

**ACTEC 2019 MID-ATLANTIC REGIONAL MEETING**  
**New York, New York**  
**State Chairs Roundtable**  
**September 13, 2019**  
**Linda Rhone Enion, Esq., Pennsylvania State Chair**

**Gift and Estate Tax and Trust Income Tax Treatment in the Mid-Atlantic Region**

**Pennsylvania Estate Tax and Pennsylvania Inheritance Tax**

The estate tax is based upon the difference between the federal state death tax credit and the amount of the inheritance tax actually paid to the Commonwealth. As the state death tax credit was replaced with a deduction for state death taxes, Pennsylvania's estate tax is not applicable. 72 P.S. § 9117. Nonetheless, the Pennsylvania Department of Revenue advises the estate tax provisions are still in effect and an estate which is required to file IRS Form 706 is required to file a copy of the 706 (and final communications with the IRS) with the Register of Wills where letters were granted, or if there is no grant of letters, with the Department in Harrisburg.

Pennsylvania assesses inheritance tax on the right of succession or privilege of receiving property at death. The tax rate imposed is a percentage based upon the relationship of the beneficiary to the decedent. Transfers to spouses are either exempt if joint property, or 0% if titled in the name of the decedent. Transfers from a child twenty-one (21) years of age or younger to a parent or stepparent are also at 0%. Transfers to grandparents, parents, lineal descendants (according to the Department of Revenue, lineal descendants include stepchildren and their descendants) and spouses of children are taxed at a 4.5% rate, siblings at 12% and other beneficiaries at 15%. See 72 P.S. § 9116. A five percent (5%) discount is available to the extent the inheritance tax is paid within three (3) months after the decedent's death. 72 P.S. § 9142.

Charities and government entities are exempt from inheritance tax. Life insurance proceeds are not taxed. Exemptions apply in some circumstances for retirement benefits, farms and qualified family-owned businesses.

While the definition of resident and nonresident no longer appear in the inheritance tax statute, the words are contained in the definition of property or estate without elaboration. Prior provisions of the inheritance tax act explicitly equated residence with domicile.

Nonresidents are taxed on real property and tangible personal property having a situs in Pennsylvania in excess of unpaid property taxes and indebtedness which is liened, mortgaged or pledged at the applicable rates in effect at death (a "flat rate"). The person responsible for filing the return may elect to pay tax computed as if decedent was a resident and the entire estate had its situs in Pennsylvania, with tax due based upon the ratio the real and tangible personal property bears to the entire estate (the "proportionate method"). 72 P.S. § 9116(2).

Pennsylvania taxes certain transfers of real property or tangible personal property, such as transfers within a year of death in excess of \$3,000 per transferee and a retained life estate in such property. The nonresident return broadly requires listing all transfers of real property or tangible personal property located in Pennsylvania on Schedule G, whether using the flat rate or the proportionate method. The statute references taxation of certain transfers by a resident or nonresident to the extent made without valuable and adequate consideration with retained or reversionary interests. See 72. P. S. § 9107(c).

All nonresident returns must include an Affidavit of Domicile to support the contention the decedent was not domiciled in Pennsylvania on his or her date of death. It must be completed by an individual with personal knowledge of the facts, with preference for a surviving spouse or member of the decedent's family. The form requires the periods the decedent lived in Pennsylvania and in the five years preceding death the following:

- time spent in Pennsylvania;
- the decedent's residence, employment, and business activities;
- whether the decedent executed certain documents in which he or she is described as a resident of Pennsylvania;
- payment of tax on income or intangible property to another state, country or municipality; and
- to what regional office of the IRS the decedent forwarded his or her return.

The Affidavit of Domicile also requires information about the will, including probate in another state or if an administrator has been appointed; ownership in any interest in real property, including lease-holds, or tangible personal property in Pennsylvania; the estimated gross value of the estate excluding real property and tangible property located outside of Pennsylvania; ownership and registration of automobiles, the name and address of any church or other organization the decedent was a member of at the time of death; why the decedent owned real property in Pennsylvania; and any other information to support nonresident status.

Recent experiences with good (though not perfect) facts and a very thorough completion of the Affidavit of Domicile has resulted in little if any inquiry from the Department of Revenue.

### **No Pennsylvania Gift Tax**

Pennsylvania does not have a gift tax. However, as with nonresident decedents, Pennsylvania does tax certain transfers (though not limited to real or tangible personal property) by a resident decedent to the extent made without valuable and adequate consideration with retained or reversionary interests. While for federal gift tax purposes, annual exclusion gifts per donee are not subject to federal gift tax, Pennsylvania inheritance tax will be due for transfers of any property made by residents within a year of death in excess of \$3,000 per transferee. See 72. P. S. § 9107(c).

## **Trust Income Tax Treatment**

By way of background, Pennsylvania taxes resident individuals, estates and trusts on enumerated classes of income, including interest and dividends, net income or loss from the operation of a business, profession or farm, and net gain or loss from the sale, exchange or disposition of property. Nonresident individuals, estates and trusts are subject to income tax for the privilege of receiving the enumerated classes of income from sources within the Commonwealth. Few deductions apply and the rate of tax is a flat 3.07%.

The Pennsylvania Department of Revenue first looks to domicile to determine residency. The Pennsylvania Code (containing regulations and other documents) defines domicile in 61 Pa. Code § 101.1 as “The place which an individual intends to be his permanent home and to which he intends to return whenever he may be absent.” Pennsylvania does not recognize domiciliary status established by the laws of another state. Domicile does not change until the taxpayer abandons his or her old domicile and moves with the sincere intent of making a new, permanent home in the new state (or country).

