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Heckerling 2015 Nuggets

Grantor Trusts, The Quest for Basis, and More!

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Some Thoughts on President Obama's Proposal, Clients and More

The New "Normal" Of Estate Planning

- The top 2/10ths of 1% of the wealthiest taxpayers will require extensive work. Consider the run-up in the stock market and the impact of that one change on wealthiest clients. What does this mean for practitioners?
- The old days of focusing planning on moving assets via gift/transfer to irrevocable trusts to remove appreciation from an estate are no longer sufficient. Basis step-up is too important and must be considered in all gift planning.
- For a zero basis asset it must appreciate more than 250% before the estate tax savings will offset the income tax result.
- 3% spending level living 20 years a $10M couple has a 27% chance of having an estate tax issue. But if spending 5% the likelihood of a tax is down to 3%.

President Obama's Proposal would Zap Step-Up

- The President referred to basis step up as "the single largest capital gains tax loophole."
- Subsequent to this year's institute, President Obama is proposing an elimination of the step up in basis at death (with exemptions and special rules for homes and tangible property).
- While it is unlikely that this will be enacted, that would completely revamp all planning, and eliminate many of the planning ideas discussed.
- He has also proposed raising capital gains tax rates which have declined over past decades, perhaps back to the 28% rate they had been. Hello CRTs. http://nyti.ms/1CILZhw .
- Might this lead to a repeal of the estate tax? Will capital gains have to be recognized at death?

Basis Step-Up is the New Discount

- Planners use to zealously seek discounts now they basis step-up is the new goal
- $12M estate use to be viewed as a large estate, and it would have faced a substantial estate tax. Now, however, the estate tax will be negligible, but the potential income tax impact much more dramatic.
- This makes the need to plan for basis step-up far more important for most estates than to plan for the reduction of estate tax.

Will Clients Tolerate New Complexity, Costs and Uncertainty

- It will be interesting to see how much cost and complexity clients under the federal estate exemption amount will tolerate for basis adjustment planning.
- Client's struggled to comprehend bypass trusts when they perceived a 50% estate tax cost.
- Now, they will have to understand different planning concepts, that for many will be more complex than the bypass trust, with a lower likely payoff.

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Miscellaneous Topics

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Miscellaneous Topics: The Perpetuities "Problem"

Perpetuities Puzzles

- Rule against perpetuities New York Times article illustrates how significant state law has become to practice.
- 28 states and Wash. DC have abolished by statute the rule against perpetuities that states that a trust cannot last forever.
- Arizona, Nevada, North Carolina, Tennessee and Wyoming. They have constitutional provisions prohibiting perpetuities but statutes permitting them. Are these viable or do they violate their state's constitutions.
- Be careful, because beneficiary of long term trust under NV law goes bankrupt, and bankruptcy court goes after it, can they get it?
- In a state that has constitutional prohibition against perpetuities like Texas, would Texas recognize a Delaware perpetual trust that was set up by Texan in Delaware?

Perpetuities Problem – What to Think and What to Do

- “Since when does an academic who writes an article mean anything?”
- “Several NV estate planning attorneys are looking to NV legislature to resolve this in favor of statute. Don't panic, let's see what they can accomplish.”
- Move to another jurisdiction. But if a trust is moved to a jurisdiction that does not face a perpetuities issue will that still saddle the trust with a shorter perpetuities period based on the failed statute in the former jurisdiction?
- If the trust has a perpetuities savings provision, it appears there is no adverse result except that the trust may not last for as long as the settlor initially hoped. If a long term duration would not be valid, then under the savings provision a traditional trust duration period (e.g., the standard lives in being plus 21 years term).

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Miscellaneous Topics: Do DAPTs Work

DAPT Considerations

- Delaware has permitted DAPTs since 1997. About 1/3rd to ½ of new Delaware trusts are some type of asset protection trust.
- Consensus is DAPTs work, but first pursue all reasonable estate planning steps (e.g., SLATs, QPRT, etc.). Exercise cautions: corroborate current issues, retain adequate assets outside plan structures; etc.

