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How ING Trusts Can Offset Adverse Effects of Tax Law: Part I

Completed gifts or not, their time has arrived

The Tax Cuts and Jobs Act (the Act) has radically changed income and estate taxation for many Americans, calling for new approaches to various aspects of planning for U.S. individuals. Although changes also were made to corporations that aren't so-called "pass-through" entities, such as S corporations, ultimately all changes made to taxpayers affect individuals.

Some of the most important changes directly affecting individuals are the doubling of the estate, gift and generation-skipping transfer (GST) tax exemptions to approximately $11 million per individual (and $22 million for a married couple); the increase in the standard deduction to $24,000 for married couples filing jointly and $12,000 for other individual taxpayers (but not estates and trusts); and the disallowance or limitations of many itemized deductions (other than for charitable contributions),[1] one of the most significant of which is the $10,000 per year deduction limit (for married couples, other individuals and estates and trusts) for non-business state and local income, sales and real estate taxes. Although the increase in exemption, the increase in the standard deduction and the disallowance or limitation of most itemized deductions all sunset after 2025, the changes suggest taxpayers reconsider income tax planning over the next eight years.

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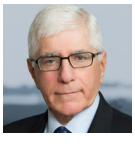

Here's how so-called "incomplete non-grantor trusts" (ING trusts), which aren't grantor trusts for income tax purposes and transfers to which aren't completed gifts for gift tax purposes, may be used to offset some of the adverse effects of the Act. In this article, we'll focus on grantor trust issues, while Part II will focus on gift tax and other issues.

Avoiding State and Local Income Tax

The tax burden for many individual taxpayers who owe state or state and local income taxes will increase because they'll get no or a reduced benefit from the deduction under Internal Revenue Code Section 164. A taxpayer will get no tax benefit if she (or a married couple filing jointly) uses the standard deduction. The taxpayer essentially will get no tax benefit to the extent she (or a married couple filing jointly) pays other taxes (such as real estate taxes), which are deductible subject to the $10,000 deduction limit. If an ING trust owned a portion of the settlor's home and paid that proportionate share of property taxes, it could qualify for up to a $10,000 property tax deduction as the ING trust would have its own $10,000 state and local tax (SALT) limitation.[2]

Note that the proposed regulations under IRC Section 199A (199A proposed regs) include restrictions on the use of multiple trusts and that they expressly state that the restrictions aren't limited to Section 199A only.[3] This may imply an intent of the Internal Revenue Service to attack the use of multiple non-grantor trusts in this regard.

Hence, avoiding SALT, which has always been important for many taxpayers, likely has become even more important to them after the Act. To avoid SALT, many taxpayers move to states where there are reduced or no such income taxes (for example, Alaska, Florida, Nevada, South Dakota, Texas, Washington

(state), Wyoming and, essentially, New Hampshire and Tennessee). Others change the type of income they receive, such as acquiring municipal bonds, the return on which is exempt from SALT.

Some have shifted income-producing assets to family members who are in lower or no effective state income tax brackets. But, shifting assets means they're legally lost to the former owner, and if the transfer is by gift (as it almost always is to be effective), then the former owner could face gift tax or the use of the lifetime gift tax exemption.

Other ING Benefits

The traditional application of the ING arrangement involved the transfer of appreciated property or property that was anticipated to produce taxable income or to appreciate significantly following the transfer, to the non-grantor trust. An example was an interest in a family business that, if properly packaged and marketed post transfer, could increase dramatically in value and then be disposed of in a taxable transaction, such as a sale. The goal was to remove that gain from the settlor's home state high income tax. While this planning benefit may remain and even be enhanced post-Act, the uses of ING trusts may have expanded considerably.

In the wake of the Act, other tax-advantaged uses of an ING trust might include:

- Maximizing IRC Section 199A deductions for qualified business income. This might be achieved if the settlor has taxable income above the Section 199A threshold amount ($157,500 for a single taxpayer; $315,000 for a married couple filing jointly). By transferring a portion of the equity to the ING, the non-grantor trust will have its own taxable income threshold with no phase-out or required use of W-2 income or depreciable property to determine the deduction amount. Thus, business interests could be transferred among several non-grantor trusts to maximize overall benefits. This benefit, however, will have to pass the multiple trust rules to succeed. The 199A proposed regs include IRC Section 643(f) proposed regs, which restrict the use of multiple trusts in this regard. However, it appears that the 199A proposed regs don't challenge this use of non-grantor trusts for this purpose if there's but one trust. Also, the provisions of the 199A proposed regs appear to exceed the scope of the statute and may not be held to be valid.[4]
- Removing passive non-source income from the reach of the grantor's home state taxation—for example, transferring to the trust low basis assets that are sold at a later date.
- Providing a vehicle to make charitable contribution deductions that won't be reduced or lost because of the use of the new high standard deduction.[5]
- Enhancing planning to minimize the net investment income tax by holding business interests in which the taxpayer isn't a material participant in a trust in which the trustee is a material participant.[6]
- In a matrimonial proceeding, exclusion of income from personal income tax returns that would otherwise be included.

