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What to do for Tax Estate Planning Now?!?

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Current Status

- Estate, Gift and GST Exemption at \$11.7 million per person with portability
- Current estate tax rate is 40%
- Step up basis at death
- Current discounts allowed at gifting
- Portability increases flexibility



Bernie Sanders – 99.5% Act

- **Reduce estate tax exemption to \$3.5 million**
- **Reduce gift tax exemption to \$1 million**
- **Estate tax rate is 45% over \$3.5 million, increases to 50% over \$10 million and increases to 65% over \$1 billion.**
- **Limit of \$30k per donor per year for gifts to irrevocable trusts or of interests in “flow-through entities”**
- **Portability remains**
- **Increases the special use (farmland) valuation for 2032A from \$1.19 million to \$3 million and indexing to inflation.**

Bernie Sanders – 99.5% Act

- **Remove step up in basis for grantor trusts that are not included in the estate of the grantor.**
- **Attempts to remove most valuation discounts for transfers of minority interest of business assets for estate and gift tax purposes.**
- **Establishes minimum term for a great of 10 years and a max of 10 years plus the life expectancy of the annuitant.**
- **The remainder interest of a GRAT is not allowed to be less than the greater of 25% of the value of the assets transferred to the trust or \$500,000, and not more than the fair market value of the property in the trust.**
- **Grantor trusts are included in the estate of the grantor.**
- **Purports to raise more than \$429 billion**

How should we plan?

- First, figure out the size of the estate.
- Second, determine if tax planning needs to occur. Income or estate tax planning?
- Third, determine the lengths of estate planning that are needed. Can simple steps be taken?
- Four, look out for the complicated approaches that may provide some benefit long term.

General Estate Planning

- Assume worst case scenario- both spouses die (or individual dies)
 - Value all assets
 - Include payouts of life insurance and retirement accounts
 - Determine total amounts
- What's the cutoff?
 - Propose \$10 million
 - Why?
 - Assumptions about exemptions - negotiations will occur
 - Looks like republicans may retake some seats next year

General Estate Planning - Part 2

- Business Planning
 - If you have a business that will grow exponentially in the future, consider a trust transfer. Sooner rather than later...
 - Consider using trusts early to remove assets from a growing estate.
 - Estate tax exemption most likely gets smaller
- Age Matters
 - I don't necessarily use a revocable trust on a young couple, but the reasons continue to increase as the couple ages.
 - Planning for other caretaker through the use of a trust
 - Probate avoidance in another state

Non-Tax Planning



Non-Tax Planning

- Make sure to have the basics
 - Last Will and Testament
 - Powers of Attorney
 - Trusts for Minor Children
 - Living Will
- Ensure planning for all non-tax issues
 - Plan for minor children
 - Specials needs
 - Trusts for irresponsible beneficiaries
 - Potential conservatorship



Community Property Trusts

Community Property Trusts

- Community Property Trusts, allowed by legislation enacted in 2010, allow for a step-up in basis in community property trust assets at the death of the first spouse to die.
- This type of trust makes sense for retired couples who are in a low-risk environment.

Community Property Trusts

- Requirements of a Tenn. Comm. Prop. Trust - (Tenn. Code Ann. 35-17-103)
 - (1) Expressly declares that the trust is a Tennessee community property trust;
 - (2) Has at least one (1) trustee who is a qualified trustee whose powers include, or are limited to, maintaining records for the trust on an exclusive or a nonexclusive basis and preparing or arranging for the preparation of, on an exclusive or a nonexclusive basis, any income tax returns that must be filed by the trust. Both spouses or either spouse may be a trustee;
 - (3) Is signed by both spouses; and
 - (4) Contains the following language in capital letters at the beginning of the trust:

THE CONSEQUENCES OF THIS TRUST MAY BE VERY EXTENSIVE, INCLUDING, BUT NOT LIMITED TO, YOUR RIGHTS WITH YOUR SPOUSE BOTH DURING THE COURSE OF YOUR MARRIAGE AND AT THE TIME OF A DIVORCE. ACCORDINGLY, THIS AGREEMENT SHOULD ONLY BE SIGNED AFTER CAREFUL CONSIDERATION. IF YOU HAVE ANY QUESTIONS ABOUT THIS AGREEMENT, YOU SHOULD SEEK COMPETENT ADVICE.



