



DUAL RESIDENT TRUST TAX CREDIT

EVALUATION SUMMARY | JULY 2022 | 2022-TE26

TAX TYPE	Income	REVENUE IMPACT (TAX YEAR 2018)	\$358,400
YEAR ENACTED	2006	NUMBER OF TAXPAYERS	55
REPEAL/EXPIRATION DATE	None		

KEY CONCLUSION: The credit is meeting its purpose to some extent because trust administrators and dual resident trusts in Colorado appear to be aware of it and are using it to partially offset the additional income tax burden they may face as residents of multiple states. However, relatively few taxpayers claimed the credit in recent years and the credit does not completely offset the additional taxes dual resident trusts may have in the state, which may discourage trusts from using a Colorado trust administrator.

WHAT DOES THE TAX EXPENDITURE DO?

The Dual Resident Trust Credit [Section 39-22-108.5, C.R.S.] allows a trust that is a resident of another state and became a resident of Colorado after May 25, 2006, and is subject to income taxes in both states, by virtue of dual residency, to claim a credit on their income tax. This income tax credit offsets the Colorado income tax liability for the portion of the trust income that is subject to income taxes in both states.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute does not explicitly state the purpose of this tax expenditure; therefore, we could not definitively determine the General Assembly's original intent. Based on our review of the bill's fiscal note, legislative history, and operation, we considered a potential purpose: to reduce the tax disincentive for trusts with residency in other states to use trust administrators located in Colorado. In general, trust administrators advise individuals to create trusts in states without income tax or with the lowest tax burden possible, so that the trust income can be maximized.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may want to consider amending statute to establish a statutory purpose and performance measures for the dual resident trust tax credit.



DUAL RESIDENT TRUST CREDIT

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

A trust is a legal instrument that holds real or personal property for the benefit of certain people or for a specified purpose. For example, a person might put money and other property into a trust for their children or grandchildren to benefit from after their death or once they reach a certain age. Many different terms are used to describe the different people and roles that can be involved in a trust. Below, we outline common trust terms and their definitions:

- Grantor, settlor, or trustor—the person, persons, or entity who set up a trust.
- Administrator, executor, or trustee—the person or entity who manages the assets in the trust.
- Beneficiary (beneficiaries)—the person or persons who receive beneficial enjoyment of the trust’s assets according to the trust’s provisions.

Unlike individuals, who may owe income tax in multiple states due to business dealings or income from work in multiple states, but can generally only be domiciled in one state at a time, trusts can have residency, and therefore owe income tax, in multiple states. Colorado determines trusts’ residency based on the location of the trust administrator. However, in other states, other characteristics—or a combination of factors—can classify a trust as a resident. Most states tax trusts based on the following factors: 1) residency of the trustor, 2) residency of the trustee or trust administrator, and 3) residency of the beneficiary. This inconsistency across states can cause trusts to be considered residents by multiple states. For example, a trust

administered in Colorado that has a beneficiary who is a resident of a state that bases trusts' residency on the residency of their beneficiaries could be considered a resident in both states.

The Dual Resident Trust Credit [Section 39-22-108.5, C.R.S.] allows a trust that is a resident of another state or states and becomes a Colorado resident and is, therefore, subject to income taxes in multiple states, by virtue of dual residency, to claim a credit on its income tax. This income tax credit offsets the Colorado income tax liability for a portion of the trust income that is subject to income taxes in both states. The credit is only available for trusts that became residents of Colorado after May 25, 2006.

This credit was created in 2006 by Senate Bill 06-211, and it has remained unchanged ever since. To take this credit, dual resident trusts must submit to the Department of Revenue (Department) their Colorado Fiduciary Income Tax Return (Form DR 0105), a copy of their tax return for the other state(s), and their Schedule G, Fiduciary Credit Schedule.

The credit amount is equal to the Colorado income tax imposed on the portion of the trust's income that is subject to tax in both Colorado and the other state, multiplied by a percentage equal to the other state's income tax rate for the income tax year, divided by the sum of the income tax rates of Colorado and the other state for the income tax year. The following illustrates the calculation:

Credit =	
	Colorado income tax imposed on the portion of the trust's income that is subject to tax in Colorado and another state.
x	Other state income tax rate for the income tax year.
÷	The sum of the income tax rates of Colorado and the other state for the income tax year.