> There seem to be constitutional limitations on the ability of a state to impose its income tax merely on the ground that the trust was created by an income tax resident of the state or that a beneficiary lived in the state.

Avoiding State Income Taxes

As indicated, an individual may be able to reduce state and local income taxes by transferring

income-producing assets to family members. However, that likely won't reduce taxes if the transfer is to her spouse or perhaps to a minor child.[7] Hence, some taxpayers transfer income-producing assets to trusts that aren't grantor trusts (the income, deductions and credits of which are attributed for income tax purposes to their grantors under IRC Section 671).

For example, an income tax resident of New York City and New York State, which impose, respectively, income taxes of 3.876 percent and 8.82 percent, may transfer property during her lifetime to a trust that's not a grantor trust so that the income avoids SALT, except to the extent a distribution of distributable net income defined in IRC Section 643(a) is made to a taxpayer who's otherwise subject to such taxes.[8] The basis on which a state may seek to impose its income tax on income of a non-grantor trust varies significantly from jurisdiction to jurisdiction.[9] There seem to be, however, constitutional limitations on the ability of a state to impose its income tax merely on the ground that the trust was created by an income tax resident of the state or that a beneficiary lived in the state. The latter position was contained in a North Carolina statute ruled unconstitutional in *Kimberley Rice Kaestner 1992 Family Trust v. North Carolina Department of Revenue* and in a Minnesota statute ruled unconstitutional in *Fielding v. Commissioner.*[10]

> The approval, disapproval and again approval of INGs by the IRS, coupled with the fact that a revenue ruling on INGs has never been issued, has some practitioners concerned about the viability of the ING technique.

Although creating a non-grantor trust can avoid SALT, there are at least two reasons why that hasn't been done widely:

- First, it's believed that neither the individual taxpayer who creates the trust nor her spouse may be a trust beneficiary, as if either is a trust beneficiary, the trust will be a grantor trust. The income will be attributed back to the individual taxpayer and, therefore, be subject to the state and local income taxes under the laws of most states, which would be imposed on the taxpayer if she'd directly earned the income. That's because almost all state and local jurisdictions impose their income taxes based essentially, but subject to exceptions and special rules, on the taxpayer's federal income—income attributed to the grantor under the grantor trust rules. Therefore, that income would continue to be taxed to the same state as would all other income reportable by the grantor.[11] Although excluding the grantor and the grantor's spouse as beneficiaries means a non-grantor trust may readily be created, many taxpayers don't want to lose access to the property transferred to a trust as well as the income the property thereafter produces. Access is more important than ever following the Act, as taxpayers endeavor to take advantage of the high temporary exemptions until the doubling of the transfer tax exemption sunsets in 2026, and they'll likely insist on access to assets transferred to use exemptions or not consummate transfers. This latter planning step will require modification of the traditional ING plan as discussed below.
- The second limitation is that it's generally perceived that any transfer of property to a non-grantor trust will be a completed gift for federal gift tax purposes resulting in the use of the taxpayer's lifetime gift tax exemption[12] and, to the extent the gift exceeds the available exemption, resulting in the payment of gift tax.[13] Many taxpayers wish to preserve their exemptions, especially if they anticipate receiving all or a portion of the gifted property back—making a gift of property and using an exemption and/or paying gift tax seems wasteful if the property is returned to the donor. Moreover, as a general rule, taxpayers wish to avoid paying gift tax even if it reduces overall wealth (that is, gift, estate and GST taxes).

Therefore, for many individuals, a more ideal result is to create a non-grantor trust so they can avoid paying SALT without making any taxable gift, while remaining eligible to receive the income of the trust. Of course,

that wouldn't advance the estate tax planning goal but is preferred by some ultra-high-net-worth taxpayers. And, that's been accomplished with the use of the traditional incomplete gift ING trust. However, in light of the current temporary exemptions, some taxpayers may be better served with a completed gift version.

ING Trusts

Beginning in the early 2000s, the Internal Revenue Service began issuing private letter rulings holding that the transfer of assets to a specifically designed trust wouldn't be a completed gift and the trust wouldn't be a grantor trust even though all the property could be returned to the grantor.[14] Although under IRC Section 6110(k)(3), these PLRs couldn't be cited or used as precedent, there were so many and they were so consistent that many practitioners created such arrangements for clients without PLRs. They called these trusts "Delaware incomplete non-grantor" (DING) trusts, although most of the PLRs were issued with respect to trusts governed by Alaska law. They're now generically known as "ING trusts," although sometimes called "NING trusts" if created under Nevada law, or "AKING trusts" if created under Alaska law, and so forth.