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Miscellaneous Topics: QTIP Division

QTIP Division

- PLR 201426016 illustrates interesting planning that might be useful in various circumstances.
- Surviving spouse was beneficiary of single QTIP trust. The QTIP was divided into three trusts. Trust 1 same terms; Trust 2 a unitrust paying 3-5% in lieu of income payment (perhaps as much as entire predecessaor QTIP paid in terms of income); and, Trust 3 same terms but it would be ended after division and distributed.
- Division was required because IRC Sec. 2519 provides if any portion of QTIP transferred during lifetime it is treated as a gift of entire interest.

QTIP and 2519 Partial Disclaimer

- Using an IRC Sec. 2519 disclaimer of the entire income interest in a QTIP to trigger a gift of the entire QTIP thereby using the DSUE. Under this plan the surviving spouse would have lost her entire income interest but perhaps been willing to do so as she remained a discretionary principal beneficiary of the QTIP after the income disclaimer. There is an interesting spin on this planning idea that would resonate better with every surviving spouse.
- This is a similar plan in that the spouse gifts an income interest in QTIP and trigger 2519 but you don’t give up whole income interest away, just a sufficient slice to trigger 2519. This works to capture the DSUE.
- You will have 2036 inclusion as you kept some income interest so it will all be included in the surviving spouse’s estate, but you will recapture the DSUE and will not have to worry about it be diverted elsewhere.

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Miscellaneous Topics: Divorce

Divorce

- In a divorce take out not only ex-spouse but family fiduciaries of the ex-spouse as well.
- If a child/heir divorces provide for the removal of their spouse and anyone related to that spouse.
- Grantor is deemed holding power of person who was spouse when trust created. IRC 673(e). Removing ex-spouse on divorce, i.e., through a divorce clause, ends grantor trust status. If not then the trust will continue to be a grantor trust with your ex-spouse as beneficiary. Ex-wife/Grantor could continue to have to pay tax on income earned by trust for benefit of ex-husband.

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Miscellaneous Topics: Trust Information

Trust Information/Reporting

- Who as the right to information about a trust and who should or must get information?
- If grantor creates trust for children can grantor still get information about trust? Perhaps not unless the trust instrument addresses it.
- Include clause that anyone with power to appoint or remove trustee, grantor and grantor's spouse, should have power to receive reports.
- The inclusion of a broader class of beneficiaries provides greater flexibility to pass income to lower bracket taxpayers. But it also puts all the people named in line to receive trust disclosures which may not be the client's intent. The growing use of non-reciprocal has implications to this as well. The issue as to what has to be disclosed under state law and the governing instrument is becoming more of a concern and will require more attention.

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Miscellaneous Topics: Trust Protectors

Are Trust Protectors Wily?

- SEC vs. Wyly was not a tax case but rather an SEC disgorgement case.
- In 1990s two brothers created an Isle of Mann trust and intended the trusts to be non-grantor trusts. They took this position, and did not report income on US tax returns. Advisers recommended not to make required SEC disclosures. They didn't.
- The SEC eventually considered these provisions and won a civil enforcement action against the brothers.
- The problem the SEC faced was that there were no investment profits so how could they punish the brothers?

Are Trust Protectors Wily?

- The court decided if the brothers had filed as required with the SEC the tax savings would not have occurred had they reported income properly. So the amount of tax savings was determined to be the amount of profits to be reached as a result of the SEC violation, and the amount to be disgorged.
- If similar facts came before the court in a tax case, as to whether a trust is a grantor trust or whether trust property should be included in the grantor's estate, it could be problematic.
- The basis for concluding that the trust was a grantor trust was the degree of control the grantors exercised over the trust decisions even though they had no legal right to do so.

Are Trust Protectors Wily?