For example, Trust A has a taxable income of \$100,000 that is taxable in both Colorado and another state. The tax in Colorado is \$4,550 (4.55 percent) and the tax in the other state, is \$6,400 (6.4 percent). The dual resident trust credit will be \$2,659 [$\$4,550 \times (6.4/10.95)$].

If the credit amount is computed using more than one other state, the percentage used is equal to the combined total of all the other states' income tax rates for the income tax year divided by the combined income tax rates of Colorado and the other states for the income tax year.

For example, Trust B has a taxable income of \$100,000 that is taxable in three states. The tax in Colorado is \$4,550 (4.55 percent), the tax in the first other state is \$5,000 (5 percent) and the tax in second other state is \$6,400 (6.4 percent). The dual resident tax credit will be \$3,252 [$\$4,550 \times (11.4/15.95)$].

Because the tax credit only reduces a portion of the trusts' liability in Colorado, to the extent that the trusts paid taxes in other states, trusts get a smaller credit than their tax liability in Colorado or in any other state and must still pay some income tax in Colorado.

WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statute does not specifically identify the intended beneficiaries of this expenditure. Based on the expenditure's statutory language, Colorado's tax structure, and stakeholder feedback, we inferred that the intended beneficiaries of this credit are primarily trusts with residency in other states that use a trust administrator in Colorado and are, therefore, liable for trust income tax in at least two states. This can happen, for example, because the beneficiaries live in another state but the trustor wants to use a trust company in Colorado or because the interested parties started a trust in another state, move to Colorado, and want their trust administration to be in Colorado as well. Trust companies in Colorado are also indirect beneficiaries since they are more likely to get trusts to move their administration from out of state if they do not have

to pay the full tax in Colorado as well as in the state where they originate.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute does not explicitly state the purpose of this tax expenditure; therefore, we could not definitively determine the General Assembly's original intent. Based on our review of the enacting bill's fiscal note, legislative history, and operation we considered a potential purpose: to reduce the tax disincentive for trusts with residency in other states to use trust administrators located in Colorado. Specifically, if a trustor moved the administration of a trust already established as a resident of another state to Colorado, the trust would be considered a resident of Colorado and potentially the other state as well, which could subject the trust to double taxation, increase the trust's overall tax burden, and discourage trusts from using Colorado trust companies as administrators. Therefore, the credit appears to have been intended to partially offset this additional tax burden.

IS THE TAX EXPENDITURE MEETING ITS PURPOSE AND WHAT PERFORMANCE MEASURES WERE USED TO MAKE THIS DETERMINATION?

We could not definitively determine whether the Dual Resident Trust Tax Credit is meeting its purpose because no purpose is provided for it in statute or in its enacting legislation. We determined that the tax expenditure is accomplishing the potential purpose we considered to conduct this evaluation to some extent since taxpayers are aware of it and using it as intended to reduce the amount of double taxation on trusts with residency in more than one state. However, because the credit does not completely offset Colorado income tax, some trusts continue to avoid using Colorado trust administrators.

Statute does not provide quantifiable performance measures for this credit; therefore, we created and applied the following performance measures to determine the extent to which the credit is meeting its potential purpose.

PERFORMANCE MEASURE 1: *To what extent are dual resident trusts in Colorado using the credit to reduce double taxation?*

RESULT: Based on data provided by the Department, 27 and 55 trusts claimed the credit in Tax Years 2016 and 2018, respectively. The Department did not have data available for Tax Year 2017. The stakeholders we contacted were aware of the credit and indicated that trusts are typically administered by trust administrators with expertise in the tax treatment of trusts across states and are likely to be aware of the credit. Furthermore, Department guidance and tax forms provide clear notice of the availability of the credit and instructions for how to calculate and claim it. Therefore, it appears that eligible trusts are likely to claim the credit. However, we did not identify adequate sources of data to reliably determine the total number of potentially eligible trusts. Therefore, we cannot determine what percentage of eligible trusts claimed the credit.

PERFORMANCE MEASURE 2: *To what extent has this tax credit helped reduce the disincentive for trusts to use Colorado trust administrators and, therefore, helped trust companies in the State?*

RESULT: Based on conversations with Colorado-based trust administration companies, we found that the credit likely helps reduce the disincentive trustors have for moving a trust to Colorado, although some dual resident trusts continue to avoid administration in Colorado in order to avoid the increased tax. One trust administrator in Colorado reported that without this tax credit they would not have any out-of-state business and, moreover, once this credit was implemented, Colorado trust companies could tell their potential customers that they would have an income tax increase, but also a credit for a portion of that increase. However, another trust administrator stated that since Colorado's credit does not completely offset Colorado income tax, as a fiduciary, they would generally recommend that a trust be administered in a state without income tax or remain in the state it is currently in if a trust faces double taxation by moving its administration to Colorado.

