

ACTEC 2019 MID-ATLANTIC REGIONAL MEETING  
New York, New York  
State Chairs Roundtable Discussion  
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F. Peter Conaty, Jr., Esquire, Delaware State Chair

Income Tax; Death Tax; Gift Tax; Other Issues; Law Enforcement Efforts<sup>1</sup>

**A. Delaware Income Tax**

1. Background

- a. The Delaware personal income tax applies to the entire taxable income of every resident of the State of Delaware. 30 *Del. C.* § 1102. The entire taxable income is equal to the federal adjusted gross income, with certain Delaware modifications. 30 *Del. C.* § 1105. Important modifications include:
  - i. Adding back tax-exempt interest on obligations and securities of states other than Delaware;
  - ii. Subtracting amounts not to exceed \$12,500 received as pensions or eligible retirement income by persons age 60 or older; and
  - iii. Subtracting social security benefits paid by the United States to the extent included in federal adjusted gross income.
- b. Nonresidents are subject to the tax based upon the fractional share of their entire taxable income which is Delaware source income. 30 *Del. C.* § 1121.
- c. Delaware source income includes the distributive share of income from a Delaware partnership, S corporation, estate or trust; compensation, other than pensions, received as an employee for personal services rendered within the state; income attributable to the ownership or disposition of any interest in real or tangible personal property located within the state; income attributable to a business carried on within the state; and income from intangible personal property (dividends, interest, gains from the disposition of intangibles) to the extent such income is from property employed by the taxpayer in a business carried on within the state. 30 *Del. C.* § 1124.
- d. The rate of tax in Delaware begins at 2.2% on taxable income in excess of \$2,000 but not in excess of \$5,000, rising to 6.6% on taxable income in excess of \$60,000. 30 *Del. C.* § 1102.

2. Individuals - Residency considerations

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<sup>1</sup> Portions of these materials are based on materials previously presented by W. Donald Sparks, II of Richards, Layton & Finger, P.A. at the ACTEC 2015 Mid-Atlantic Regional Meeting.

- a. Delaware law provides both a quantitative test and a qualitative test for residency for tax purposes:
  - i. Qualitative - an individual who is domiciled in the state is a resident. 30 *Del. C.* § 1103(1).
  - ii. Quantitative - an individual who maintains a place of abode in the state and spends in the aggregate more than 183 days of the taxable year in the state is a resident. 30 *Del. C.* § 1103(2).
- b. An individual will be considered a resident of Delaware if either the qualitative or the quantitative test is met.
- c. A nonresident is any individual who is not a resident. 30 *Del. C.* § 1104.
- d. Domicile for purposes of the qualitative test is generally established upon the showing of two factors: (1) physical presence at a dwelling place, and (2) the intention to make that dwelling the home indefinitely. *New York Trust Co. v. Riley*, 16 A.2d 772 (Del. 1940).
- e. The Delaware Supreme Court has held that in order to establish domicile in accordance with *Riley*, an individual must demonstrate that “the totality of circumstances clearly establishes factors showing an integration into the chosen locale of residency,” and that, at least for purposes of jurisdiction in a divorce action, “[r]esidence plus an expression of intent to make Delaware home is insufficient to establish domicile without clear and unequivocal proof of permanency.” *Wife (J. F. V.), v. Husband (O. W. V., Jr.)*, 402 A.2d 1202 (Del. 1979).
- f. While there is limited authority specifically addressing domicile for tax purposes, Delaware courts have examined numerous factors in determining an individual’s intention with respect to domicile including:
  - i. Place of residence and place of voting- *Mitchell v. Delaware State Tax Com’r*, 42 A.2d 19, 22 (Del. Super. 1945)(examining domicile, and therefore residence, for income tax purposes).
  - ii. Location of intangibles (furniture); automobile registration; bank accounts; declaration of domicile in estate planning documents; address used on tax returns - *Taormina v. Taormina Corporation*, 109 A.2d 400 (Del. Ch. 1954)(examining the domicile of a decedent for purposes of distribution of Delaware tangible property).
  - iii. Location of bank accounts, children’s schools, financial institutions from which loans were obtained, and address used on government documents - *In re Marriage of Pascavage v. Pascavage*, 1994 WL 837452, at \*9 (Del. Fam. July 1, 1994) aff’d sub nom. *Pascavage v. Aperio*, 655 A.2d 1225

(Del. 1995)(examining domicile for purposes of jurisdiction in a divorce action).

- g. In order to establish a new domicile, an individual must show “actual abandonment of the prior domicile with an intention not to return thereto, coupled with actual residence at new domicile with intention of making that place a permanent home.” *Gahn v. Gahn*, 116 A.2d 902, 904 (Del. Super. 1955) (citing *Riley*, 16 A.2d at 783).