If you are domiciled in Pennsylvania, you are considered a resident unless (i) you do not maintain a permanent abode in Pennsylvania for yourself or your family, (ii) you do maintain a permanent abode outside Pennsylvania for the entire taxable year, and (iii) you do not spend, in the aggregate, more than 30 days of the taxable year in Pennsylvania.

If you are not domiciled in Pennsylvania, you are considered a resident if you maintain a permanent abode in Pennsylvania and spend, in the aggregate, more than 183 days of the taxable year in Pennsylvania.

For “snowbirds” wintering in Florida (and others) with permanent abodes in two locations, Pennsylvania looks at which place the individual has the greatest connections for the taxable year, and which place the individual intends to be his or her domicile. The Pennsylvania Department of Revenue publishes a Personal Income Tax Guide which lists twenty-eight factors to consider regarding domicile. According to the Guide, the weight of all the answers determines the state of domicile.

A resident trust is defined in 72 P.S. § 7301 as (i) a trust created by the will of a decedent who was a Pennsylvania resident at the time of his death, and (ii) any trust created by, or consisting in whole or in part of property transferred to trust by a person who was a Pennsylvania resident at creation or transfer. A nonresident estate or trust is defined by exclusion, i.e. any estate or trust which is not a resident estate or trust. (Charitable trusts or pension or profit sharing trusts are specifically excluded from the definitions.)

Pennsylvania differs from federal law by not recognizing grantor trusts, other than a self-settled revocable trust, which must file a PA-41 Fiduciary Income Tax Return. If an IRC § 645 election is made for federal purposes, a separate PA-41 must be prepared on a calendar basis for each of the estate and the trust.

Pennsylvania has long sought to tax trusts with a resident settlor or testator as the “single controlling factor” as set forth in the regulations defining a resident trust. 61 Pa. Code § 101.1 Previously, the only exception the Department of Revenue would recognize was a change of situs approved by the court. Pennsylvania’s Uniform Trust Act authorizes a change of situs by qualified beneficiaries or a nonjudicial settlement agreement.

However, In McNeil v. Commonwealth, 67 A.3d 185 (Pa. Cmwlth. Ct. 2013) the Commonwealth Court of Pennsylvania held two inter vivos trusts created by a Pennsylvania resident, located in, administered in, and governed by the laws of Delaware were not subject to Pennsylvania personal income tax based upon the residence of the discretionary beneficiaries or the settlor’s residence at the time the trusts were created in 1959. The settlor had reserved no control or power over the trusts. The trusts had no Pennsylvania income or assets in 2007 when the Department of Revenue assessed income tax, interest and penalties. Commonwealth Court concluded the imposition of Pennsylvania income tax based upon the definition of a resident trust, stated above, violates the Commerce Clause of the U.S. Constitution because the trusts lacked substantial nexus with Pennsylvania, taxes were not fairly apportioned and taxing the trusts was not fairly related to the benefits conferred by the taxing jurisdiction. Further, the Court questioned the Commonwealth’s argument to tax based upon the residence of the beneficiaries by citing the Department of Revenue’s own regulation defining a resident trust which includes the statement, “The residence of the fiduciary and the beneficiaries of the trust shall be immaterial.”

Post McNeil, there has been no change to the Pennsylvania statute, but the instructions for the Pennsylvania fiduciary income tax return now provide under the definition for a Nonresident Trust, that “An inter vivos trust or a testamentary trust created by a resident can become a nonresident trust if the settlor is no longer a resident or is deceased, and the trust lacks sufficient contact with Pennsylvania to establish nexus.” Sufficient contact to remain (or requalify) as a resident trust would be any one of the following: a resident trustee; trust administration in Pennsylvania; trust assets which include real or tangible personal property located in Pennsylvania, or stock, securities or intangible personal property, evidenced by the documents, certificates or other instruments that are physically located, or have a business situs within Pennsylvania; or the situs of the trust is Pennsylvania under 20 PA. C.S. § 7708.

Further, Act 52 of 2013, now cited in the instructions for the fiduciary income tax return and effective for tax years beginning after December 31, 2013, requires resident trusts with Pennsylvania source income to withhold income tax from distributions for nonresident beneficiaries, and trusts which are nonresident trusts with Pennsylvania beneficiaries (without reference to Pennsylvania source income) to file a Pennsylvania fiduciary income tax return, along with a copy of the federal return (presumably to assist with determining what income is taxable for the Pennsylvania resident). There is a \$250 penalty for failure to file and a \$250 penalty for each of the beneficiary schedules. Setting aside contemplation of the legality, the difficulties of practical enforcement for nonresident trusts are obvious.

## **A Note About Recent Supreme Court Cases**

The Supreme Court in North Carolina Department of Revenue v. Kimberley Rice Kaestner 1992 Family Trust, 588 U.S. \_\_\_ (2019) held “The presence of in-state beneficiaries alone does not empower a State to tax trust income that has not been distributed to the beneficiaries where the beneficiaries have no right to demand that income and are uncertain to receive it.” The Court concluded the North Carolina taxation of undistributed income of the trust based solely on the residence of the beneficiary violated the Due Process clause of the Constitution.

The ruling specifically states it is limited to the circumstances of a beneficiary who has not received, has no right to demand, and no guarantee to receive a specific share of trust income.

As has been noted by a number of commentators, *Kaestner* does not provide much guidance in analyzing other state statutes.

In South Dakota v. Wayfair, 138 S. S. Ct. 2080 (2018) the Supreme Court reviewed a South Dakota law requiring out-of-state sellers to collect sales tax based upon sales, rather than imposition of a sales and use tax for sellers with a physical presence in the state. The Court determined the sales established a significant nexus to permit the imposition of the South Dakota tax.

*Wayfair*, of course, dealt with sales tax, but there has been speculation it may have an impact on the taxation of trusts.

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