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Sent: Friday, February 7, 2014 5:27 PM
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Transfers of Property Between Settlor and Grantor Trust Subject to New York Sales Tax

Citations: TSB-A-14(6)S; Petition No. S131007A

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The New York State Department of Taxation and Finance explained that when a settlor transfers property to a grantor trust or a revocable living trust in exchange for trust property, the transfer is subject to sales tax because an exchange has been made between two separate entities, even if there is no negotiation and the transfer is not supported by consideration.

Sales Tax
January 29, 2014

ADVISORY OPINION

The Department of Taxation and Finance received a Petition for an Advisory Opinion from *** name and address redacted ***. Petitioner requests guidance on whether the substitution of property between himself and the trust is subject to sales and use taxes in New York.

We conclude that the Petitioner and the trust are separate taxpayers capable of entering into a sale. Any substitution of property between the two entities would be a sale, because it would constitute a transfer of title or possession for consideration. Therefore, sales and use taxes are due on any substitution of property transferred between the Petitioner and the trust.

Facts

Petitioner (the "Settlor") created an irrevocable trust (the "Trust") pursuant to a trust agreement between the Trustees and the Settlor. The Settlor is deemed to own the Trust property for Federal and New York State income tax purposes, as provided in §§ 671-679 of the Internal Revenue Code (IRC). Under the terms of the Trust Agreement, the Settlor has the administrative right to reacquire trust property by substituting property of equivalent value at any time (the "Power to Reacquire"). The provision of the Trust Agreement creating the Settlor's Power to Reacquire reads as follows:

POWER TO REACQUIRE. Except as otherwise provided below, the Grantor, in an individual and nonfiduciary capacity, without the approval or consent of any person in a fiduciary capacity, shall have the power to reacquire property of the trust, other than shares of voting stock of a controlled corporation (within the meaning of section 2036(b) of the Code), whether owned directly or indirectly through one or more limited liability companies, partnerships or other entities, by substituting other property of an equivalent value; provided that the Independent Trustees are satisfied that the substituted property is of equivalent value. If no Independent Trustee is then serving, upon the exercise of this power by the Grantor, the Trustees shall appoint an Independent Trustee in accordance with subparagraph (C)(1) of Clause EIGHTH. Notwithstanding the foregoing, the Grantor may not exercise his power under this paragraph in such a manner that may shift benefits among the trust beneficiaries within the meaning of Revenue Ruling 2008-22 and Revenue Ruling 2011-28. The Grantor may at any time and from time to time release, in whole or in part, the powers retained by him under this Clause SEVENTH. Such release may be for a limited period or under stated conditions or indefinitely. Such release shall be made by an instrument in writing delivered to the Trustees

The Settlor in this case wishes to exercise the Power to Reacquire by substituting tangible personal property he owns (the "Substituted Property") for Trust property other than tangible personal property (the "Trust Property") having an equivalent value to the Substituted Property. He has requested guidance on whether this substitution is considered a sale subject to New York State sales and use taxes.

Analysis

When a Settlor establishes an irrevocable trust for another's benefit but retains non-fiduciary dominion and control, pursuant to IRC §§ 671-679, the Settlor has created an intentionally defective grantor trust. This trust is treated differently by different parts of the IRC. For the Estate tax the property is no longer considered to be part of the Settlor's estate. However, for the Personal Income Tax, income from the trust is considered part of the Settlor's income, because he retains non-fiduciary dominion and control over the income produced by the trust and can enter into transactions for his own benefit. The question presented in this case is how the trust should be treated for purposes of the sales and use tax in New York.

Section 1105(a) of the Tax Law imposes sales tax on the receipts from every retail sale of tangible personal property, unless otherwise exempt. Section 1101(a) of the Tax Law provides that the term "person" includes "an individual, partnership, limited liability company, society, association, joint stock company, corporation, estate, receiver, trustee, assignee, referee, and any other person acting in a fiduciary or representative capacity, whether appointed by a court or otherwise, and any combination of the foregoing." In addition, for sales tax purposes, a "sale" includes "[a]ny transfer of title or possession or both, exchange or barter, rental, lease or license to use or consume . . . conditional or otherwise, in any manner or by any means whatsoever for a consideration, or any agreement therefor. . . ." Tax Law § 1101(b)(5); see also 20 NYCRR § 526.7 (a), (b).

When an individual transfers title or possession of property to a trust, a transfer has been made to a separate entity. See TSB-A-99(22)S. This is true even in the case of a grantor trust or a revocable living trust. Id. If there is consideration given in any form in connection with the transfer, a retail sale of tangible personal property occurs and sales tax is imposed. Id. Even though such a transfer may be a non-event for income-tax purposes, it will still be a sale under the sales tax as long as it is made to a separate entity. See TSB-A-06(8)S.

Petitioner contends that the terms of the trust agreement do not allow the exchange between the Settlor and Trust to be supported by consideration. The Settlor alone, in a non-fiduciary capacity, decides whether to exercise the Power to Reacquire and what property will be substituted. The Trustee has no power to consent or agree to the substitution. Under these terms, the Petitioner contends there is no negotiation or bargaining between the parties and the exchange is not supported by consideration.

However, a transfer to a trust does not require negotiation to be supported by consideration. See TSB-A-99(22)S; see also 20 NYCRR 526.7(a)(3) (definition of sale includes involuntary transfer). As long as the individual receives something of value in the transfer, consideration is present. Id. Because Petitioner plans to transfer tangible personal property to the trust and receive other than tangible personal property of equivalent value from the trust in return, this transaction is a sale for sales tax purposes and, unless some other exemption applies, the sales tax will be imposed on the value of the property received in the exchange.

Sales tax is imposed on retail sales of tangible personal property. See Tax Law § 1105(a). A "retail sale" is defined, in part, as sale "for any purpose other than . . . resale as such. . . ." Tax Law § 1101(b)(4). Petitioner's initial purchase of the tangible personal property that is to be transferred to the trust may qualify for the resale exclusion if Petitioner intended at the time the property was purchased to transfer it to the trust for consideration. See *Matter of D.J.H. Construction v. Chu*, 145 AD2d 716 (3d Dep't 1988). However, to establish that he purchased the property for resale and thereby qualify the purchase for the resale exclusion, Petitioner must show that [the property] was purchased for one and only one purpose: resale." *Matter of the Petition of P.H. Fine Arts, Ltd*, Tax Appeals Tribunal, October 13, 1994, confirmed 227 AD2d 683 (3d Dep't 1996) (petitioner's purchase of artwork does not qualify for the resale exclusion because petitioner displayed the artwork before reselling it). Although not determinative, later activities may be relevant to ascertain Petitioner's intent at the time of sale. See *Matter of D.J.H. Construction*, supra.

DATED: January 29, 2014

Deborah R. Liebman
Deputy Counsel

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