

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition	:	
of	:	
<b>THE AMAURIS TRUST</b>	:	
for Redetermination of a Deficiency or for Refund of New York State Personal Income Tax under Article 22 of the Tax Law for the Years 2001 through 2003.	:	DETERMINATION DTA NOS. 821369 AND 821497

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In the Matter of the Petition	:	
of	:	
<b>THE NIAVIUS TRUST</b>	:	
for Redetermination of a Deficiency or for Refund of New York State Personal Income Tax under Article 22 of the Tax Law for the Years 2002 and 2003.	:	

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Petitioner The Amauris Trust, f/k/a The Alexandra Peterffy Subchapter S Trust (the Amauris Trust), filed a petition for redetermination of a deficiency or for refund of New York State personal income tax under Article 22 of the Tax Law for the years 2001 through 2003.

Petitioner The Niavius Trust, f/k/a The William Peterffy Subchapter S Trust (the Niavius Trust), filed a petition for redetermination of a deficiency or for refund of New York State personal income tax under Article 22 of the Tax Law for the years 2002 and 2003.

On August 27, 2007 and September 20, 2007, respectively, the Amauris Trust and the Niavius Trust, by their representative, Withers Bergman LLP (Christopher R. Uzpen, Esq., of counsel) and the Division of Taxation, by Daniel Smirlock, Esq. (Barbara J. Russo, Esq., of

counsel), waived a hearing and agreed to submit this matter for determination based on documents and briefs submitted by January 25, 2008, which date began the six-month period for the issuance of this determination. After a review of the evidence and arguments presented, Brian L. Friedman, Administrative Law Judge, renders the following determination.

***ISSUES***

I. Whether the Division of Taxation (Division) properly determined that the Amauris Trust and Niavius Trust are taxable as New York resident trusts.

II. Whether imposition of New York State income tax on the income of the Amauris Trust and Niavius Trust violates the Due Process Clause and Commerce Clause of the U.S. Constitution.

III. Whether penalties imposed on the Amauris Trust and Niavius Trust should be abated.

***FINDINGS OF FACT***

On October 23, 2007, petitioners and the Division entered into a written stipulation of facts, the relevant portions of which are substantially incorporated into the following Findings of Fact.

In its brief, the Division submitted 38 proposed findings of fact, each of which has been incorporated into the following Findings of Fact with the exception of: proposed finding of fact 16, which is not supported by the record; proposed finding of fact 19, which is incomplete in that it omits the trustee's power to distribute Peterffy Trust property elsewhere pursuant to Article VII of the Peterffy Trust Indenture; and proposed findings of fact 37 and 38, which are not relevant in this proceeding.

1. The Thomas P. Peterffy Income Trust (the Peterffy Trust) was created on July 30, 1990.

2. The Amauris Trust, f/k/a The Alexandra Peterffy Subchapter S Trust, was created on July 30, 1990.

3. The Niavius Trust, f/k/a The William Peterffy Subchapter S Trust, was created on July 30, 1990.

4. Thomas Peterffy was the settlor of the Peterffy Trust, the Amauris Trust and the Niavius Trust.

5. Thomas Peterffy conveyed 445,363 shares of Class A common stock of Timber Hill, Inc., to the Peterffy Trust on July 30, 1990 on the terms provided in the Peterffy Trust.

6. At the time of the conveyance of the aforesaid stock to the Peterffy Trust, Thomas Peterffy was domiciled in New York State.

7. Since 1991, Thomas Peterffy has been domiciled in Connecticut.

8. The Peterffy Trust Indenture provides that the net income of the Peterffy Trust is payable at least annually to Thomas Peterffy during the continuance of the Peterffy Trust, until termination. Pursuant to section 2036 of the Internal Revenue Code of 1986, as amended, the Peterffy Trust is a grantor retained income trust which provides that the income is payable to the grantor during the term of the trust. The Peterffy Trust Indenture, in Article I (1) provides that any and all income accrued but not paid to Mr. Peterffy prior to the termination of the trust shall be paid, upon such termination, to Mr. Peterffy, absolutely, or if he is not then living, to the legal representative of his estate.

9. Article XIII of the Peterffy Trust Indenture provides that “[t]his Trust Indenture is irrevocable and the Grantor shall have no right whatsoever to alter, amend, revoke, or terminate the trust created hereunder, in whole or in part.”