Tax Planning

Tax Planning Wills

Tax Planning Wills

- Generally, we see this as funding a family trust to the greatest extent of the estate tax exemption (currently \$11.7 million).
- The remaining assets fund a marital trust that qualifies for the marital deduction and provides that no tax is paid on the first spouse's death.
 - Generally, since the marital trust will be included in the surviving spouse's estate, the marital trust should be spent down while the family trust continues to grow free from estate tax.
- We add flexibility by using a Clayton QTIP Trust in which the assets all transfer to a qualifying marital trust with a tax professional making an election to fund a family trust. This added flexibility helps make the best decision at time of death rather than simply relying on a funding formula.
- Current benefit of the tax planning wills is the growth of the family trust.

Transferring to Tax Trusts

Life Insurance Trusts

- Step 1 - Move Life Insurance into Life Insurance Trust.
 - This is one of the most efficient transfers from a cost/benefit analysis.
 - Can instantly move an asset outside of the taxable estate and save at least 40% of the life insurance benefit
 - Careful - there is a 3 year lookback rule unless you transfer the existing life insurance appropriately.
 - Make sure you either transfer the policy appropriately or get a new policy.
 - Don't forget crummey letters...

Intentionally Defective Grantor Trusts



Defective Trusts

- These are fun! They are generally referred to as intentionally defective grantor trusts and are used as an estate “freeze” technique.
- The general structure is a taxpayer creates an irrevocable trust that for tax purposes is taxed as a “grantor trust.”
- Simply, a grantor trust is a trust under which the grantor of the trust is taxed on the income of the trust, but the assets in the trust, if the trust is structured correctly, are not included in the grantor’s taxable estate.
- However, the value of the asset transferred to the IDGT (usually captured in the value of the promissory note) is included in the taxpayer’s taxable estate at the value transferred to the IDGT and not at the actual value of the asset in the IDGT upon the taxpayer’s death. Hence, it “freezes” the asset value for estate tax purposes

- Grantor trusts have to be carefully considered, as they may be the best option but they also have some burdens that could become onerous.
- Grantor trusts are most often used in the sale context (like a IDGT mentioned previously) or in a wealth shifting technique.
- The premise of a grantor trust is that the grantor is treated as the owner for INCOME tax purposes without the grantor necessarily being treated as the owner for estate tax purposes. Often, that allows the assets in the trust to grow without the burden of the tax to reduce the value of the trust.

What Grantor Trusts Are Used For

Defective Trusts

- **Some of the tax issues related to a sale to an IDGT:**
- **No gain or loss is recognized on the sale because the taxpayer is still treated as the owner of the assets in the IDGT for income tax purposes.**
- **Any interest paid for the sale is non-deductible, since the taxpayer is essentially paying himself/herself.**
- **As mentioned above, future appreciation of the assets in the IDGT are not included in the taxable estate of the decedent.**
- **Any unpaid balance on a promissory note for the payment of the purchase price for the assets will be included in the taxpayer's estate unless the note is something like a self-cancelling installment note ("SCIN").**

Defective Trusts

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- **Interest rate in the promissory note or SCIN must be at least the AFR, which is lower than private annuity or GRAT interest rates.**
 - **Grantor pays the tax on the income of the IDGT which is a further benefit to the beneficiaries under the IDGT because the assets in the IDGT are not reduced by paying the taxes on the trust's income.**
 - **Generation skipping tax does not generally apply because the transfer is for full and adequate consideration.**
 - **No gain recognition, so no step up in basis on the transfer to the IDGT, so income tax is still built in to the trust.**

Types of Grantor Trusts

- **Most trusts mentioned today can be structured to be a grantor trust.**
- **The qualification of a grantor trust is less about who is the beneficiary or how something gets paid, and more about the powers retained by the grantor over the trust. So, grantor trust status can apply to a variety of trusts.**

Gifts to Irrevocable Trusts

Funding the Trusts

Issues.

- **In any trust funding, it is not necessarily the amount that matters but whether the transfer will remove the assets from the transferor's taxable estate.**
- **Historically, a trust was often used to remove assets from a taxpayer's estate to remove the burden of the estate tax. Today, we have to balance income tax planning versus estate tax exemption.**

Funding the Trusts

Gift tax issues.

- If the funding of the trust does not qualify as a “present interest”, then the amount of the assets funding the trust will remain in the transferor’s taxable estate, including any appreciation on those assets.
- Often, a trust is created with “Crummey powers”, which takes its name from the case of *Crummey v. Commissioner*, 397 F.2d 82 (9th Cir. 1968). The Crummey powers are the power of a beneficiary to withdraw from transfers made to a trust by a transferor. Because the beneficiary has the right to the current enjoyment of the property transferred, the transfer qualifies as a transfer of a present interest and is subject to the annual gift tax exclusion.