The structure of the trusts that were the subject of these PLRs was essentially the same. The trusts were irrevocable, and the trustee had authority to make distributions to any beneficiary during the grantor's lifetime only at the direction of a group of individuals, who were beneficiaries in addition to the grantor, called the "distribution committee" (Committee),[15] either by their unanimous direction or by the direction of the grantor and a member of the Committee. The grantor also retained a testamentary special (non-general) power of appointment (POA) and, in default of its effectual exercise, the trust remainder would pass to the grantor's descendants or, if not, to alternate remainder beneficiaries (for example, charitable organizations). Under this structure, the IRS consistently held that the transfer to the trust wasn't a completed gift, and the trust wasn't a grantor trust. For moderate wealth taxpayers, this provision may warrant re-examination post-Act.

Eventually, taxpayers began asking for a third ruling: that the individual beneficiaries who were members of the Committee and who held the power, in a non-fiduciary capacity, to require the trustee to make distributions, wouldn't be treated as making a gift for federal gift tax purposes by directing the trustee to make distributions to a beneficiary (for example, the grantor) other than themselves because the members of the Committee didn't hold general POAs described in Section 2514.[16]

Release 2007-127

On July 9, 2007, the IRS issued Release 2007-127 (the Release) in which the Chief Counsel of the IRS requested comments on whether the PLRs holding that no member of the Committees held general POAs were consistent with Revenue Ruling 76-503 and Rev. Rul. 77-158. Many professional organizations submitted comments, with the greatest number concluding that no member of a Committee held a general POA.[17]

> There seems to be no authority holding or commentary suggesting that a trustee's discretionary power to distribute principal or income to the transferor, with the consent of an adverse party, constitutes a reversionary interest under Section 673.

However, some practitioners viewed the Release as having signaled IRS displeasure with INGs, which was then reversed in later PLRs. The approval, disapproval and again approval of INGs by the IRS, coupled with the fact that a revenue ruling on INGs has never been issued, has some practitioners concerned about the viability of the ING technique. However, other practitioners feel that the unofficial implication of the many PLRs approving INGs both before and after the Release suggests that the ING technique is quite secure. Many practitioners also view the import of the Release and subsequent pronouncements as suggesting that the Release shouldn't be viewed negatively. To date, the IRS hasn't issued any

guidance on its position with respect to the issue raised in the Release. But, beginning in 2012, the IRS began again issuing PLRs addressing all three issues involving a somewhat different trust structure, which appears to obviate the issue addressed in the Release.[18]

Grantor Trust Issues

A trust, as indicated earlier, may be a grantor trust, causing the trust income to be attributed and therefore taxed to the grantor, for one of several reasons including if it's a foreign trust with a U.S. beneficiary as described in IRC Section 679,[19] when certain administrative powers described in IRC Section 675 are present or when certain borrowing of trust property has occurred within the meaning of Section 675(3). As a general rule, careful drafting of the trust document and administration of the trust may avoid these grantor trust rules.

> While the IRC is written in the singular, most of the post-2012 PLRs have the Committee functioning not in the singular but by majority rule when the settlor is acting or by unanimous consent when the settlor isn't acting.

However, other circumstances in which grantor trust status is sought to be avoided may be more difficult to find, such as when the grantor or the grantor's spouse holds certain powers over or has interests in the trust. For example, if the grantor (or the grantor's spouse) holds a reversionary interest in the trust described in IRC Section 673, it will be a grantor trust. Similarly, if the grantor (or the grantor's spouse) holds certain powers to control the beneficial enjoyment of trust property as described in IRC Section 674, it will be a grantor trust. Moreover, if income or corpus must or may be distributed to or for the grantor (or the grantor's spouse) as described in IRC Section 676 or IRC Section 677, it will be a grantor trust. Hence, for the trust not to be a grantor trust (one of the results sought in the PLRs), these provisions must be avoided.

IRC Section 672. It's appropriate to note that many of the powers or interests that would make a trust a grantor trust don't apply if these powers or interests are exercisable or enjoyable only with the consent of an adverse party. Section 672(a) uses a three-part test to define "adverse party" as any person having a: (1) substantial, (2) beneficial interest in the trust that would be, (3) adversely affected by the exercise or non-exercise of the power that he possesses respecting the trust. While the IRC is written in the singular, most of the post-2012 PLRs have the Committee functioning not in the singular but by majority rule when the settlor is acting or by unanimous consent when the settlor isn't acting. When use of a single person as the adverse party was included in a recent PLR request, the IRS wanted to decline to rule. While they agreed as a matter of law, they were concerned that trusts are being prepared in the singular when so many so-called adverse parties have a minimal interest. This is a drafting point as well as a cautionary point. The compromise to the submitted ruling request was to remove the descriptive paragraph from the ruling request but leave the use of a singular person as the adverse party in the trust itself.