10. Article VIII of the Peterffy Trust Indenture provides that “no powers enumerated herein or accorded to the Trustees generally pursuant to law shall be construed to enable the Grantor or the Trustees . . . to purchase, exchange, or otherwise deal with or dispose of the principal or income of the Trust Property for less than an adequate or full consideration in money or money’s worth, or to enable the Grantor to borrow the capital or income of the trust estate, directly or indirectly, without adequate interest and security.”

Article VIII also states that “[d]uring the term of this trust, the Grantor may, however, reacquire the Trust Property by substituting other property of an equivalent value.”

11. The Peterffy Trust Indenture provides that no principal of the Peterffy Trust is to be paid to the grantor, Thomas Peterffy, or the legal representative of his estate prior to termination.

12. The Peterffy Trust Indenture provides that the Peterffy Trust terminates on the tenth anniversary of the creation of the Peterffy Trust or upon Thomas Peterffy’s death, whichever occurs earlier.

13. The Peterffy Trust Indenture provides that if the Peterffy Trust terminates upon Thomas Peterffy’s death, the entire principal and income of the Peterffy Trust is to be distributed to Thomas Peterffy’s estate and would thereafter be distributed pursuant to the terms of his Last Will and Testament, if any, or the laws of intestacy of his state of domicile.

14. If such property was distributed to Mr. Peterffy’s estate, the property would be includible in his federal taxable estate and the taxable estate in his state of domicile at the time of his death.

15. The Peterffy Trust Indenture provides that if the Peterffy Trust terminates upon the ten year anniversary of the Trust’s creation, the entire principal of the Peterffy Trust, subject to the trustee’s power to distribute such property elsewhere pursuant to Article VII of the Peterffy Trust

Indenture, shall be divided into three equal shares to be distributed to the Amauris Trust, the Niavius Trust and the Danaus Trust (not a party to this proceeding), if then in existence.

16. The laws of the State of New York govern the Peterffy Trust.

17. The initial situs of administration of the Peterffy Trust was New York, and this situs could be moved with the consent of the trustee and the beneficiaries of the Peterffy Trust as provided therein.

18. Thomas Peterffy was still living on the tenth anniversary of the creation of the Peterffy Trust.

19. The Peterffy Trust terminated on July 30, 2000, the tenth anniversary of its creation.

20. Upon the termination of the Peterffy Trust, the principal of the Peterffy Trust was distributed pro rata to the named beneficiaries, specifically: the Amauris Trust, the Niavius Trust and the Danaus Trust.

21. At all times, the Peterffy Trust was a grantor trust under section 671 *et seq.* of the Internal Revenue Code of 1986, as amended.

22. All of the Peterffy Trust's taxable income was reported on Mr. Peterffy's personal federal income tax returns.

23. Since at least 1991, all of the Peterffy Trust's taxable income was reported on Mr. Peterffy's personal resident Connecticut income tax returns and the New York source portion was reported on Mr. Peterffy's personal nonresident New York State income tax returns.

24. Mr. Peterffy paid Connecticut, New York and federal income tax on the Peterffy Trust's taxable income as if the Trust did not exist.

25. The Amauris Trust is irrevocable and was an irrevocable trust when created in 1990.

26. The initial situs of the Amauris Trust property was New York and this situs could be moved with the consent of the trustee and beneficiaries of the Amauris Trust as provided therein.

27. Other than one dollar received from Thomas Peterffy upon the creation of the Amauris Trust on July 30, 1990, and the distribution received from the Peterffy Trust, as contingent beneficiary thereof, no other property was transferred to the Amauris Trust from the period of July 30, 1990 through the years at issue in this proceeding.

28. The trustee of the Amauris Trust was domiciled in Connecticut during the years at issue in this proceeding.

29. The Amauris Trust owned no property in New York State during the years at issue herein. The Amauris Trust was, however, allocated New York source income from a limited liability company indirectly owned by the Trust during the years at issue.

30. The Niavius Trust is irrevocable and was an irrevocable trust when created in 1990.

31. The initial situs of the Niavius Trust property was New York and this situs could be moved with the consent of the trustee and beneficiaries of the Niavius Trust as provided therein.

32. Other than one dollar received from Thomas Peterffy upon the creation of the Niavius Trust on July 30, 1990, and the distribution from the Peterffy Trust, as contingent beneficiary thereof, no other property was transferred to the Niavius Trust from the period of July 30, 1990 through the years at issue in this proceeding.