- The trustees were required to take direction from trust protectors (the brother's attorney and 2 employees). The court viewed these protectors as agents for the grantors, and that there was therefore defacto control by them. This supported treatment as grantor trusts under IRC Sec. 674. All investment decisions were made by the brothers. This rationale might yield the same result under IRC Sec. 2036 as to control.
- In past we did not have to worry about the grantor's power in this type of instance based on the Byrum case. But the Wyly case casts doubt on this.
- Should be sure that clients are careful in how they make decisions.

Trust Protector Powers

- Powers to consider granting:
  - Power to make administrative changes to facilitate administration of the trust without changing beneficial interests.
  - Changes to address tax law changes.
  - Correct scrivener errors.
  - Power to change the name of the trust.
  - Prevent use of income to pay insurance premiums.

Trust (Non-Protectors) "Persons"

- Powers someone in a non-fiduciary capacity (generally not the protector) might hold:
  - Facilitate amending the trust in future.
  - Change distribution of assets among children.
  - Change terms of trusts for grandchildren.
  - Add charitable beneficiaries, example divert money via a power of appointment from a bad child to a charity.
- The potential liability exposure of holding a power to change beneficiaries this creates for the power holder could be substantial.
- Many (perhaps most) trust protectors will be acting in a fiduciary capacity, e.g., a person holding the power to replace a trustee. Some of the powers, such as adding a beneficiary, should be given to a different person who perhaps holds no other powers and expressly does not have to act in a fiduciary capacity.

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Miscellaneous Topics: NINGs and DINGs

NINGs and DINGs

- Delaware [Nevada] Incomplete Gift Trust (DING [NING]).
- Grantor retains a limited power of appointment so there is no completed gift into the trust so no gift tax exemption is used. All assets in trust will be treated as in estate and obtain a basis step-up.
- NINGs and DINGS appear to work as a state income tax plan. PLRs 201410001-201410010.
- New York no longer permits this technique for a New York resident. NY will treat the trust as a grantor trust for NY income tax purposes.

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Miscellaneous Topics: Business Opportunity

Business Opportunity

- Allocation of goodwill as between personal and corporate goodwill has long been an issue with significant income tax consequences, and based on recent cases potentially valuable estate planning consequences.
- It is common to plan for goodwill in corporate transactions. Sellers want to allocate some consideration to personal goodwill rather than corporate goodwill. This will create only one layer of tax, a capital gains tax, since the proceeds will be received directly by the shareholder not by the corporation. If in contrast it is the corporation’s goodwill being sold you have two layers of taxation.
- These issues can be relevant to the business succession and estate planning areas.

Boss Trucking Inc. v. Commr. TC Memo 2014-17

- Dad had trucking company. Regulatory issues arose. Three sons started their own business and used some equipment used in Dad's business and some of the same suppliers and customers.
- Dad was not involved in the new business started by sons. IRS said the creation of new business by sons was a distribution of goodwill by Boss Trucking to Dad, followed by a gift of goodwill by dad to the 3 sons.
- The Tax Court said that the IRS was not correct. The goodwill belonged to the Dad as a shareholder, not the corporation. There was never an employment agreement or non-compete agreement that would have formalized this. Tax Court also held that there was no gift by Dad to sons (or sons' business) because the new company had a different name, etc.

Business Opportunity Planning Ideas

- Does this suggest not having those documents in place? Or perhaps provide the opposite of a typical corporate opportunity clause by stating that there will be no such restrictions
- If transition business to younger generation have them form their own business and build their own relationships. As long as senior generation is not involved there may be no gift transfer. This might provide a gift tax free succession strategy.
- Case provide a framework to avoid transfer tax issues on the transfer of family business interests.
- If the senior family member's estate is below exemption it would be preferable to retain the business in the estate for basis step up since there will be no tax.

Business Opportunity Planning Ideas

- If the company would have a claim against the child for taking the corporate opportunity then it would be a taxable gift. So be careful with employment agreements and shareholders agreements not to provide for such a restriction.
- However, employment and other agreements may be useful to support compensation, etc.
- Consider the impact on other siblings and the intra-family issues of a child in the business securing investment opportunity and not sharing it with other siblings. In this context the opposite planning might make sense.
- Better plan - have new ventures started in an irrevocable trust outside any estate.