Funding the Trusts

Practical Matters.

- **Notify the trustee of the trust, make sure they are willing to serve.**
- **Obtain an EIN for the trust at <https://sa.www4.irs.gov/modiein/individual/index.jsp> - keep in mind a person can only request 1 EIN per calendar day, so if you are setting up multiple, you need to plan ahead.**
- **Open a bank account.**
- **Make sure all assets are appropriately transferred.**

Funding the Trusts

- Practical Drafting Issues.
 - By their definition, Irrevocable Trusts are irrevocable and don't have the same flexibility as a revocable trust
 - Important to add in flexibility.
 - Use powers of appointment (general and limited) as needed and appropriate, keeping in mind estate tax inclusion of general powers of appointment
 - Consider the use of a trust protector. Tennessee adopted a statute (Tenn Code Ann 35-15-1201 et seq) that outlines some of the powers that a trust protector can have.
 - Trust Protector may be the best and most flexible power to add into the irrevocable trust if used correctly.
 - Tennessee Changes its Decanting Statute
 - Tenn Code Ann 35-15-816(b)(27) changed to -816(c)
 - Adds limitations on the use of the decanting power

SLATS

Explanation of SLATs

- SLATs stands for Spousal Lifetime Access Trusts.
 - Setup by one spouse for the other spouse.
 - Can made distributions for HEMS
 - Beneficiary spouse may serve as trustee, but distributions must be limited to HEMS. This may be dangerous though, so consider having a third party trustee serve as the trustee to avoid any potential inclusion in a beneficiary's estate for estate tax purposes.
 - Can designate a distribution trustee and investment trustee, so the grantor can pick the financial advisor to manage investments
 - Spouse and children, and others, can be beneficiaries.
 - Generally add a limited power of appointment in an independent trustee to make distributions to spouse outside of HEMS.

Explanation of SLATs - 2

- SLATs (continued)
 - Transfer doesn't qualify for the marital deduction, so we use the \$11.7 million exemption now but still have access to it.
 - Appreciation in the SLAT is not included in the Estate of the grantor or the spousal beneficiary.
 - There is creditor protection assuming no fraudulent conveyances.
 - Still get discounts for transferring minority interests in businesses to the SLATs.
 - Payment of rent for use of a vacation house in the SLAT has no income tax consequences if it is a grantor trust and essentially enables additional gift-tax free transfers to the SLAT.
 - Have to avoid the reciprocal trust doctrine.
 - Great option to use the estate tax exemption without losing the



Charitable Remainder Trusts

Charitable Remainder Trusts

Charitable Remainder Trust is a trust set up for noncharitable beneficiaries during their lifetimes with the remainder going to a charity.

- More exact, a CRT is a “trust which provides for a specified distribution, at least annually, to one or more beneficiaries, at least one of which is not a charity, for life or for a term of years, with an irrevocable remainder interest to be held for the benefit of, or paid over to, charity.” Treas. Reg. § 1.664-1(a)(1)(i).
- The specified distribution to be paid at least annually must be a sum certain which is not less than 5 percent of the initial net fair market value of all property placed in trust (in the case of a charitable remainder annuity trust) or a fixed percentage which is not less than 5 percent of the net fair market value of the trust assets, valued annually (in the case of a charitable remainder unitrust). Treas. Reg. § 1.664-1(a)(1)(i).
- A trust created after July 31, 1969, which is a charitable remainder trust, is exempt from all of the taxes imposed by Subtitle A of the Code for any taxable year of the trust, except for a taxable year beginning before January 1, 2007, in which it has unrelated business taxable income. Treas. Reg. § 1.664-1(a)(1)(i).

Charitable Remainder Trusts

- For taxable years beginning after December 31, 2006, an excise tax, treated as imposed by Chapter 42, is imposed on charitable remainder trusts that have unrelated business taxable income. Treas. Reg. § 1.664-1(a)(1)(i).
- In order for a trust to be a charitable remainder trust, it must meet the definition of and function exclusively as a charitable remainder trust from the creation of the trust. Solely for the purposes of Section 664 and the regulations thereunder, the trust will be deemed to be created at the earliest time that neither the grantor nor any other person is treated as the owner of the entire trust under Subpart E, Part 1, Subchapter J, Subtitle A of the Code (relating to grantors and others treated as substantial owners), but in no event prior to the time property is first transferred to the trust. For purposes of the preceding sentence, neither the grantor nor his spouse shall be treated as the owner of the trust under such Subpart E merely because the grantor or his spouse is named as a recipient. Treas. Reg. § 1.664-1(a)(4).