33. The trustee of the Niavius Trust was domiciled in Connecticut during the years at issue in this proceeding.

34. The Niavius Trust owned no property in New York State during the years at issue herein. The Niavius Trust was, however, allocated New York source income from a limited liability company indirectly owned by the Trust during the years at issue.

35. Thomas Peterffy filed a U.S. Gift Tax Return in 1990, following the creation of the Peterffy Trust, reporting gift tax due on the amount of the remainder interest gifted to the Amauris Trust, the Niavius Trust and the Danaus Trust. Due to the unified credit, no tax was required to be paid upon the filing of the return.

36. Thomas Peterffy's U.S. Gift Tax Return reported that the

[g]ift was of the remainder interest in The Thomas P. Peterffy Income Trust, a grantor retained income trust paying all income to the grantor, Thomas Peterffy, for a 10 year period. The remainder interest was gifted equally to three trusts for the children of the grantor, each dated July 30, 1990: The Alexandra Peterffy Subchapter S Trust [Amauris Trust], The Catherine Peterffy Subchapter S Trust, and The William Peterffy Subchapter S Trust [Niavius Trust]. The value of the remainder interest was determined to be 34.279% of the property placed in trust, in accordance with the attached calculation. The property placed in trust was 445,363 shares of Class A Common Stock of Timber Hill, Inc. valued at \$1,699,995 so that the value of the gift was \$582,741 (34.279% of \$1,699,995).

The gift tax return reports the transfer date of the remainder interest to the Amauris and Niavius Trusts as occurring in July 1990.

37. The Amauris Trust filed income tax returns with New York State as a nonresident trust for tax years 2001, 2002 and 2003 and paid tax on the portion of income from New York sources.

38. The Niavius Trust filed income tax returns with New York State as a nonresident trust for tax years 2002 and 2003 and paid tax on the portion of income from New York sources.

39. The Division conducted an audit of the trust returns for the Amauris Trust for tax years 2001, 2002 and 2003 and the Niavius Trust for tax years 2002 and 2003.

40. On July 17, 2006, the Division issued a Notice of Deficiency to the Amauris Trust (Notice No. L-027424837) asserting that the Amauris Trust owed additional tax in the amount of \$4,134,048.00, plus penalty and interest.

41. On October 5, 2006, the Division issued a Notice of Deficiency to the Niavius Trust (Notice No. L-027759028) asserting that the Niavius Trust owed additional tax in the amount of \$2,380,293.00, plus penalty and interest.

42. Subsequent to the issuance of the Notice of Deficiency, the Amauris Trust provided information which indicated that it had paid taxes to other states. Therefore, if it is determined that the Amauris Trust is a New York resident trust, the Amauris Trust will be entitled to a credit against its New York State income tax liability for taxes paid to another jurisdiction as follows: \$1,234,945.00 for 2001, \$792,717.00 for 2002 and \$862,883.00 for 2003.

43. Subsequent to the issuance of the Notice of Deficiency, the Niavius Trust provided information which indicated that it had paid taxes to other states. Therefore, if it is determined that the Niavius Trust is a New York resident trust, the Niavius Trust will be entitled to a credit against its New York State income tax liability for taxes paid to another jurisdiction as follows: \$792,717.00 for 2002 and \$862,888.00 for 2003.

44. If it is determined that the Amauris Trust and the Niavius Trust are New York nonresident trusts, no additional New York State income tax is due for the years at issue in this proceeding.

#### ***SUMMARY OF THE PARTIES' POSITIONS***

45. Petitioners assert the following:

a. While petitioners agree that under New York State Tax Law a trust is a New York resident trust if property was transferred to it by a New York domiciliary at a time when it was irrevocable or the trust became irrevocable when such person was a New York domiciliary, petitioners contend that the assets were conveyed to the Amauris Trust and Niavius Trust on

July 30, 2000, when Mr. Peterffy was no longer a New York domiciliary. Petitioners maintain that the transfers did not occur on July 30, 1990, the date on which the Division contends the transfers occurred, because no transfer occurs when the property is conveyed to a grantor trust (the Peterffy Trust) since there has been no change in ownership of the property for income tax purposes. Thomas Peterffy continued to own the property of the Peterffy Trust, for federal income tax purposes, until July 30, 2000, since he possessed a swap power (the power to reacquire the trust corpus by substituting other property of equivalent value) over the principal of the Peterffy Trust. The Amauris and Niavius Trusts did not possess or control any property or earn any income in 1990 and there was no certainty that any of the income or corpus of the Peterffy Trust would ever be paid over since there was a possibility that Thomas Peterffy would die prior to July 30, 2000 or that the trustee of the Peterffy Trust could exercise his discretion under Article VII of the Peterffy Trust Indenture to distribute the trust property elsewhere;

b. The Peterffy Trust was a grantor trust and, as such, was not capable of and did not own, receive or transfer any property for income tax purposes or recognize any income.