The Treasury regulations interpret the three-part test in Section 672(a) as follows:

(1) Whether an interest is substantial and whether it's adverse are, in general, questions of fact[20] determined by the value of property subject to the power, which must be significant in relation to the total value of the property. Note that an independent trustee isn't adverse merely because it has fiduciary duties to other beneficiaries.[21]

(2) The test as to whether the purported adverse party has a beneficial interest can be met even if the person to be adverse is merely a discretionary beneficiary in the trust income and principal. Although a contingent remainderman might qualify,[22] there's risk in assuming that such a remainderman makes it all work.

(3) The requirement that the person be adversely affected requires that the exercise or non-exercise of the power could reduce the income or principal

to be received by the person to be viewed as adverse. The implications of this effect aren't always simple or obvious. Will the power affect the particular person's interest in the trust or just another beneficiary's interest?

The IRS apparently has concluded that, because the members of the Committee have absolute discretion to direct distributions from income and principal among themselves, the members of the Committee, at least in the aggregate, have a substantial interest in both the income and principal of the trust that would be adversely affected by any decision to accumulate income in the trust rather than distribute the income currently among the members.[23] Practitioners also might contemplate a plethora of members, some with minute interests. Because the question of whether an interest is substantial and adverse is one of fact, it isn't possible to conclude with complete certainty that the interest of any one member is necessarily adverse and, therefore, the concern of the IRS doesn't seem to be unreasonable. In any case, this determination by the IRS is critical to the conclusion that the trusts involved in the PLRs weren't grantor trusts.

Section 673. A trust is a grantor trust if the grantor (or the grantor's spouse) has a reversionary interest in the corpus or income of the trust that, at the trust's inception, has a value of more than 5 percent of the value of the corpus or income.[24] It doesn't seem that the grantor (or the grantor's spouse) has any reversionary interest in the type of trust that's been the subject of the PLRs. The trust agreement never provides for distributions by its trustee to the grantor; the grantor's testamentary POA can't be exercised in favor of the grantor, the grantor's estate or creditors or the creditors of the grantor's estate; and, to the extent the POA isn't effectually exercised, the trust property passes to other default takers that don't include the grantor or the grantor's estate. (Of course, the grantor could exercise the retained testamentary POA to direct for the trust assets to pass to the members of the Committee, his spouse or anyone else other than the grantor's creditors.)

Perhaps, more critical, a reversion under Section 673 apparently can arise only in situations involving a traditional reversion under property law. Under the traditional definition, a reversion arises when a person having a vested estate transfers a lesser vested estate to another. There seems to be no authority holding or commentary suggesting that a trustee's discretionary power to distribute principal or income to the transferor, with the consent of an adverse party, constitutes a reversionary interest under Section 673.

The IRS has acknowledged that "a reversionary interest is the interest a transferor has when less than his entire interest in property is transferred to a trust and which will become possessory at some future date."[25]

Similarly, in General Counsel Memorandum 36,410, when comparing a possibility of reverter under Section 676(a) with a reversion, the IRS defined a reversion as "the residue left in the grantor on determination of a particular estate" and stated that "the reversionary interest arises only when the transferor transfers an estate of lesser quantum than he owns." Although the IRC provides that the grantor's reversionary interest is determined assuming the maximum exercise of discretion in favor of the grantor, the trusts that are the subject of the ruling provide for alternative remainder beneficiaries so no portion of the trust may ever revert to the grantor or the grantor's estate.[26] As stated in a PLR, when the number of members constituting the Committee became too small, the corpus reverted to the grantor.[27] This PLR was revoked by a later PLR[28] that held that the reversion makes the trust a grantor trust under Section 673.

Hence, the IRS seems correct in concluding in the PLR that Section 673 doesn't apply to cause these trusts to be grantor trusts.

Section 674. Section 674(a) provides that a trust will

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be a grantor trust if the beneficial enjoyment of its corpus or the income is subject to a power of disposition, exercisable by the grantor or a non-adverse party, or both, without the approval or consent of any adverse party. The real scope of Section 674 is determined by the many exceptions it contains. Some powers of disposition may be held by anyone (including the grantor or the grantor's spouse) without causing the trust to be a grantor trust. Others may be held only by persons other than the grantor (or the grantor's spouse), and certain others may be held by persons who are neither related nor subordinate to the grantor if they're subservient to the wishes of the grantor without causing the trust to be a grantor trust. Parties who are related include a spouse, issue, sibling, parent or employee.[29]

Alaska, Delaware, Nevada and other states permit the grantor to hold both a lifetime and testamentary special POA without creditor attachment exposure, which seems critical to obtaining a favorable ruling.

As mentioned, the only powers retained by the grantor in the trust are:

- A power to appoint principal exercisable by will;
- A power to appoint income (accumulated with the consent of the Committee, the members of which are adverse parties) exercisable by will; and
- A non-fiduciary power to distribute principal limited by a reasonably definite standard.

