

New Jersey Taxes Undistributed Charitable Remainder Trust Earnings

Executive Summary: New Jersey's Division of Taxation has issued a technical bulletin finding that resident New Jersey CRTs and certain nonresident CRTs are subject to New Jersey's gross income tax.

Editor's Note: In general for income tax purposes, a CRT is a resident of the state where the trustmaker resided at the time the trust was created. A nonresident trust, generally a trust that is not a resident of a state but which owns real property or a small business interest in the state, may be taxed on activity occurring within the state.

A charitable remainder trust (CRT) is exempt from Federal income tax under Internal Revenue Code (IRC) § 664. However, this Federal exemption does not necessarily translate into a *state* income tax exemption.

In June 2009, the New Jersey Division of Taxation issued a Technical Bulletin ([TB-64](#)) which states:

A Charitable Remainder Trust, in contrast to a charitable trust, has “non-charitable” beneficiaries and does not operate exclusively for charitable purposes. Accordingly, **a Charitable Remainder Trust is not an exclusively “charitable trust” exempt from New Jersey income tax under N.J.S.A. §54A:2-1 and income that is not distributed and which is not deemed to be permanently and irrevocably set aside or credited to a charitable beneficiary is taxable income to the trust.** [emphasis added]

While this is the first official pronouncement regarding the taxability of charitable remainder trusts by New Jersey, it is not the result of a change in New Jersey's income tax code, nor does it represent a change in the interpretation of New Jersey law by New Jersey's Division of Taxation. In short, this has probably been the law all along.

Resident CRTs

What does TB-64 mean for clients with New Jersey CRTs? First, a *resident* New Jersey CRT must file Form NJ-1041, *New Jersey Gross Income Tax Fiduciary Return*, each year. A trust is allowed a deduction for income distributed to its beneficiaries. However, if the trust earns more income than it distributes in a given calendar year, then the trust will more than likely have taxable income and be required to pay tax to the state of New Jersey.

Nonresident CRTs

A *nonresident* CRT must file Form NJ-1041NR for any year in which the trust has New Jersey activity. For example, if the trust receives rental income from real property situated in New Jersey, or sells real property situated in New Jersey. In addition, when a non-resident CRT sells real property situated in New Jersey, the trust must prepare and submit a [Nonresident Seller's Tax Declaration](#) (Declaration) and Form NJ-1040-ES *New*

Jersey Gross Income Tax Declaration of Estimated Tax-VOUCHER (a copy can be found at the bottom of the *Nonresident Seller's Tax Declaration*)

Example 1

Because pre-gift appreciation inherent in contributed property is generally not distributable to income beneficiaries, a New Jersey CRT (or nonresident CRT selling property situated in New Jersey) will generally not escape New Jersey's gross income tax on the sale of appreciated property transferred to the CRT. For example, Alan Smith, a New Jersey resident, owns stock valued at \$1,000,000 with an adjusted tax basis of \$150,000. Alan transfers this stock to a CRT and then sells the stock. For Federal income tax purposes, Alan's CRT will not pay any tax on the \$850,000 of capital gain realized upon sale of the stock. However, Alan's CRT will still report the \$850,000 of gain on Form NJ-1041 and, barring any available deductions, will pay \$67,229 (or approximately 7.9%) in tax.

Example 2

Assume the same facts as example 1, except that Alan is a resident of Florida (a state with no income tax) and the appreciated property is land situated in New Jersey. Under these facts, Alan's CRT must still file New Jersey Form NJ-1041 and will pay New Jersey's gross income tax on the gain from the sale of the property. In addition, Alan must prepare the Nonresident Seller's Tax Declaration (Declaration). Following the sale, the *buyer*, or the buyer's attorney, must submit the *seller's* Declaration, along with the *seller's* Form NJ-1040ES and the *seller's* estimated tax payment, to the county clerk at the time of recording the deed.