Therefore, there was no change in ownership, for income tax purposes, of the assets upon the creation of the Peterffy Trust. Mr. Peterffy continued to own the assets until July 30, 2000; he recognized income on the assets and paid income taxes thereon until July 30, 2000, when the Amauris Trust and the Niavius Trust became the owners and began filing federal, Connecticut and New York income tax returns;

c. The Peterffy Trust was revocable within the meaning of Tax Law § 605(b)(3)(C) until July 30, 2000 because it was subject to a power of reversion (to reversion title in the grantor) given its reversion to Mr. Peterffy's estate upon the event of his premature death, i.e., the trustee of the Peterffy Trust was required to pay the assets to Mr. Peterffy's estate if he died prior to

July 30, 2000. The Peterffy Trust became irrevocable only when the possibility that Mr. Peterffy would not live until July 30, 2000 lapsed;

d. Even assuming, arguendo, that the Amauris Trust and the Niavius Trust are New York resident trusts, by failing to limit income taxation of the trusts to their income from New York sources, New York is denying the trusts due process of law in accordance with the Fourteenth Amendment and the Commerce Clause of the U.S. Constitution. Existing U.S. Supreme Court and New York Court of Appeals precedents provide that New York may tax the income of the trusts only to the extent that such income is derived from New York sources.

(1) Mr. Peterffy's domicile at the time of the creation of the Peterffy Trust is an insufficient connection to satisfy the Due Process Clause;

(2) The Amauris Trust and the Niavius Trust are inter vivos trusts, not created by the probate of a Will of a New York domiciliary in the New York Surrogate's Court; therefore, there is no continuing connection with New York; and

(3) Imposition of tax on all of the trusts' income violates the Commerce Clause of the U.S. Constitution since New York provided no benefit to the trusts during the years at issue;

e. The Trusts engaged competent tax advisors to assist with the interpretation of New York Tax Law and significant Federal statutory, regulatory and case law exists to support the Trusts' conclusions. Moreover, the Danaus Trust (the third trust receiving a distribution from the Peterffy Trust) was also audited by the Division; the auditor concluded that the Danaus Trust was a nonresident trust and the audit supervisor determined that penalties should not have been imposed.

46. In response, the Division contends as follows:

a. On July 30, 1990, a contingent remainder interest consisting of 445,363 shares of Class A common stock of Timber Hill, Inc., was transferred to the Amauris and Niavius Trusts via the Peterffy Trust, an irrevocable trust, also created on July 30, 1990. The transfer of a contingent future interest is a transfer of property which creates a beneficial interest in the property to the contingent beneficiaries. Because this creation and transfer of a property interest occurred while Thomas Peterffy was domiciled in New York, this portion of the Amauris and Niavius Trusts is a New York resident trust;

b. The U.S. Gift Tax Return filed by Thomas Peterffy in 1990 evidences the fact that the transfers to the Amauris and Niavius Trusts occurred on July 30, 1990, when Mr. Peterffy was domiciled in New York. Pursuant to section 2512(a) of the Internal Revenue Code, the gift tax is imposed at the time of the transfer of the property. The U.S. Gift Tax Return reported gift tax due on the amount of the remainder interest gifted to the Amauris and Niavius Trusts and the return reported the transfer date as occurring in July 1990. Therefore, petitioners' argument that Thomas Peterffy retained ownership of the assets until July 30, 2000 is without merit;

c. The Peterffy Trust is irrevocable. While Thomas Peterffy retained an income interest during the term of the Peterffy Trust, he gave up dominion and control over the trust principal upon the execution of the Peterffy, Amauris and Niavius Trusts. The trustee, not Thomas Peterffy, held legal title to the shares of Timber Hill stock after July 30, 1990;

d. Tax Law § 605(b)(3)(D)(i) and 20 NYCRR 105.23(c) satisfy the requirements of due process since all that is required is some minimal connection between the taxpayer and the state and that the income sought to be taxed be rationally related to values connected with the state. Since a portion of the income and gains of the trusts is derived from or connected with New York sources, the required minimum connection to New York has been established;

e. The requirements of the Commerce Clause are also satisfied since the trusts were created by a New York domiciliary, the situs of administration of the trusts was New York and the trust instruments provide that the trusts are governed by the laws of the State of New York, thereby constituting substantial nexus to New York. In addition, the tax falls equally on the trusts and does not pass an unfair share of the tax burden onto interstate commerce; and

f. Petitioners' argument that they relied on competent tax advisors to assist with the interpretation of New York Tax Law is insufficient to establish reasonable cause for the abatement of penalties. Evidence as to an audit of the Danaus Trust is not part of the record in this matter and must, therefore, be disregarded.