Power to appoint corpus and accumulated income by will. Under Section 674(b)(3), a trust isn't a grantor trust merely because someone (including the grantor) holds a power exercisable only by will, other than a power in the grantor to appoint by will the income of the trust in which the income is accumulated for such disposition by the grantor, or may be so accumulated in the discretion of the grantor or a non-adverse party, or both, without the approval or consent of any adverse party. Under the trusts involved in the PLRs, the grantor has a testamentary POA not just over the original corpus of the trust but also over accumulated income.

However, as mentioned above, accumulation of income may occur under the trust only with the consent of the Committee (as the grantor may direct the distribution of trust property only with the consent of the Committee, which Committee the IRS concluded is an adverse party). Hence, accumulation of income may occur only with the consent of an adverse party. Therefore, the Section 674(b)(3) exception to the general rule of Section 674(a) applies and, as a result, the testamentary power doesn't trigger grantor trust status.

Power to distribute principal pursuant to a standard. Under Section 674(b)(5), a trust isn't a grantor trust merely because someone (including the grantor) holds a power to distribute corpus to or for a beneficiary or beneficiaries or to or for a class of beneficiaries (whether or not income beneficiaries) provided that the power is limited by a reasonably definite standard that's set forth in the trust instrument.[30] Such a standard is broader than the familiar ascertainable standard relating to health, education, maintenance and support (HEMS) commonly used to avoid the powerholder from being treated as holding a general POA under Section 2514 and IRC Section 2041 for gift and estate tax purposes.[31] In any case, a HEMS standard falls within the reasonably definite standard under Section 674(b)(3).[32] Hence, the retention of the power by the grantor to appoint the principal of the trust among the beneficiaries (other than the grantor) pursuant to a HEMS standard doesn't cause a trust to be a grantor trust.

Some powers trigger grantor trust status only if held in a non-fiduciary capacity.[33] Although it seems that the exception contained in Section 674(b)(5) applies whether the power to distribute is held in a fiduciary or non-fiduciary capacity, the reason the Section 674(b)(5) power in the post-Release PLRs is held in a non-fiduciary capacity relates to the incomplete gift aspect of the rulings.

Section 675. A swap power (a power to reacquire the trust corpus by substituting other property of an

equivalent value), the power to borrow without adequate security and other powers or activity described in Section 675 also must be avoided to achieve non-grantor trust status.

Sections 676 and 677. Section 676 provides for a trust to be a grantor trust when it provides for the possible return to the grantor of the corpus of a trust but only if not requiring the consent of an adverse party. (Exercise caution as to what powers are given to a trust protector, or other powerholder, under the trust instrument or applicable law that could result in a return of corpus to the grantor.) Section 677 triggers grantor trust status in a situation in which the income of a trust may be distributed to or used for the benefit of the grantor or accumulated for the grantor (or the grantor's spouse) but only if not requiring "the approval or consent of any adverse party."

Although under the terms of the trusts that are the subject of the earlier PLRs, all of the income and corpus may be returned to the grantor but only with the consent of at least one member of the Committee, the later PLRs require the consent of a majority of the members of the Committee with that of the grantor or the unanimous consent of the Committee without that of the grantor. Hence, the grantor's power to direct the distribution of income and principal to himself doesn't cause either Section 676 or 677 to apply because that may occur only with the consent of one or more adverse parties.

Importance of state law. As indicated earlier, it seems all of the pre-Release PLRs deal with trusts formed[34] under the laws of Alaska or Delaware. Since then, several PLRs have been issued with respect to trusts formed under the laws of Alaska, Nevada and South Dakota. Although not discussed in the PLRs, the laws of those states were used because, even though the assets in the trust could be distributed to the grantor, the governing law didn't permit creditors to attach the trust assets.[35] If the grantor's creditors could attach trust property in satisfaction of the grantor's debts, the trust would be characterized for income tax purposes as a grantor trust.[36] The remedy for a creditor in non-domestic asset protection trust (DAPT) states can be illustrated using the California statute as an example.[37] The trust may be held valid, but pursuant to the statute, the court can require the trustee to distribute to the creditor an amount equal to the maximum that the trustee could distribute to or for the benefit of the settlor. Thus, an argument can be made that the trust isn't self-settled or violative of California (or New York or New Jersey) laws or public policy because under the ING, the trustee can't make distributions to or for the benefit of the settlor (without the consent of an adverse party). The initial post-Release PLR dealt with a trust formed under the laws of Nevada. The laws in each of Alaska, Nevada, South Dakota and Wyoming, as well as several other states, permit individuals to create trusts that aren't subject to the claims of the creditors of the grantor, even if the grantor holds both a lifetime and a testamentary special POA.[38]

Alaska, Delaware, Nevada and other states permit the grantor to hold both a lifetime and testamentary special POA without creditor attachment exposure, which seems critical to obtaining a favorable ruling.[39] However, as we'll discuss in Part II, INGs to be formed for moderate wealth clients when the current gift tax exemption is so high may be structured as completed gifts, which would require the exclusion of the limited testamentary POA, which would cause estate tax inclusion under Sections 2036(a)(2) and 2038.

