



# Planning with Grantor Trusts

SLEPC- November 15, 2018

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**BAKER BOTTS**



# You Gotta Have an Intro

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- **Super outline, but no time**
  - My focus is estate tax planning
  - Nothing on foreign/international
- **Plan to skip around**
  - Quickly cover basics (some but not all)
  - More time on good, bad, and ugly
- **Start on page 1**
  - History from *Clifford* to IDGTs
  - Priority guidance plan
- **Go to page 39**

# Benefits of Grantor Trusts

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- **Rev. Rul. 2004-64**
  - This ruling totally rocks
  - Classic IDGT assumed by IRS
  - No gift by grantor when income tax paid
- **Rev. Rul. 85-13**
  - Really opened the door
  - Look how old it is now (30+ years)
  - Indirect borrowing, so §675(3)
  - Grantor = Maker = Owner
- **Go back to page 2**

# General Principles - §671

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- **Exclusive rules for tax to grantor**
- **Defined terms in the §671 regulations**
  - "Income" v. "ordinary income"
  - "Grantor" and "gratuitous transfer"
- **Ownership of portions**
  - We want 100%
  - Example regarding power of substitution
- **Methods of reporting**
- **Go to page 10**

# Definitions and Rules - §672

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- **Adverse party**
  - Substantial = not insignificant
  - Trustee not adverse per se
- **Related or subordinate party**
  - Only non-adverse
  - Presumed subservient for §674 and §675
- **Grantor holds power or interest of spouse**
  - Spouse never adverse
  - Other specific provisions
- **Go to page 14**

# Reversionary Interests - §673

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- **Changed approach in 1986**
  - 10-year rule became 5% rule
  - Regulations are a mess
- **Let's skip ahead...to page 15**

# Powers over Beneficial Enjoyment - §674

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- **A huge pain (10 pages in outline)**
  - Long list of exceptions, and their exceptions
  - Can trigger by accident
- **General rule**
  - Power of disposition by grantor or non-adverse party
  - Without consent of adverse party
- **Exceptions for powers held by...**
  - Anyone (6 pages in outline)
  - Independent trustees
  - Anyone other than grantor or spouse
- **Go to page 25**

# Administrative Powers - §675

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- **Power to borrow without adequate security**
  - Grantor or non-adverse party can enable
  - Useful as a trigger? §2036 risk? Need a "turn off"
- **Actual borrowing**
  - Rev. Rul. 85-13
  - Toggle opportunity, but to what end?
- **Power of substitution**
  - Non-fiduciary capacity
  - Reacquire (see "grantor" and "gratuitous transfer")
  - Rev. Rul. 2008-22
- **Go to page 30**



# Power to Revoke - §676

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- **Power to "revest...title"**
- **By grantor or non-adverse party**
- **Without consent of adverse party**
- **Includes power to revoke, terminate, alter, amend, or appoint**
- **Let's move on...to page 31**

# Income for Grantor or Spouse - §677

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- **Income without approval of adverse party is or, in discretion of grantor, spouse, or non-adverse party, may be**
  - Distributed to grantor or spouse
  - Held for future distribution to grantor or spouse
  - Applied to life insurance on either life
- **Rules apply only during marriage?**
  - Spousal attribution rule - §672(e)
  - Repeal of §682
- **SLATs: better know this cold**
- **Go to page 36**

# Person Other Than Grantor - §678

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- ***Mallinckrodt* powers**
  - Power to vest in self
  - Released power that triggers §§671-677
- **Exception if grantor is taxable**
- **Testamentary and inter vivos trusts**
- ***Crummey* trusts, BDITs, and BDOTs**
- **Or, is it a Crummy BDIT?**
- **Skip to page 41**

# Which Powers to Use for IDGTs?

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- **Is one power enough?**
- **Power of substitution**
  - Rev. Rul. 2008-22
  - Easy to draft; easy to release
- **Power to enable borrowing without security?**
- **Power to add beneficiaries?**
- **Go to page 42**

# Toggling

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- **Must be able to turn off grantor status**
- **But can we turn it back on?**
  - Borrow from the trust (like Rev. Rul. 85-13) – to what end?
  - Trust protector who enables unsecured borrowing – §2036?
  - Someone else with substitution power v. “reacquire”
  - Decanting
- **Be aware of “transactions of interest”**
- **Go to page 43**

# Income Tax when Toggle Off

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- **During lifetime, deemed sale/exchange**
- **At death?**
  - See articles referenced in the outline
  - IRD or not IRD
  - Carryover basis
  - Deemed sale basis (immediately before/after)
  - §1014(a) stepped up basis
- **Go to page 49**

# Tax Reimbursement Clauses

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- **Rev. Rul. 2004-64**
- **Three scenarios**
  - No reimbursement = no §2036
  - Mandatory reimbursement = yes §2036
  - Discretionary = unclear but not per se §2036
- **Too cute by half?**

# Other Topics of Interest

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- **Community property and two grantors**
- **Recent challenges to IDGT sales**
- **BDITs and BDOTs**
- **SLATs**
- **Spousal attribution rule and divorce (page 50)**



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