### ***CONCLUSIONS OF LAW***

A. Tax Law § 601(c) imposes an income tax on resident trusts. Tax Law § 605(b)(3) provides, in relevant part, as follows:

Resident estate or trust. A resident estate or trust means:

(C) a trust, or portion of a trust, consisting of the property of:

(i) a person domiciled in this state at the time such property was transferred to the trust, if such trust or portion of a trust was then irrevocable, or if it was then revocable and has not subsequently become irrevocable; or

(ii) a person domiciled in this state at the time such trust, or portion of a trust, became irrevocable, if it was revocable when such property was transferred to the trust but has subsequently become irrevocable.

B. Tax Law § 605(b)(3)(D)(iii) defines irrevocable and revocable trusts as:

a trust or portion of a trust is revocable if it is subject to a power, exercisable immediately or at any future time, to revest title in the person whose property constitutes such trust or portion of a trust, and a trust or portion of a trust becomes irrevocable when the possibility that such power may be exercised has been terminated.

C. 20 NYCRR 105.23 provides, in part, as follows:

(c) The determination of whether a trust is a resident trust is not dependent on the location of the trustee or the corpus of the trust or the source of income; provided, however, no New York State personal income tax may be imposed on such trust if all of the following conditions are met:

(1) all the trustees are domiciled in a state other than New York State;

(2) the entire corpus of the trust, including real and tangible property is located outside of New York State; and

(3) all income and gains of the trust are derived or connected from sources outside of New York State, determined as if the trust were a nonresident.

(d) *Examples.* The following examples illustrate the provisions of this section.

\* \* \*

*Example 2:* Taxpayer C creates an irrevocable trust while such taxpayer is a domiciliary of New York State. Subsequent to the creation of such trust, C moves and becomes a domiciliary of California and transfers additional property to such irrevocable trust. The portion of such trust attributable to property transferred while C was a domiciliary of New York State is a New York State resident trust and the portion of such trust attributable to property transferred while C was a domiciliary of California is a New York State nonresident trust.

D. A reading of Tax Law § 605(b)(3)(C) reveals that in order to ascertain whether the Amauris Trust and the Niavius Trust are resident trusts for purposes of the imposition of New York State income tax, it is necessary to determine: (1) who transferred the property to the Amauris and Niavius Trusts; (2) what was the domicile of the person who transferred the property to these trusts; and (3) when was the property transferred to the trust.

E. Pursuant to Findings of Fact 25 and 30, the Amauris Trust and the Niavius Trust are irrevocable trusts and were irrevocable when created on July 30, 1990.<sup>1</sup> The settlor of the Amauris and Niavius Trusts, Mr. Peterffy, was a New York domiciliary on July 30, 1990 and remained a New York domiciliary until 1991, when he became domiciled in Connecticut. Accordingly, any portion of the Amauris and Niavius Trusts consisting of property transferred in 1990 is a New York resident trust.

Pursuant to Findings of Fact 27 and 31, it has been established that each of the trusts received \$1.00 from Thomas Peterffy upon their creation on July 30, 1990. Therefore, this portion of the trust is a New York resident trust because this was the property of a person domiciled in New York at the time of transfer to irrevocable trusts. In this matter, the issue to be determined is whether the balance of the trust assets, i.e., the shares of Class A common stock of Timber Hill, Inc., were transferred to the Amauris and Niavius Trusts at their creation, when the settlor, Thomas Peterffy, was a New York domiciliary, or upon the Peterffy Trust's termination on July 30, 2000, when Mr. Peterffy was a domiciliary of Connecticut.

F. Petitioners argue that the Timber Hill, Inc., stock portions of the Amauris and Niavius Trusts are not New York resident trusts because they were transferred on July 30, 2000 from a Connecticut domiciliary. Petitioners argue that this is true because the Peterffy Trust was a grantor trust under federal law (*see* Findings of Fact 8, 21). As such, Mr. Peterffy owned the property within the Peterffy Trust until it was transferred upon the trust's termination on July 30, 2000 (as opposed to making a transfer at the time of the trust's creation).