The need for creditors not to be able to reach ING assets for grantor trust status to be avoided has continued to evolve since the initial ING rulings were issued. From a positive perspective, about 17 states now permit self-settled trusts (assuming that an ING is even so characterized). However, there also have been a number of developments that some practitioners argue are adverse to self-settled trusts and may negate the efficacy of self-settled trusts.[40] Some commentators view the negative interpretations some have cast over self-settled trusts as overstated.[41] There's been no indication in any of the prior or recent ING rulings that a trust created by a taxpayer residing in a state that doesn't permit asset protection for self-settled trusts but created in a state that does, wouldn't be respected and treated as an effective ING. Nonetheless, cautious practitioners might wish to alert such clients to the possibility of these risks affecting the grantor trust income tax status and that the protection afforded by the ING plan could be jeopardized if the taxpayer resides in a state without self-settled trust legislation and if the ING is characterized as a self-settled trust. Some commentators believe that the aforementioned risk is overstated. The rationale for this latter position flows from the earlier comments that an ING trust should be disrespected in a

non-DAPT state because it's not violative of any public policy of such a state. The remedy for self-settled trusts shouldn't necessarily be applicable to an ING trust.

—A portion of this article is derived from Jonathan G. Blattmachr & William D. Lipkind, "Fundamentals of DING Type Trusts: No Gift Not a Grantor Trust," 26 Probate Property Report *1 (April 2014).*