Charitable Remainder Trusts

- The value of the remainder interest must be at least 10% of the initial net fair market value of all property placed in the trust. IRC § 664(d)(1)(D).
- CRT must ensure that no estate taxes will be paid by the CRT, or the trust will not qualify as a CRT. Rev. Rul. 82-128, 1981-2 CB 71.
- A trust is not a charitable remainder trust if the provisions of the trust include a provision which restricts the trustee from investing the trust assets in a manner which could result in the annual realization of a reasonable amount of income or gain from the sale or disposition of trust assets. In the case of transactions with, or for the benefit of, a disqualified person, see Section 4941(d) and the regulations thereunder for rules relating to the definition of self-dealing. Treas. Reg. §1.664-1(a)(3). This is a facts and circumstances determination

Charitable Remainder Trusts

- Can't require the trustee to retain certain assets (Rev. Rul. 73-160) or invest in only tax-exempt securities (PLR 7802037).
- Have to be very careful of making any investments subject to approval by 3rd parties.
- Have to be very careful in prohibiting investments in certain categories.
- Unrelated business taxable income (UBTI) – any CRT that has UBTI is subject to a 100% excise tax on any UBTI. UBTI generally is income the trust regularly earns from carrying on a trade or business. Debt-financed income is also UBTI.
- All CRTs must contain provisions that prohibit the trust from engaging in any act of “self-dealing” as defined in Section 4941(d) and from making “taxable expenditures” as defined in Section 4945(d).
- A CRAT cannot receive additional contributions following the initial contribution.
- Normal rule is that the payments under the CRAT or CRUT have to be paid before the end of the calendar year, with only limited exceptions.

Charitable Remainder Trusts - Example

- Husband, 57, and Wife, 55, own a sizable block of stock in a major computer software developer. They acquired this stock for a low cost basis when they founded their own company, which was acquired in a stock-for-stock exchange in the larger corporation. This stock is now worth \$1 million, and Husband and Wife's basis is \$25,000. They receive annual dividends of about \$20,000 per year. Husband and Wife are in the highest federal income tax bracket.
- On January 1, 1998, Husband and Wife contribute the stock to a CRUT and are the recipients of quarterly unitrust payments equal to 8 percent of the FMV of the trust property, as valued annually. Here are the benefits of this transaction to Husband and Wife as follows:

Charitable Remainder Trusts - Example

- *Capital Gain Avoidance.* When Husband and Wife transfer their stock to the CRUT, they pay no tax on the transfer. When the trustee sells the stock for reinvestment, it pays no tax on the sale. The transaction avoids \$975,000 in potential capital gain and gives Husband and Wife an income tax savings of as much as \$195,000 ($\$975,000 \times 20$ percent).
- *Income Tax Deduction.* Based on a **Section 7520** rate of 7.6 percent, the income tax charitable deduction for Husband and Wife will be \$120,510. This results in a tax savings of \$47,722 ($\$120,510 \times 39.6$ percent).

Charitable Remainder Trusts - Example

- *Increased Income.* If the total return on the trust investments is 9 percent and the CRUT pays out 8 percent of the FMV of the trust assets, valued annually, the pre-tax income over Husband and Wife's combined life expectancy of 33.5 years is \$3,165,068.
- *Estate Tax Consequences.* Because Husband and Wife are the only recipients, the interplay of the unlimited marital and charitable deductions eliminates the assets from both of their gross estates.

Provisions Triggering Grantor Trust Status



Provisions Triggering Grantor Trust Status

- Code Provisions. Code §§ 671-679 deal with the grantor trust rules. Best way to approach them is going through the different provisions.
- Code § 671 – “Where it is specified in this subpart that the grantor or another person shall be treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under this chapter in computing taxable income or credits against the tax of an individual. Any remaining portion of the trust shall be subject to subparts A through D. No items of a trust shall be included in computing the taxable income and credits of the grantor or of any other person solely on the grounds of his dominion and control over the trust under section 61 (relating to definition of gross income) or any other provision of this title, except as specified in this subpart.

