York State Resident Trusts

Dear Co-Chairs McCall and Solomon:

I am pleased to submit the attached report of the Tax Section of the New York State Bar Association, which responds to the New York State Tax Reform and Fairness Commission's (the "Commission") request for our recommendations with respect to certain issues relating to the income tax treatment of certain New York State resident trusts.

By way of background, New York State resident trusts are generally exempt from New York State income tax when (i) all trustees are domiciled outside of New York State, (ii) all of the trust's real property and tangible personal property is located outside of New York State, and (iii) the trust has no New York State source income (we refer to these trusts as "NYS Exempt Resident Trusts"). A proposal put forth in 2010 would have significantly altered the tax treatment of NYS Exempt Resident Trusts. In a prior report submitted in 2010, we recommended against the 2010 proposal because we thought it raised serious Federal constitutional issues and certain practical concerns.

The Commission asked the Tax Section to reconsider our prior recommendation regarding the 2010 proposal. The Commission has asked us to recommend other approaches under which the income of NYS Exempt Resident Trusts could be subject to New York State income tax, with a particular emphasis on a form of trust known as a Delaware Incomplete Non-Grantor Trust (or "DING Trust").

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Mr. McCall
Mr. Solomon
November 18, 2013

We appreciate the goals of the Commission in asking that we reconsider our recommendation regarding the 2010 proposal. However, we continue to believe that enactment of the 2010 proposal would raise the issues and concerns discussed in our 2010 report. In fact, the Federal constitutional concerns discussed in our 2010 report are underscored by two recent state court cases.

In response to the Commission's request for a recommendation as to how the accumulated income of NYS Resident Trusts could be subject to New York State income tax, we continue to recommend a system of "throwback rules," pursuant to which the income of such trusts would be taxed at the point in time that the income is distributed to a New York State resident. We also set forth certain specific issues for the Commission's consideration when thinking about throwback rules.

Finally, we recommend three alternative approaches in response to the Commission's inquiry as to how New York State could tax on a current basis the income of so-called DING Trusts. The first approach would amend the New York State Tax Law in a manner that would remove DING Trusts from being classified as NYS Exempt Resident Trusts. The Second approach would amend the New York State Tax Law so that NYS resident DING Trusts would be classified as "grantor trusts" for New York State income tax purposes even though they are not treated as such for Federal income tax purposes. The third approach would allow the Trustee of a NYS resident DING Trust to elect at the outset whether the first or second approach would apply.

We appreciate your solicitation and consideration of our recommendations. Please let us know if you would like to discuss these matters further or if we can assist you in any other way.

Respectfully submitted,

A handwritten signature in blue ink, appearing to read 'DS', with a long horizontal flourish extending to the right.

David H. Schnabel

Enclosure