### 3. Taxation of Trusts and Estates

- a. The Delaware income tax imposed on individuals also applies to the taxable income of estates and trusts, and is computed in the same manner as in the case of an individual. 30 *Del. C.* §§ 1631, 1632.
- b. For a Delaware resident estate or trust, the taxable income is generally its federal taxable income, subject to certain adjustments as with individuals. 30 *Del. C.* § 1635. A deduction is allowed, however, for any income which is accumulated for future distribution to nonresident beneficiaries. 30 *Del. C.* § 1636. Therefore, a trust that has no Delaware resident beneficiaries will generally not be subject to income tax by the State of Delaware.
- c. 30 *Del. C.* § 1601(8) provides that a “resident trust” is:
  - i. A trust created by the will of a decedent domiciled at death in Delaware;
  - ii. An inter vivos trust created by, or consisting of property of, a Delaware domiciliary; or
  - iii. A trust with 1 trustee who is either an individual who is a Delaware resident or a corporation or other entity having an office for the conduct of trust business in Delaware; or a trust with more than 1 trustee at least 1 of which is a corporation or other entity having an office for the conduct of trust business in Delaware, or of which all the trustees are individuals and at least ½ are Delaware residents.
- d. Due in part to the taxpayer-favorable nonresident beneficiary deduction, there have not been any cases challenging Delaware’s resident trust definition or addressing the constitutionality of its bases of trust taxation.
- e. Subjecting a trust to taxation solely on the basis of the domicile of the testator for a testamentary trust, or on the domicile of the trustor for an inter vivos trust, has been successfully challenged on constitutional grounds in other states. See *Potter v. Taxation Div. Director*, 5 N.J. Tax 399 (Tax Ct. 1983); *Pennoyer v. Taxation Div. Director*, 5 N.J. Tax 386 (Tax Ct. 1983); *McNeil v. Commonwealth*, 67 A.3d 185, Pa. Comm. Court, Nos. 651 F.R. 2010, 173 F.R. 2011 (2013); *Linn v. Dept. of Revenue*, 2013 IL App. (4<sup>th</sup>) 121055, 2 N.E.3d 1203; *Fielding v. Commissioner of Revenue*, 916 N.W.2d 323 (Minn. 2018). It is therefore possible that Delaware’s

imposition of income tax on resident trusts solely based upon the residence of the testator or trustor would also not withstand constitutional scrutiny.

- f. It would be more difficult to challenge the third basis for a trust being considered a resident trust, having a Delaware resident Trustee, as the nexus with the state is stronger. Furthermore, since Delaware permits a deduction for taxable income set aside for future distribution to non-resident beneficiaries, a trust will essentially only have fiduciary income tax liability to the State of Delaware if there is a Delaware resident Trustee and a resident beneficiary, thus providing a stronger basis to determine that the definition of a resident trust based upon the residence of the Trustee is Delaware is constitutional. See *N. Carolina Dep't of Revenue v. The Kimberley Rice Kaestner 1992 Family Tr.*, 139 S. Ct. 2213, 2019 WL 2552488 (U.S. June 21, 2019).

## **B. Delaware Estate Tax**

After expiring in 2004, the Delaware Estate Tax was reinstated effective July 1, 2009. The original legislation provided that the tax would only apply to the estates of decedents dying after June 30, 2009 and before July 1, 2009. In 2013 the tax was made permanent. However, effective for decedents dying after January 1, 2018, the Delaware Estate tax has been repealed.

### **1. Planning to Avoid in the Event of a Reinstatement**

- a. Planning to avoid the imposition of the Delaware estate tax focuses on establishing domicile outside of Delaware, and clearly establishing sufficient indicia that a change in domicile has taken place in the event it would be necessary to present facts to support such a change.
- b. Key steps to this planning include ensuring no real or tangible personal property located in the state of Delaware is directly owned - ownership through a limited liability company is often recommended.

## **C. Delaware Gift Tax**

1. The Delaware gift tax was repealed effective January 1, 1998.

## **D. Law Enforcement Efforts**

1. The Delaware Division of Revenue of the Department of Finance is charged with collecting taxes and other revenues required by law to be remitted to the State of Delaware, and enforcing Delaware's tax laws. 29 *Del. C.* § 8305.
2. The head of the Division of Revenue is the Director, who is also the State Tax Commissioner. 30 *Del. C.* § 502.
3. Appeals from determinations of the Director are made to the Delaware Tax Appeal Board. 30 *Del. C.* § 544. The Tax Appeal Board consists of 5 members appointed by

the Governor to 3 year terms. Decisions of the Tax Appeal Board can be appealed to the Superior Court in the county in which the hearing is held. 30 *Del. C.* § 331.

4. The Director of the Division of Revenue is represented before the Tax Appeal Board and the Delaware courts by Deputy Attorneys General in the Government Services Unit of the Civil Division of the Delaware Department of Justice. The Delaware Attorney General is the elected head of the Department of Justice. Historically, one Deputy Attorney General has been assigned to handle all Division of Revenue matters statewide.
5. Delaware historically has not aggressively pursued purported nonresidents to assert Delaware residency. The Department of Justice has indicated that it is a case by case inquiry, and will generally arise if there is a connection to Delaware such as the filing of Delaware income tax returns or source income from employment in Delaware.
6. Recent staffing changes following the appointment of a new Director of the Division of Revenue in 2017 may result in increased enforcement efforts with respect to Delaware tax matters.