Provisions Triggering Grantor Trust Status

- The grantor is treated as the owner of the income and has to pay tax on those items.
- If the trust is not entirely a grantor trust, but only a grantor trust as to a certain percentage of the trust, then the remaining trust income will be taxed as a separate taxpayer like other trusts.
- The only rules that allow a grantor to be taxed on the income, deductions and credits against tax of the trust are in §§ 671-679 and the related regulations.

Provisions Triggering Grantor Trust Status

- Code § 672 – Rules and Definitions
 - Adverse Party is any person having a substantial beneficial interest in the trust which would be adversely affected by the exercise or nonexercise of the power which he possesses respecting the trust. A person having a general power of appointment over the trust property shall be deemed to have a beneficial interest in the trust.
 - Nonadverse Party is anyone who is not an Adverse Party.
 - Related or Subordinate Party means any nonadverse party who is
 - the grantor's spouse if living with the grantor;
 - any one of the following: The grantor's father, mother, issue, brother or sister; an employee of the grantor; a corporation or any employee of a corporation in which the stock holdings of the grantor and the trust are significant from the viewpoint of voting control; a subordinate employee of a corporation in which the grantor is an executive.
 - A related or subordinate party shall be presumed to be subservient to the grantor in respect of the exercise or nonexercise of the powers conferred on him unless such party is shown not to be subservient by a preponderance of the evidence

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 - Nonadverse Party is anyone who is not an Adverse Party.
 - Related or Subordinate Party means any nonadverse party who is
 - the grantor's spouse if living with the grantor;
 - any one of the following: The grantor's father, mother, issue, brother or sister; an employee of the grantor; a corporation or any employee of a corporation in which the stock holdings of the grantor and the trust are significant from the viewpoint of voting control; a subordinate employee of a corporation in which the grantor is an executive.
 - A related or subordinate party shall be presumed to be subservient to the grantor in respect of the exercise or nonexercise of the powers conferred on him unless such party is shown not to be subservient by a preponderance of the evidence

Provisions Triggering Grantor Trust Status

- Code § 673
- The grantor shall be treated as the owner of any portion of a trust in which he has a reversionary interest in either the corpus or the income therefrom, if, as of the inception of that portion of the trust, the value of such interest exceeds 5 percent of the value of such portion.
 - The purpose of this 5% rule is to rule out de minimis situations where somehow the grantor gets the assets back but it is not at all intended by the terms of the trust for that to happen.
 - Grantor not treated as the owner if the grantor setups a trust for a lineal descendant, the lineal descendant holds all of the present interests in any portion of the trust, and the lineal descendant dies before reaching age 21, and the owner would receive that portion from the beneficiary by his failure to survive past the age of 21.

Provisions Triggering Grantor Trust Status

- Code § 674
- The grantor shall be treated as the owner of any portion of a trust in respect of which the beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition, exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party.
- Exceptions to rule: the following will not be deemed a power under this section:
 - A power to pay a support obligation to the extent that the grantor would not be subject to tax under § 677(b).
 - A power, the exercise of which can only affect the beneficial enjoyment of the income for a period commencing after the occurrence of an event such that a grantor would not be treated as the owner under section 673 if the power were a reversionary interest; but the grantor may be treated as the owner after the occurrence of the event unless the power is relinquished.
 - A power exercisable only by will, other than a power in the grantor to appoint by will the income of the trust where the income is accumulated for such disposition by the grantor or may be so accumulated in the discretion of the grantor or a nonadverse party, or both, without the approval or consent of any adverse party.

Provisions Triggering Grantor Trust Status

- Exceptions to § 674 continued..
- A power to determine the beneficial enjoyment of the corpus or the income therefrom if the corpus or income is irrevocably payable for a purpose specified in section 170(c) (relating to definition of charitable contributions) or to an employee stock ownership plan (as defined in section 4975(e)(7)) in a qualified gratuitous transfer (as defined in section 664(g)(1)).
- A power to distribute corpus either—
 - 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 which is set forth in the trust instrument; or
 - to or for any current income beneficiary, provided that the distribution of corpus must be chargeable against the proportionate share of corpus held in trust for the payment of income to the beneficiary as if the corpus constituted a separate trust.
 - A power does not fall within the powers described in this paragraph 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 where such action is to provide for after-born or after-adopted children.