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Hunting Basis: Community Property

Community Property and Basis

- Community property has grown in importance in recent years.
- If one spouse dies owning property characterized as community property only ½ of the property is included in the gross estate, but all of the property receives a basis step-up.
- When a client from a non-community property state has community property you may wish to segregate that property to retain the community property status since it may then benefit from this double basis step up afforded to community property.

Community Property and Basis

- Generally, community property assets will remain “community property” unless that status is destroyed. Consider separating this property into a separate trust.
- If you instead the client has income from say a community property account deposited into one spouse’s separate bank account, that might taint the characterization of the entire property, not just the income so deposited, as non-community property.

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Hunting Basis: Alaska/Tennessee Community Property

AL/TN - Community Property and Basis

- Alaska and Tennessee statutes differ from other community property states.
- Everything you acquire is separate property unless you agree that it is community property. All community property states allow you to opt in for separate property, but in Alaska and Tennessee you have to opt in for any property to be covered.
- Both Alaska and Tennessee have provisions making this result available to assets held in a trust with situs in AL/TN state even though the grantors of the trust do not live in that state.

AL/TN - Community Property and Basis

- The situs of property held by a trust is usually the situs of the trust. You must have a trustee in Alaska (Tennessee). The trustee must have certain functions like preparing tax returns and maintaining records and have possession of some of the assets.
- Some commentators would want trustee to be in charge of all trustee functions to minimize the risks of an argument with the IRS over conflict of laws.
- Does this technique work? There are no cases on point. But the general rules on situs support this.

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Hunting Basis: JEST

JEST and Basis

- The JEST trust is an attempt made to get community property like treatment in a non-community property state.
- The JEST can minimize the problems of 1014(e). It is a means to get a basis step up on the first death if that spouse has insufficient assets.
- Married couple in common law state may be able to secure a basis step up on all trust assets.
- They fund a joint revocable trust in which each spouse owns an equal share.
- 1st to die spouse's assets in joint trust fund a Credit Shelter Trust-A and QTIP-A (all of which get a basis step up if 1014(e) does not apply).
- Surviving spouse's assets are used to fund a separate Credit Shelter Trust-B up to the exemption remaining from the 1st spouse to die (i.e., to fund any shortfall). Remaining assets of surviving spouse fund QTIP-B.
- All assets arguable get basis step up on 1st death since each spouse has a general power of appointment over other spouse's assets. The IRS has argued otherwise but commentators believe the IRS is incorrect.

JEST and Basis

- Risk – general power of appointment 1st to die spouse has over surviving spouse's assets may be viewed as a GPOA only exercisable in conjunction with surviving spouse = creator of the GPOA.
- Risk – IRS could argue step-transaction doctrine taints intended results, so that Credit Shelter Trust-B is included in surviving spouse's estate. Solution – have Credit Shelter Trust-B in a DAPT state.

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Hunting Basis: 1014(e)

IRC Sec. 1014(e) - Statute

- *(e) Appreciated property acquired by decedent by gift within 1 year of death …if— (A) appreciated property was acquired by the decedent by gift during the 1-year period ending on the date of the decedent's death, and (B) such property is acquired from the decedent by (or passes from the decedent to) the donor of such property (or the spouse of such donor), the basis of such property in the hands of such donor (or spouse) shall be the adjusted basis of such property in the hands of the decedent immediately before the death of the decedent.*

IRC Sec. 1014(e) - Considerations

- If H receives property from W within one year of death and she leaves it back to H, that property should get a carryover basis, not a step-up.
- This is not really an in "contemplation of death" concept, but rather based on a time frame -- within the one year time frame.
- Maximizing basis step up is a substantial consideration. If you can transfer property by gifting to a terminally ill spouse why not try it? First be certain that there are no creditors of that spouse, and that the transferor spouse will really get the assets back (not some other party).