Endnotes

1. In fact, the charitable deduction limitation for an individual was increased from 50 percent of the taxpayer's contribution base (basically, adjusted gross income (AGI)) to 60 percent but only for cash gifts to so-called "public charities." *See* Internal Revenue Code Section 170(b)(1)(G). This change is a permanent one. *See* Section 11023(b) of the Tax Cuts and Jobs Act (the Act).
2. For a more complete discussion, *see* Jonathan G. Blattmachr, Martin M. Shenkman and Mitchell M. Gans, "Use Trusts to Bypass Limit on State and Local Tax Deduction," 45 *Estate Planning* 3 (April 2018).
3. Proposed Treasury Regulations Section 1.643(f)-1.
4. *Cf. Stephenson Trust*, 81 T.C. 283 (1984).
5. *See generally* Jonathan G. Blattmachr, F. Ladson Boyle and Richard L. Fox, "Planning for Charitable Contributions by Estates and Trusts," 43 *Estate Planning* 3 (November 2016). The Act increases the charitable deduction limitation for individuals for cash gifts to public charities to 60 percent of the taxpayer's AGI (as specially computed). Nonetheless, there's no limitation on the charitable deduction for non-grantor trusts (except with respect to related business income). *See* IRC Section 642(c).
6. IRC Section 1411; *Mattie K. Carter Trust v. United States*, 256 F. Supp. 536 (N.D. Texas 2003).
7. *See* IRC Section 1(g).
8. Like many states, New York defines a "resident trust" as one created by a New Yorker and imposes its income tax on such resident trusts. *See* New York Tax Law Section 605. However, no tax is imposed if the trust has no New York trustee and no New York source income.
9. Under California law, for example, the state income tax is imposed if there's a California trustee or a California non-contingent beneficiary. *See* CA Rev. & Tax Code Section 17742. The tax residence of the grantor of the trust isn't a factor in determining whether California will seek to impose its income tax. New York has passed legislation that effectively ignores incomplete non-grantor (ING) trusts by providing that if the gift to a trust that isn't a grantor trust is incomplete, the trust will nonetheless be treated as a grantor trust for New York income tax purposes. New York Tax Law Section 612(b)(41). New York source income includes C corporations and other entities in which more than 50 percent of the fair market value of the assets is New York realty.
10. *See, e.g., Kimberley Rice Kaestner 1992 Family Trust v. North Carolina Department of Revenue*, No. 307PA15-2 (June 8, 2018); *Fielding v. Commissioner*, A17-1777 (Sup. Ct. July 28, 2018); *Neil Trusts v. Commonwealth of Pennsylvania*, 2013 Pa. Comm. LEXIS 168 (PA Commonwealth, May 24, 2013); *Linn v. Department of Revenue*, 2013 IL. App (4th) 121055 (Ill. App Ct. 4th Dist. 2013); *cf., however, Chase Manhattan Bank v. Gavin*, 249 Conn. 172 (1999).
11. *See, e.g.*, IRC Section 677.
12. *See* IRC Section 2505(b).
13. "The [Internal Revenue] Code states that if a donor 'transfers property by gift,' such donor will be liable for a gift tax. However, not all transfers of property are considered 'gifts' or, more appropriately, 'completed gifts.' This is important because only completed gifts are taxable gifts." Harry S. Margolis (ed.), *The Elder Law Portfolio Series* (Aspen Publishers 2007), Section 4-4. Of course, a taxpayer could make a gift of property to charity and avoid gift tax under the gift tax charitable deduction of IRC Section 2522, but that's usually not a reason to make a transfer to charity. A taxpayer also could transfer property to his spouse and avoid gift tax under the gift tax marital deduction of IRC Section 2523 if the spouse is a U.S. citizen but the income generated on the gifted property will be taxed to the spouse. If the transfer is to a marital deduction trust, at least the so-called "ordinary income" tax portion of the trust's income will be taxed back to the grantor under IRC Section 677, although the "principal income" portion (for example, capital gains) might not be if that portion of the income isn't available for distribution to the taxpayer or the spouse. Thus, the income portion could be a grantor trust portion and the principal portion a non-grantor portion.
14. *See, e.g.*, Private Letter Rulings 20024713 (Aug. 14, 2002), 200502014 (Sept. 17, 2004), 200612002 (Nov. 23, 2005), 200647001 (Aug. 7, 2006), 200715005 (Jan. 3, 2007) and 200731019 (May 1, 2007).
15. In some of the trusts, this committee was called the "Power of Appointment Committee." *See, e.g.*, PLR 200612002 (Nov. 23, 2005).
16. *See, e.g.*, PLR 200502014 (Sept. 17, 2004).
17. *See, e.g.*, letter dated Sept. 26, 2007, submitted on behalf of the American Bar Association Section of Real Property, Trust & Estate Law, *www.americanbar.org/content/dam/aba/publications/rpte_ereport/2007/october/comments_on_private_letter_rulings.authcheckdam.pdf* and letter dated Oct. 3, 2007, submitted on behalf of the Association of the Bar of the City of New York Estate and Gift Tax Committee, *www.nycbar.org/pdf/report/IR-2007-127.pdf.*
18. The first was PLR 201310002 (Nov. 7. 2012). *See also* PLRs 201310003 (Nov. 7, 2012) through 201310006 (Nov. 7, 2012) and PLRs 201410001 (Oct. 21, 2013) through 2014100010 (Oct. 21, 2013).
19. In each trust that's the subject of one of the PLRs, provisions essentially prohibit the trust from being a foreign trust and, to avoid Section 677(a)(3), prohibit using income of the trust to pay premiums on a policy insuring the life of the grantor or the grantor's spouse. Because no beneficiary may unilaterally withdraw all income or corpus from a trust, no trust could be a grantor trust with respect to a beneficiary under Section 678. *See generally* Jonathan G. Blattmachr, Mitchell M. Gans and Alvina H. Lo, "A Beneficiary as Trust Owner: Decoding Section 678," 35 *ACTEC Journal* 35 (Fall 2009).