Further, the administrator indicated that it is not fiscally responsible to increase a trust's tax rate just so that a company in Colorado can administer the trust if the trust did not otherwise have to pay income tax in Colorado. Another trust company indicated that it maintains a separate branch in Wyoming, a state without any income tax, and often advises trusts considering moving their administration to Colorado to use this branch instead of the Colorado branch to avoid Colorado's income tax. Therefore, it appears that although the credit may encourage some trusts to use Colorado trust administrators, because the credit does not completely eliminate the potential for double taxation of trusts, some trusts continue to avoid administration in Colorado.

WHAT ARE THE ECONOMIC COSTS AND BENEFITS OF THE TAX EXPENDITURE?

Based on Department data, beneficiaries of the credit saved \$164,200 in Tax Year 2016 (about \$6,100 per taxpayer) and \$358,400 in Tax Year 2018 (about \$6,500 per taxpayer). The State incurred a direct revenue loss of the same amounts. However, the revenue impact to the State may be offset to the extent that the credit encourages trusts to be administered in Colorado when they would have otherwise used administrators in other states. This is the case since the credit reduces, but does not eliminate, beneficiaries' Colorado income tax liability.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

If this credit were eliminated, dual resident trusts currently benefitting from the credit would see an increase in their Colorado tax liability. Based on our review of Department data, trusts that took the credit during the 2018 tax year had an average Colorado taxable income of \$217,700 and a total Colorado tax liability of \$10,100, before applying the average \$6,500 credit. Thus, on average, the credit provides about a 65 percent reduction in Colorado income tax for dual resident trusts that would no longer be available if the credit was eliminated. This tax increase could cause some dual resident trusts to move their

administration out of Colorado and may act as a disincentive for trusts that are currently administered in other states from moving administration to Colorado. According to stakeholders, trusts and trust administrators are typically sensitive to states' tax treatment and usually attempt to establish residency in states with the most favorable tax treatment possible, while also meeting the needs of the trust. Therefore, Colorado trust administrators would likely see a decrease in business from dual resident trusts if the credit was eliminated.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

Of the 42 other states that impose income taxes, including the District of Columbia, 38 offer a credit for income taxes paid by a trust in another state. However, in most states, the credit for income taxes paid in another state is solely available to resident trusts, does not allow for trusts being dual residents, and does not offer any tax credit for dual residency. Only four other states offer a dual resident income tax credit, like the one in Colorado: Arizona, Indiana, Oregon, and Virginia.

ARE THERE OTHER TAX EXPENDITURES OR PROGRAMS WITH A SIMILAR PURPOSE AVAILABLE IN THE STATE?

The Credit for Taxes Paid to Other States [Section 39-22-108, C.R.S.] allows Colorado residents filing as individuals, estates, or trusts to claim a credit to offset their Colorado income tax liability in proportion to the amount of their income that was earned in and taxed in another state. Residents can claim the lesser of:

- The amount of tax paid in the other state(s); or
- A prorated share of the resident's income earned in the other state compared to the resident's Colorado income tax.

Although Colorado trusts are eligible for this credit, they cannot claim it in the same tax year in which they claim the Dual Resident Trust Credit.

WHAT DATA CONSTRAINTS IMPACTED OUR ABILITY TO EVALUATE THE TAX EXPENDITURE?

We did not identify any data constraints during our evaluation of the credit.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

THE GENERAL ASSEMBLY MAY WANT TO CONSIDER AMENDING STATUTE TO ESTABLISH A STATUTORY PURPOSE AND PERFORMANCE MEASURES FOR THE DUAL RESIDENT TRUST TAX CREDIT. As discussed, statute and the enacting legislation for the credit do not state the credit's purpose or provide performance measures for evaluating its effectiveness. Therefore, for the purposes of our evaluation, we considered a potential purpose for the credit: to reduce the tax disincentive for trusts with residency in other states to use trust administrators located in Colorado. We also developed performance measures to assess the extent to which it is meeting its potential purpose. However, the General Assembly may want to clarify its intent for the credit by providing a purpose statement and corresponding performance measure(s) in statute. This would eliminate potential uncertainty regarding the credit's purpose and allow our office to more definitively assess the extent to which the credit is accomplishing its intended goals.