IRC Sec. 1014(e) - Planning

- This may represent a significant new planning step for many clients with substantial late-in-life gifts. Perhaps the “old” approach of dividing assets to fund a bypass trust will give way to shifting appreciated assets to the older/sicker spouse.
- Might practitioners complete lien and judgment searches on a donee spouse before such large transfers to endeavor to identify possible issues the client might not be aware of?
- Consider who the agent is of the donee spouse’s durable power of attorney.

IRC Sec. 1014(e) – Planning Risks

- Even if the will provides for a bequest back from ill W to H what if W's children from a prior marriage are her named agents? Might her agents use a broad gift provision to transfer H's property to them before W's will can transfer assets back to H (or wherever agreed)? Perhaps W's children might just "help themselves" even without the authority of a broad gift provision in their favor under W's POA.
- What if H dies unexpectedly before W those asset that H transferred may pass to W's children instead if his.
- If the client is amendable to this type of planning steps should be taken now. To facilitate this type of planning broad spousal gift provisions should be included, when appropriate and agreeable, in client durable powers and revocable trusts.

IRC Sec. 1014(e)

- H gifts assets to W and W bequeaths assets with basis step up to someone other than H, e.g. the children. There is no issue under 1014(e). Directing bequests to a third party, not the transferor spouse, can be called "triangulation."
- The more difficult issue is what if the property is bequeathed to a trust in which the transferor spouse is a discretionary beneficiary? If it comes back to a trust of which the transferor/surviving spouse is a beneficiary, the basis step up should be disallowed to the extent of the transferor/spouse's proportionate interest in the trust. I
- If the transferor is a beneficiary pursuant to an ascertainable standard or income beneficiary that can be determined. If the H has an interest only as a discretionary beneficiary how can you evaluate this?

IRC Sec. 1014(e) – Hybrid Trust

- What about using triangulation with a bequest in the ill spouse's will to a trust to which the transferor spouse can be added.
- This mechanism is quite similar to the hybrid DAPT approach. A similar mechanism could be added here. The trust agreement provides that the trust protector or independent trustee can add additional beneficiaries, including the settlor.

IRC Sec. 1014(e) – Statute Limitations

- The time period after which the transferor spouse might be added is after the statute of limitations. But waiting until after the running of the estate tax statute of limitations has run may not be sufficient. It is an income tax issue, not an estate tax issue.
- Use the liquidation of assets following death to begin the tolling of the income tax statute of limitations.
- If the trust sells off all assets shortly after funding and buys new investment assets the gain will be triggered and the income tax statute of limitations will also toll.
- Will the statute run? What about the 25% rule? Could the IRS argue prearrangement and fraud to prevent tolling statute of limitations?

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Hunting Basis: Proving Basis

Proving Basis

- If the taxpayer provides some relevant information the IRS should agree to some basis. Burnett v. Houston 283 US 223.
- If sufficient information is provided the IRS cannot simply ignore it. Cohan v. Commr. 39 F. 2nd 540.
- If you believe you will have to go to court and you can provide information but the IRS is not being reasonable, use IRC Sec. 7491. Once you have done what this provision requires you may shift the tax burden of proof from the taxpayer to the IRS.

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Hunting Basis: Distribute Appreciated Assets out of Trust

Power to Distribute Appreciated Assets Out of Trust

- Give independent trustee or trust protector right to distribute assets out to surviving spouse so that they will be included in that spouse's estate and be stepped-up on his/her death.
- This is a relatively easy approach to use.
- Independent trustee merely distributes and included in surviving spouse's estate under IRC Sec. 2033.
- The difficult issue is who will do this? An institutional trustee will not be comfortable doing this. Whether or not an individual trustee or protector is willing to do so will be dependent on the family circumstances.

Power to Distribute Appreciated Assets Out of Trust

- You need to make sure that the trustee acts before the death of the surviving spouse.
- You have to verify that there are no creditor issues affecting the surviving spouse.
- The trustee will have to obtain the information as to exemption remaining in order to do this analysis.
- Accurate information as to the surviving spouse's health is essential to making a decision and this may be quite difficult.
- If surviving spouse transfers or bequeaths assets to unintended beneficiaries the trustee will be sued.
- What if assets increase substantially in value and create an unintended estate tax.