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<sup>1</sup>It must be noted that these findings of fact were established pursuant to a written stipulation of facts entered into between the parties on October 23, 2007.

G. Unlike the Amauris Trust and the Niavius Trust, which are irrevocable, nongrantor trusts, the Peterffy Trust is a revocable grantor trust under federal law (*see* Finding of Fact 8, 21). Tax Law § 618 provides that the New York taxable income of a resident estate or trust means its federal taxable income, as defined in the Internal Revenue Code (IRC), with certain modifications thereto. Therefore, it is appropriate to look to the IRC and its regulations for guidance in this matter.

H. Under federal law, subpart E of part 1 of subchapter J of the IRC sets forth the rules applicable to grantor trusts:

IRC § 673(a) provides that:

[t]he grantor shall be treated as the owner of any portion of a trust in which he has a reversionary interest in either the corpus or the income therefrom, if, as of the inception of that portion of the trust, the value of such interest exceeds 5 percent of the value of such portion.

IRC § 675(4) provides that the grantor shall be treated as the owner of any portion of a trust in respect of which:

[a] power of administration is exercisable in a nonfiduciary capacity by any person without the approval or consent of any person in a fiduciary capacity. For purposes of this paragraph, the term “power of administration” means any one or more of the following powers: . . . (C) a power to reacquire the trust corpus by substituting other property of an equivalent value.

As noted by petitioners, Article VIII of the Peterffy Trust Indenture provides that during the term of the trust, the Grantor (Thomas Peterffy) may reacquire the trust property by substituting other property of equivalent value (*see* Finding of Fact 10). Therefore, Mr. Peterffy continued to own the shares of Timber Hill stock during the trust period.

Additionally, IRC § 677(a)(2) provides:

**GENERAL RULE.** - The grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under section

674, whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be -

(1) distributed to the grantor or the grantor's spouse;

(2) held or accumulated for future distribution to the grantor or the grantor's spouse;

The Peterffy Trust's income, including capital gains, was either paid to Mr. Peterffy during its term or was accumulated for possible distribution to him if he died prematurely (*see* Finding of Fact 8). Therefore, Mr. Peterffy also owned the trust principal because all income, including accumulated income allocated to principal, could be distributed to him during the trust period.

I. Numerous revenue rulings from the Internal Revenue Service support petitioner's position that Mr. Peterffy owned the Timber Hill Stock until the transfer to the Amauris and Niavius Trusts on July 30, 2000. Rev Rul 79-84, 1979-1 CB 223, is particularly illustrative and provides, in relevant part, the following:

The applicable provisions of the Code are subpart E of part 1 of subchapter J (sections 671 - 679), relating to grantors and others treated as substantial owners of trusts.

Subpart E of the Code provides that if the grantor of a trust has certain powers over or interests in that trust, the grantor shall be considered the owner of that trust [hereinafter such trusts will be referred to as grantor trusts].

Section 676(a) of the Code provides that the grantor shall be treated as the owner of any portion of a trust if at any time the power to revest in the grantor title to that portion is exercisable by the grantor.

Section 677(a) of the Code provides that the grantor shall be treated as the owner of any portion of a trust whose income without the approval or consent of any adverse party, or in the discretion of the grantor or a non-adverse party, or both, may be distributed to the grantor.

\* \* \*

Rev Rul 77-402, 1977-2 CB 222, discusses whether gain or loss is recognized to a taxpayer upon the taxpayer's renunciation of powers over a trust. In that revenue ruling the taxpayer created a trust and retained powers of the kind described in subpart E of part 1 of subchapter J of the Code. The trust then purchased an interest in a partnership engaged in investing in real property. After deductible losses had flowed from the partnership through the trust to the taxpayer, the taxpayer renounced the above-described powers.

Rev Rul 77-402 concludes that because the taxpayer retained the above-described powers, the trust was a grantor trust for the period between the trust's creation and the taxpayer's renunciation. For that period the taxpayer is therefore considered the owner of the entire trust and thus the owner of all the trust property (including the partnership interest) for federal income tax purposes. Therefore, for that period the taxpayer rather than the trust is considered to have been the partner. After the taxpayer's renunciation, however, the taxpayer no longer held the above-described powers, and the trust no longer qualified as a grantor trust. The taxpayer thus was no longer the owner of the trust and trust property for federal income tax purposes. The Revenue Ruling concludes that the taxpayer is considered to have transferred the partnership interest to the trust at the time of the renunciation.

