

Accessing N.H.'s Tax, Creditor Protection Benefits

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Trust situs has emerged as a critical issue for high-net-worth families and their trusts. Whether seeking privacy, securing protection from creditors or a dissident spouse, updating existing trust provisions or looking to minimize taxes, Bay State families need look no further than their close neighbor to the north.

In recent years, New Hampshire has modernized its trust laws to make it easier for out-of-staters to achieve all of the above, without forsaking long-standing relationships with their trusted advisors.

As a result, New Hampshire's specialized trust administration companies are building strategic partnerships with these advisors, enabling them to maintain their primary roles and relationships with the families they serve, maintain fees for their services, and still provide access to New Hampshire's highly favorable trust laws.

Tax Advantages, Other Benefits

Through careful structuring of a change in a trust's situs, Massachusetts attorneys have a unique opportunity to build and preserve wealth for their clients.

A trust can avoid taxation by both New Hampshire and Massachusetts by replacing a trust's current Massachusetts resident trustee with a successor "directed trustee" residing in New Hampshire.

Because a directed trustee is an "excluded fiduciary" that simply takes direction from trust advisors, the arrangement doesn't jeopardize attorneys' hard-won relationships with their clients.

Eliminating the Massachusetts tax on the trust's income and capital gains can easily justify the costs associated with the move of a trust's situs north of the border.

Beyond the potential tax advantages, trusts with New Hampshire situs can take advantage of the management and administrative benefits that the state's progressive trust laws afford, including non-judicial settlement agreements; "virtual" representation (which can eliminate the need for guardians ad litem); accessible "decanting" opportunities; self-settled asset protection trusts; "quiet" trusts; flexible trust investment standards (including the ability to waive the prudent investor standard); and perpetual generation-skipping trusts.

Moreover, these trusts can be insulated from diversion by dissident spouses, creditors and other challengers to a degree unmatched by the laws of Massachusetts and most other jurisdictions.

Of course, the Granite State's favorable tax environment should not be overlooked. A broad range of trusts can potentially realize the benefits of lower taxes. Ideal candidates are substantially funded, long-term, non-grantor trusts that make no or modest annual distributions to Massachusetts resident beneficiaries and have no or very few New Hampshire resident beneficiaries.

However, other types of trusts also may achieve state tax benefits from a situs change, especially if the trustee expects to realize substantial capital gains from anticipated sales of highly appreciated holdings.

One type of trust that can provide shelter from Massachusetts state tax is a "non-grantor incomplete gift trust" that has a New Hampshire directed trustee.

For example, John, a business owner residing in Massachusetts, is considering selling the stock of his closely held company to a strategic buyer. If John, individually, continues to own the stock, the sale of the company would create significant capital gains that would be subject to Massachusetts tax.

However, if John first puts a portion of his stock into a specially designed trust with a New Hampshire directed trustee, the gain on the sale of that portion may be sheltered from Massachusetts tax.

To accomplish that, John could make an incomplete gift of the stock to a self-settled, non-grantor trust. The trustee of the trust would be a New Hampshire resident with legal ownership of the trust assets. The trust could have other fiduciary advisors to direct the New Hampshire trustee with respect to distributions and investments.

Later, when the New Hampshire trustee acts on the investment advisor's instructions to sell the stock, there should be no state capital gains tax. John and the trust's other beneficiaries (perhaps John's wife and descendants) would be eligible to receive distributions from the trust at the discretion of the trust's distribution committee.

Resident or Non-Resident?

An important question for families and advisors considering moving a trust to New Hampshire is whether the family's existing coterie of trusted advisors (attorneys, accountants, investment advisors, etc.) can continue to serve without subjecting the trust to the risk of Massachusetts taxation.

The answer depends on the state of residency of the trust's empowered parties and their responsibilities. The remainder of this article will provide some guidance for Massachusetts-based families and their advisors on how to access New Hampshire's favorable trust and tax laws while retaining their long-standing and mutually beneficial relationships.

From a statutory perspective, determining taxation of a trust with Massachusetts connections is a two-step inquiry:

First, is it a resident or non-resident trust? An inter vivos trust is a Massachusetts resident if it has at least one Massachusetts trustee *and* if at least one grantor was a Massachusetts resident when the trust was created, at death, or during any part of the tax year at issue. A trust that doesn't meet those criteria is a "non-resident" trust that is taxed by Massachusetts only on its Massachusetts-source income (e.g., rental income from Massachusetts real property).

Second, for a resident trust, are the beneficiaries Massachusetts residents? The share of the income of a Massachusetts beneficiary is taxed to the trust. A non-resident beneficiary's share of the income is taxed to the beneficiary. Unborn and unascertained beneficiaries are treated as Massachusetts residents, and income accumulated for their benefit is taxed to the trust.

In other words, a trust created by a Massachusetts resident will not be subject to Massachusetts taxation if the trust does not have a Massachusetts resident trustee. Having a Massachusetts trustee triggers resident trust status.

High-net-worth families often engage a team of specialized advisors — attorneys, accountants and various asset managers — to optimize their wealth preservation strategy by spreading critical fiduciary functions among multiple non-trustee participants.

There is no indication that Massachusetts will consider Massachusetts-resident participants in a trust's administration to be "co-trustees," if the trustee holding legal title to the trust assets, and performing at least some administrative duties, resides in New Hampshire.

Careful structuring of the trust, and its participants' duties, should avoid any problems in that regard. To this end, Bay State families can restructure their trust's chain of command and avoid Massachusetts taxation by limiting the authority of their Massachusetts resident advisors.

For example, the original Massachusetts resident trustee could resign and appoint a New Hampshire resident trustee, but remain empowered as "trust advisor." The trust advisor could orchestrate all distributions and investments, just as he did before the change of trustee, except that the trust advisor's instructions must be executed by the New Hampshire trustee.

The only substantive differences after the move are that the trust no longer has a Massachusetts resident trustee, and the trust's administrative functions (recordkeeping, tax preparation, etc.) are performed in New Hampshire.

The directed trustee typically charges a fiduciary fee commensurate with the minimal risk it undertakes as an "excluded fiduciary," leaving room for other advisors to charge their customary fees.

Another option is a "delegated" trust, which offers a more conservative alternative. With a delegated trust, a New Hampshire trustee establishes a non-fiduciary agency relationship with the Massachusetts resident service provider(s) (e.g., the investment manager).

The cost of choosing a delegated trust, versus a directed trust, is that the delegating New Hampshire trustee is likely to charge a greater "surcharge premium" to reflect the increased responsibilities and risks of delegation (compared to the lower risks associated with merely executing the instructions given by the trust advisor).

The Granite State's modern and progressive trust statutes offer Massachusetts families and their attorneys and wealth advisors the proverbial opportunity to have their cake and eat it, too. Massachusetts resident advisors can carry out to the fullest extent a trustee's fiduciary duty "to preserve the trust property," without having to sacrifice their client relationships.

To be sure, careful attention must be paid to structuring the trust properly to optimize the benefits of favorable trust jurisdiction. Rewards for that attention to detail include long-term security, investment flexibility, confidentiality and mutually beneficial wealth preservation.

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