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Hunting Basis: Create GPOA to for Step-Up

Create GPOA for Step-Up

- Give an independent person the right to create a general power of appointment in favor of the surviving spouse to create estate inclusion.
- Instead of creating a GPOA from scratch consider granting a LPOA and permitting conversion to a GPOA.
- Be cautious that there are no other clauses in the instrument that will prevent this from occurring properly.
- This complex concept has to be explained to the client.
- The benefit of this is that it can function automatically.
- The problems with this are legion, the drafting and asset selection are both complex.

Create GPOA for Step-Up

- Might it be preferable for a person in a non-fiduciary capacity to take this action? If trust protectors will often, perhaps generally, be deemed to be acting in a fiduciary capacity, perhaps someone else should be given this power.
- You want to pick assets with lowest basis. But not assets that may not be sold for the foreseeable future. Selecting assets is quite complex.
- Parent/client may be adamant that the heirs will vacation in the family cottage forever. The heirs hate going there and will sell as soon as parent dies. The planners and the client may not know this.
- Must there be a real economic effect to the power independent of its tax reasons? Kurz v. Commr. 101 TC 44.

Create GPOA for Step-Up – State Trap

- Where the heir is domiciled will determine if there is a state estate tax as result of the general power of appointment.
- The use of powers of appointments in various forms has grown, and will continue to increase, in an effort to secure basis step-up. This comment points out just one of the myriad of unexpected, and perhaps uncontrollable issues that may confound such planning. Where might mom live in five years? If an elderly parent is given a general power and falls ill, might she move from a non-tax state to a decoupled state with a harsh tax system to be near a child? How can the family members giving an elderly parent or other relative general powers be monitored? What if several siblings grant an elderly parent a general power? How many siblings actually would share personal financial and estate planning information to coordinate this?

GPOA Plan for Mom

- Create a trust for parent, kids and grandchildren.
- Make a gift to that trust and then sell low basis assets to this trust. Give the parent a general power of appointment. If the parent has a very modest estate the inclusion in the parent's estate for a step up in basis.
- If parent doesn't exercise power of appointment pay off the note with now how basis asset. After parents death if the power wasn't exercised the grantor trust status as to the child/settlor does not change. Now the child/settlor can depreciate the asset again.
- 1014(e) should not apply since it was not a gift but a sale. If the client is not a beneficiary 1014)(e) should not apply at all.

Addressing GPOA - Safeguards

- A possible solution may be to make the parent/power-holder's exercise of the power subject to the consent of a non-adverse person. The person holding the consent power cannot have a substantial interest adverse to the exercise of the power in favor of the decedent, his or her estate, his or her creditors or the creditors of his or her estate. Treas. Reg. Sec. 20.2041-3(c)(2).
- What if the trust is a silent trust in a jurisdiction permitting such trusts? Would that negate the power?

GPOA Substantial Compliance Issues

- Goal is to avoid inadvertent non-exercise. Mom creates POA the exercise of which requires the power holder to make specific reference to the power.
- Many cases occur each year where the power holder gets close but not quite, e.g., they mention the wrong trust.
- At common law there was no notion of substantial compliance. So if Mom's will provides son can appoint property in his will by giving specific reference to that power then for sure he could not exercise by including a provision exercising it in his revocable trust. Nor could he do so without referencing to the power and specifically noting that it was created under the mother's will dated [date].
- An exception to the above is if there was a material purpose mother had in mind by the express or detail in the provision creating the POA.

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Hunting Basis: 754 Election

754 Election

- Obtaining a 754 basis adjustment may be essential to realizing the desired inside basis increase on assets held in a partnership/LLC.
- Securing that is not merely a matter of the appropriate election being made but may also require consent of a general partner of a limited partnership or manager of an LLC.
- Advise clients to address this issue now by confirming that partnership and operating agreements mandate the election when appropriate, or if not, negotiating that change now, before it becomes necessary.