Under Rev Rul 77-402, if a grantor trust holds a partnership interest, for federal income tax purposes the grantor rather than the trust is considered the partner. Additionally, when the trust ceases to be a grantor trust, the partnership interest is deemed to be transferred from the grantor to the trust.

In *Estate of O'Connor v. Commissioner* (69 TC 165 [1977]), the Tax Court stated:

When a grantor or other person has certain powers in respect of trust property that are tantamount to dominion and control over such property, the Code "looks through" the trust form and deems such grantor or other person to be the owner of the trust property and attributes the trust income to such person. . . . By attributing such income directly to a grantor or other person, the Code, in effect, disregards the trust entity. (69 TC at 174.)

In the matter at issue herein, the grantor of the Peterffy Trust, Mr. Peterffy, reported the income of the trust on his federal, Connecticut, and New York tax returns for each and every year

from 1991 until such time as the Peterffy Trust terminated on July 30, 2000. On July 30, 2000, the Amauris Trust and Niavius Trust began filing returns and paying tax on the income resulting from their shares of the remainder interests (i.e., the shares of Timber Hill stock), which they received from the Peterffy Trust upon its termination.

J. The Division contends that, on July 30, 1990, Mr. Peterffy transferred contingent remainder interests of 445,363 shares of Class A common stock of Timber Hill, Inc., to the Amauris Trust and the Niavius Trust. The contingent remainder interests were transferred to the Amauris and Niavius Trusts via the Peterffy Trust, an irrevocable trust, which was also created on July 30, 1990.

The Division states that creation of these contingent remainder interests occurred in July 1990, when Thomas Peterffy was a New York domiciliary, and therefore, the remainder interest in the stock is a New York resident trust. In addition, the Division asserts that evidence that the transfers to the Amauris and Niavius Trusts occurred in July 1990, can be found in the fact that Thomas Peterffy filed a U.S. Gift Tax Return in 1990 reporting gift tax due on the amount of the remainder interest gifted to the Amauris Trust, the Niavius Trust and the Danaus Trust on July 30, 1990. A careful review of the applicable statutes, regulations and case law leads to the conclusion that the Division's position is without merit.

K. In its brief, the Division asserts that pursuant to the Estates, Powers and Trusts Law (EPTL) and certain cases cited therein, the creation of the contingent remainder interest in the Timber Hill stock in favor of the Amauris and Niavius Trusts "is clearly a transfer of property to the Amauris and Niavius Trusts." The Division points to EPTL 6-3.2(a)(2), which provides that a remainder is a future estate, created in favor of a person other than the creator, and to EPTL 6-5.1, which states, "[f]uture estates are descendible, devisable and alienable, in the same manner

as estates in possession.” What the Division omitted from its discussion are the provisions of EPTL 6-4.2 which states, “[a] future estate is an estate limited to commence in possession at a future time, either without the intervention of a precedent estate, or on the determination, by lapse of time or otherwise, of a precedent estate created at the same time.”

There is no dispute that the remainder interests to each petitioner were future estates. As noted above, such interests were “estate[s] limited to commence in possession at a future time,” to wit, upon the termination of the Peterffy Trust upon the tenth anniversary of its creation (July 30, 2000). The Peterffy Trust Indenture provided that if the trust terminated upon Thomas Peterffy’s death, the entire principal and income of the trust were to be distributed to Mr. Peterffy’s estate and then distributed pursuant to the terms of his Last Will and Testament, if any, or the laws of intestacy of the state of his domicile. Clearly, if Mr. Peterffy died at any time prior to the tenth anniversary of the Peterffy Trust’s creation (July 30, 2000), then the Amauris Trust and the Niavius Trust would have received nothing from the Peterffy Trust. Of course, neither would have had income tax liability for income received from its share of the Timber Hill stock because neither would ever have received possession thereof.

L. Much is made, by the Division, of the fact that Thomas Peterffy filed a U.S. Gift Tax Return in 1990, following the creation of the Peterffy Trust, reporting gift tax due on the amount of the remainder interest gifted to the Amauris, Niavius and Danaus Trusts. The gift tax return reported that the “[g]ift was of the remainder interest in The Thomas P. Peterffy Income Trust, a grantor retained income trust paying all income to the grantor, Thomas Peterffy, for a 10 year period.” The value of the remainder interest was determined to be 34.279% of the property placed in trust, which was the 445,363 shares of Class A common stock of Timber Hill, Inc., valued at \$1,699,995.00, so the value of the gift was \$582,741.00. The gift tax return reported

the transfer date of the remainder interest to the Amauris Trust and Niavius Trust as occurring in July 1990. The Division argues that this fact shows that the transfers to the Amauris and Niavius Trusts occurred on July 30, 1990, while Thomas Peterffy was domiciled in New York.