20. This is discussed in detail in F. Ladson Boyle and Jonathan G. Blattmachr, *Blattmachr on Income Taxation of Estates and Trusts* (PLI 2014), at 4:2.4[A].
21. Treas. Regs. Section 1.672(a)-1(a).
22. Treas. Regs. Section 1.672(a)-1(a) and (d).
23. Although the current beneficiaries in each of the post-Release PLRs were also the default remainder beneficiaries of the trust, the grantor could appoint the remainder to others pursuant to his testamentary power of appointment.
24. Treas. Regs. Section 1.671-3(b)(3).
25. Technical Advice Memorandum (TAM) 8127004. As with a PLR, under IRC Section 6110(k)(3), a national office TAM may not be cited or used as precedent.
26. IRC Section 673(c).
27. PLR 201426014 (Feb. 24, 2014).
28. PLR 201642019 (June 20, 2016).
29. IRC Section 672(c).
30. Note that a power doesn't fall within the powers described in IRC Section 674(b)(5) if any person has a power to add to the beneficiary or beneficiaries or to a class of beneficiaries designated to receive the income or corpus, except when such action is to provide for after-born or after-adopted children.
31. *See* IRC Sections 2514(c)(1) and 2041(b)(1)(A).
32. Treas. Regs. Section 1.674(b)-1(b)(5)(i).
33. *See, e.g.*, IRC Section 675(4)(C). *Also see* Treas. Regs. Section 25.2511-2(c), second sentence, as a cautionary matter.
34. These trusts are commonly referred to as "AKINGs" or "DINGs," respectively.
35. *See, e.g.*, AS 34.40.110. *Also see* PLR 200944002 (July 15, 2009), discussed in detail in Gideon Rothschild, Douglas J. Blattmachr, Mitchell M. Gans and Jonathan G. Blattmachr, "IRS Rules that Self-Settled Alaska Trust Will Not Be In Grantor's Estate," 37 *Est. Plan.* 3 (January 2010).
36. *See* Revenue Ruling 54-516. It's at least arguable that an ING-type trust isn't subject to claims of creditors. Although the law in most states essentially provides that a trust a person creates or settles for himself (a so-called "self-settled trust") is permanently subject to the claims of the settlor's creditors (*see, e.g.*, NY EPTL 7-3.1 and *Restatement (Third) of the Law of Trusts* Section 60), it seems somewhat uncertain what constitutes a self-settled trust. For example, under New York EPTL 7-3.1, a self-settled trust is void with respect to creditors of the settlor. In *Herzog v. Commissioner*, 116 F.2d 591 (2d Cir. 1941) decided by what some view as America's greatest three-judge panel (Judge Learned Hand, Judge Augustus Hand and Judge Harrie B. Chase), the court held that the trust wasn't subject to the claims of creditors of the settlor because the trustee could distribute income and corpus to persons other than the settlor. Subsequent New York state case law suggests that *Herzog* was incorrectly decided. *See, e.g.*, *Vanderbilt Credit Corp. v. Chase Manhattan Bank*, 100 A.D.2d 544 (1984). Perhaps, even more important is that with an ING trust, the trustee isn't authorized to make distributions to the grantor but only individuals (the members of distribution committee) who are acting in an individual and not a fiduciary capacity.
37. Cal. Prob. Code Section 15304.
38. *See, e.g.*, AS 34.40.110(b)(2), as amended. Some states provide this protection only in limited circumstances. For example, in Arizona and Florida, the interest of a settlor in a trust created for his benefit from a lifetime qualified terminable interest property trust (*see* Section 2523(f)) isn't subject to the claims of the settlor's creditors. Asset protection is provided for self-settled trusts other than for certain retirement plans such as an individual retirement account. *See* David G. Shaftel (ed.), "Eleventh Annual ACTEC Comparison of the Domestic Asset Protection Trust Statutes Updated Through August 2017," *http://shaftellaw.com/docs/article-38.pdf*. It's at least arguable that an ING-type trust may be created under the law of any state because a self-settled trust (that is, a trust the assets of which may be attached by the creditors of the settlor) includes only one from which the trustee must or may distribute assets to the settlor. As explained earlier, the trustees of the trusts that were the subject of the PLRs didn't hold the power to distribute trust property to the grantor. The grantor couldn't distribute trust property to himself that would make it subject to the claims of his creditors under the law of virtually all states. However, some states continue to provide protection of the trust's assets when the grantor's power of revocation is held only with the consent of an adverse party. *See, e.g.*, AS 34.40.110(b)(2). Hence, the conclusion is that the trust should be formed under the law of a state that protects the trust assets from claims of the creditors of the grantor, although this technically may not be necessary even if the trust isn't formed in an asset protection state, of which there are now 17, including Alaska, Delaware and Nevada.
39. *See* AS 34.40.110(b)(2), as amended.
40. *Rush Univ. Med. Center v. Sessions*, 2012 IL (112906 2012); *Waldron v. Huber* (*In re Huber*), 493 BR 798 (Bankr. W.D. Wash. 2013); *Battley v. Mortensen* (*In re Mortensen*), 10 Alaska Bankr. 146 (Bankr. D. Alaska 2011). The Uniform Voidable Transfers Act at Section 4, Comment 8, makes mention that a transfer to a self-settled domestic asset protection trust (DAPT) is voidable if the transferor's home state doesn't have DAPT legislation. The Comment provides: "By contrast, if Debtor's principal residence is in jurisdiction Y, which also has enacted this Act but has no legislation validating such trusts, and if Debtor establishes such a trust under the law of X and transfers assets to it, then the result would be different. Under § 10 of this Act, the voidable transfer law of Y would apply to the transfer. If Y follows the historical interpretation referred to in Comment 2, the transfer would be voidable under § 4(a)(1) as in force in Y." Note that while there doesn't seem to be a uniform definition of "self-settled trust," *Restatement (Second) of Trusts*, Section 156(2) (1959) by providing in relevant part "[w]here a person creates for his own benefit, a trust for support or a discretionary trust, his transferee or creditors can reach the maximum amount which the trustee under the terms of the trust could pay to him or apply for his benefit" indicates that only if the trustee has the power to distribute property to the settlor will it be treated as self-settled.
41. Jonathan G. Blattmachr, Matthew Blattmachr, Martin M. Shenkman and Alan Gassman, "*Toni 1 Trust v. Wacker*—Reports of the Death of DAPTs for Non-DAPT Residents Is Exaggerated," *Asset Protection Planning Newsletter* #362 (March 19, 2018), *www.leimbergservices.com*.