754 Election

- Generally you would want to make the election to avoid disparity.
- The election can be complex and create significant accounting burdens. Must track basis for each type of assets. If have multiple deaths each will have their own 754 account. You will also need a separate account to track for regular tax and AMT tax purposes.

754 Election

- 754 adjusts only the inside basis. Outside basis was changed as a result of death or sale or exchange and was increased. Assets attributable solely to that partner are adjusted.
- When an estate funds a trust as part of distributions to beneficiaries does that create a second basis adjustment (the first being at death). IRC Sec. 761.Funding a pecuniary bequest should logically result in a step-up but does this result in another 754 election on funding a non-pecuniary bequest? . “It does not appear that anyone follows this.”

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Hunting Basis: Exchange Fund Technique

Exchange Fund Planning Technique

- Multi-owner exchange funds.
  - Use partnership structure to defer income tax and achieve economic goals.
    - Exchange funds formed by many clients contributing low basis marketable assets, and others contributing sufficient non-marketable assets to avoid triggering gain on formation. As a result all have created a diversified portfolio.
    - 7 year wait

Exchange Fund Planning Technique

- Enhance the exchange fund strategy to maximize basis.
- Partnership borrows and buys non-marketable real estate. More than 7 years old. Parent pulls out the real estate with 30% discount since it is a non-marketable interest. If parent had -0- basis in partnership (presumably as a result of initially contributing zero basis stock when the exchange fund was formed) the real property on distribution will also have a zero basis. When the parent later dies there is a basis step up in the real estate they hold.
- Where did the basis go to? To the remaining assets in the partnership. Basis gets allocated to low basis stock. Kids sell stock and pay off debt. They are left with diversified portfolio that has some basis.

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Hunting Basis: Swap Power

Swap Power

- Exercise swap power.
  - Get appraisal.
  - Consider a defined value mechanism.
  - Try to use cash if you can.
  - If no cash borrow from third party lender.
  - If trust doesn't have a swap power consider trustee and settlor entering a purchase and sale agreement and if it is a grantor trust the transaction will be income tax free.
  - If the trust is not a grantor trust perhaps it can be converted by decanting, judicial reformation, etc.

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Grantor Trusts

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Grantor Trusts: Planning Template

Portability and Grantor Trusts Planning Template

- Assume each spouse has $10M. H leaves $5M in a QTIP'able trust. Use a reverse QTIP for $5M to safeguard the GST exemption. Surviving spouse gets $5M outright and now has $15M (her original $10M plus the $5M that was inherited directly and not placed in the trust).
- W creates a $5M grantor trust shortly after H's death using H's DSUE. This is analogous to the bypass trust but is a grantor trust so more powerful.
- If W inherits DSUE and transfer it to a grantor trust that is beneficial because it can compound. Paying the income tax on a grantor trust is not a gift and income tax rates are higher so the benefits of a grantor trust are an incredible shifting tool. Rev. Rule 2004-64. The surviving spouse's may lose benefit unless a DAPT is used.

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Grantor Trusts: Note Sales

Sales to Grantor Trusts Generally

- Sale to grantor trust it is a non-event. Rev. Rul. 85-13.
- If grantor trust status terminates while grantor is alive and if debt is in excess of basis, this results in recognition of gain.
- The real issue is what happens on death and grantor trust status terminates on death? “There is not a good answer.”
- Death is not a recognition event. CCA 200937028.
- What about assets inside trust? What happens to their basis? Is it a receipt of property from a decedent under IRC Sec. 1014?
- Consider that for a non-resident alien you can get a basis step up with no quid-pro-quo.

Estate of Woelbing

- Note sale to grantor trust being challenged by IRS.
- Profitable company sells lip balm. Founder’s son sold $60M interest for a note to a grantor trust. Trust has seed assets in excess of 10% of the value of the note. There was also a guarantee.
- Donald died in 2009 and the note was still outstanding.
- IRS is arguing: 1) value of the shares transferred was $116M not $60M; 2) not a sale but a transfer to a trust with a retained interest and that was not a “qualified” retained interest so it was deemed a transfer of the entire interest; 3) value definition clause should be disregarded;4) valuation penalties; 5) shares included in gross estate.