M. Treas Reg § 25.2503-1 states that: “The entire value of any gift of a future interest in property must be included in the total amount of gifts for the calendar period in which the gift is made.”

Treas Reg § 25.2503-3(a) provides, in relevant part, as follows:

No part of the value of a gift of a future interest may be excluded in determining the total amount of gifts made during the “calendar period” (as defined § 25.2502-1(c)(1)). “Future interest” is a legal term, and includes reversions, remainders, and other interests or estates, whether vested or contingent, and whether or not supported by a particular interest or estate, which are limited to commence in use, possession, or enjoyment at some future date or time.

Rev Rul 75-415, 1975-2 CB 374 explains the above regulation as follows:

A donee’s interest does not qualify as a present interest if the property or the income from the property is subject to restrictions that postpone the present use, possession or enjoyment thereof. Thus, if under the provisions of the instrument of transfer the donee’s present enjoyment of the transferred property or income therefrom is deferred for a period of time, subject to some contingency or subject to the will of some other person, the interest is not a present interest. (Citations omitted.)

Clearly, therefore, Thomas Peterffy was required to file a U.S. Gift Tax Return upon the creation of the contingent remainder interest (a future interest) in the Timber Hill stock in favor of the Amauris and Niavius Trusts in 1990. However, meeting this requirement does not evidence that “such property was transferred to the trust,” as required by Tax Law § 605(b)(3)(C). This is true because as of July 30, 1990, the Amauris Trust and Niavius Trust did not have and might never have the use, possession or enjoyment of the stock.

N. In this case, what the Amauris and Niavius Trusts were given was a contingent remainder interest in the Timber Hill stock, a future interest therein. Pursuant to the terms of the Peterffy Trust Indenture, there were a number of scenarios under which the Amauris and Niavius Trusts would never receive the use, possession or enjoyment of the Timber Hill stock. Article VIII of the Indenture permitted the Grantor (Mr. Peterffy) or the trustees to purchase, exchange or dispose of the stock as long as adequate or full consideration in money or money's worth was provided. Article VIII also permitted the Grantor to borrow the capital or income of the trust estate, directly or indirectly, with adequate interest and security provided by the Grantor and to reacquire the trust property by substituting other property of an equivalent value. If Thomas Peterffy died prior to the ten-year anniversary of the Peterffy Trust's creation, i.e., July 30, 2000, the entire principal and income of the Peterffy Trust would be distributed to Thomas Peterffy's estate and thereafter be distributed pursuant to the terms of his Last Will and Testament (or the laws of intestacy of his state of domicile). Article VII of the Peterffy Trust Indenture provided the Trustee with the power, subject to certain restrictions, to distribute or appoint the principal and income of the trust.

Therefore, it is clear that the Amauris and Niavius Trusts received a future interest in the principal (i.e., the Timber Hill, Inc., stock) of the Peterffy Trust, the possession of which could not and did not vest until the ten-year anniversary of the Peterffy Trust. Accordingly, since the transfers were not effectuated until July 30, 2000, the ten-year anniversary of the Peterffy Trust, the Amauris and Niavius Trusts could not properly be taxed as resident trusts by the State of New York because, pursuant to Tax Law § 605(b)(3), Thomas Peterffy was a Connecticut and not a New York domiciliary at the time the stock was transferred to these trusts. As such, since the

Timber Hill, Inc., stock was not transferred to the Amauris Trust and the Niavius Trust until July 30, 2000, at a time that the grantor of the Peterffy Trust was a Connecticut domiciliary, it is hereby determined that the Amauris Trust and the Niavius Trust were not resident trusts as defined by Tax Law § 605(b)(3)(C).

O. By virtue of the holding herein, Issues II and III are moot.

P. The petitions of The Amauris Trust and The Niavius Trust are granted and the notices of deficiency issued on July 17, 2006 to The Amauris Trust and on October 5, 2006 to The Niavius Trust are hereby canceled.

DATED: Troy, New York  
July 24, 2008

/s/ Brian L. Friedman  
ADMINISTRATIVE LAW JUDGE