Estate of Woelbing

- What can be done with similar transactions?
  - You should inform clients that IRS may attack such transactions.
  - You could use GRATs instead of note sales until the issue is resolved but many commentators do not believe that is necessary and the loss of GST benefits by using GRATs rather than note sale to dynastic trusts, is significant. While GRATs are safer sales to a grantor trust can be more effective.
  - You could use a note sale but structure the payments to conform to GRAT annuity payments. Not so simple.

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Grantor Trusts: Supercharged Credit Shelter Trust

Supercharged Credit Shelter Trust

- Goal – trying to have a credit shelter trust that is a grantor trust.
- Create an inter-vivos QTIP.
- Navigate the reciprocal trust doctrine. Each QTIP is included in the client's gross estate. These are not the reciprocal trusts like SLATs endeavoring to remove from the estate. This is in part because at the end you will only have one credit shelter trust under one QTIP.
- If H creates a QTIP for W. Make a reverse QTIP election and currently allocate GST exemption. This will leak the required income payment to H, but on a total return investment plan, this is not that big a deal.

Supercharged Credit Shelter Trust

- When H dies the exemption is allocated to the QTIP trust and it comes back to W as a credit shelter trust. QTIP regulations provide that if you set up a QTIP for spouse there should be no issues under IRC Sec. 2036 or 2038.
- IRC Sec. 2041 is a potential issue – creditor rights. This may be viewed as a self-settled trust because the transferor spouse, H, is also the beneficiary of the credit shelter trust under the QTIP formed for W.
- Florida and Arizona have specific legislation that provides if you have a QTIP for spouse and you become a beneficiary on spouse's death it is not deemed a self-settled trust. So this planning must be done in a DAPT state or a state that has legislation similar to Florida's or Arizona's.

Supercharged Credit Shelter Trust

- What is the opportunity for this? Because the beneficiary/surviving spouse funded the trust it will be a grantor trust.
- What is an issue with this strategy? The notion that this property was included in the spouse’s estate for estate tax purposes. Will this shift the grantor? The Regulations provide that unless there is a general power of appointment, and you exercise it, nothing has happened with the identity of the grantor.

Heckerling 2015 Nuggets

Grantor Trusts: QSST Path to Grantor Trust Nirvana

QSST'ing Your Way to Grantor Trust Status

- Existing old trust with boilerplate to permit investing in a Subchapter S, such as QSST language. If the older trust does not have these clauses it may be feasible to reform the trust to have this flexibility added.
- If a trust beneficiary makes a QSST election he is treated as the grantor just as if it were a grantor trust. IRC Sec. 1361(d)(1)(B) provides that for purposes of IRC Sec. 678(a) the beneficiary of a QSST will be treated as the owner of that portion of the trust which consists of stock in an S corporation for which the IRC Sec. 1361(d)(2) election is made.

QSST'ing Your Way to Grantor Trust Status

- If sell into a grantor trust there is no capital gains. It is unclear whether sell into the QSST you can you avoid capital gains consequences.
- What if the trust is testamentary? The trustee of a credit shelter trust forms QSST after death. Note that this should not raise an IRC Sec. 2036 issue if sell non-voting stock. Rev. Rul. 81-15.
- Simulating a credit shelter trust but you don't have the problems with DSUE/DAPT plan since the trust can be both a creditor protected trust, and a GST trust.

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Conclusion

Conclusions

- Basis step up and grantor trusts are the hot items.
- Planning to achieve basis step-up for the vast majority of taxpayers will provide less tax benefit, cost more and be more complex: portability, bypass trust, DSUE planning, etc.
- For taxpayers subject to federal estate tax planning to minimize both estate and capital gains tax will be even more complex: exchange funds, partnership basis planning; swap powers and more.
- Modern trust drafting continues to present more flexibility and options but remains subject to significant uncertainty: NV, DAPT, protector and other issues abound.