Provisions Triggering Grantor Trust Status

- Exceptions to § 674 continued..
 - A power to distribute or apply income to or for any current income beneficiary or to accumulate the income for him, provided that any accumulated income must ultimately be payable—
 - to the beneficiary from whom distribution or application is withheld, to his estate, or to his appointees (or persons named as alternate takers in default of appointment) provided that such beneficiary possesses a power of appointment which does not exclude from the class of possible appointees any person other than the beneficiary, his estate, his creditors, or the creditors of his estate, or
 - on termination of the trust, or in conjunction with a distribution of corpus which is augmented by such accumulated income, to the current income beneficiaries in shares which have been irrevocably specified in the trust instrument.
 - Accumulated income shall be considered so payable although it is provided that if any beneficiary does not survive a date of distribution which could reasonably have been expected to occur within the beneficiary's lifetime, the share of the deceased beneficiary is to be paid to his appointees or to one or more designated alternate takers (other than the grantor or the grantor's estate) whose shares have been irrevocably specified. A power does not fall within the powers described in this paragraph 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 where such action is to provide for after-born or after-adopted children.

Provisions Triggering Grantor Trust Status

- Exceptions to § 674 continued..
- A power exercisable only during —
 - the existence of a legal disability of any current income beneficiary, or
 - the period during which any income beneficiary shall be under the age of 21 years,
 - to distribute or apply income to or for such beneficiary or to accumulate and add the income to corpus. A power does not fall within the powers described in this paragraph 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 where such action is to provide for after-born or after-adopted children.
- A power to allocate receipts and disbursements as between corpus and income, even though expressed in broad language.
 - Independent Trustee exceptions.

Provisions Triggering Grantor Trust Status

- Exceptions to § 674 continued..
- Subsection (a) shall not apply to a power solely exercisable (without the approval or consent of any other person) by a trustee or trustees, none of whom is the grantor, and no more than half of whom are related or subordinate parties who are subservient to the wishes of the grantor—
 - to distribute, apportion, or accumulate income to or for a beneficiary or beneficiaries, or to, for, or within a class of beneficiaries; or
 - to pay out corpus to or for a beneficiary or beneficiaries or to or for a class of beneficiaries (whether or not income beneficiaries).
 - A power does not fall within the powers described in this subsection 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 where such action is to provide for after-born or after-adopted children. For periods during which an individual is the spouse of the grantor (within the meaning of section 672(e)(2)), any reference in this subsection to the grantor shall be treated as including a reference to such individual.

Provisions Triggering Grantor Trust Status

- Exceptions to § 674 continued..
 - Subsection (a) shall not apply to a power solely exercisable (without the approval or consent of any other person) by a trustee or trustees, none of whom is the grantor or spouse living with the grantor, to distribute, apportion, or accumulate income to or for a beneficiary or beneficiaries, or to, for, or within a class of beneficiaries, whether or not the conditions of paragraph (6) or (7) of subsection (b) are satisfied, if such power is limited by a reasonably definite external standard which is set forth in the trust instrument. A power does not fall within the powers described in this subsection 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 where such action is to provide for after-born or after-adopted children.

Provisions Triggering Grantor Trust Status

- Code § 675 – grantor shall be treated as the owner of any portion of a trust in respect of which
 - A power exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party enables the grantor or any person to purchase, exchange, or otherwise deal with or dispose of the corpus or the income therefrom for less than an adequate consideration in money or money's worth.
 - A power exercisable by the grantor or a nonadverse party, or both, enables the grantor to borrow the corpus or income, directly or indirectly, without adequate interest or without adequate security except where a trustee (other than the grantor) is authorized under a general lending power to make loans to any person without regard to interest or security.
 - The grantor has directly or indirectly borrowed the corpus or income and has not completely repaid the loan, including any interest, before the beginning of the taxable year. The preceding sentence shall not apply to a loan which provides for adequate interest and adequate security, if such loan is made by a trustee other than the grantor and other than a related or subordinate trustee subservient to the grantor. For periods during which an individual is the spouse of the grantor (within the meaning of section 672(e)(2)), any reference in this paragraph to the grantor shall be treated as including a reference to such individual.

Provisions Triggering Grantor Trust Status

- Code § 675 – continued...
- A power of administration is exercisable in a nonfiduciary capacity by any person without the approval or consent of any person in a fiduciary capacity. For purposes of this paragraph, the term “power of administration” means any one or more of the following powers: (A) a power to vote or direct the voting of stock or other securities of a corporation in which the holdings of the grantor and the trust are significant from the viewpoint of voting control; (B) a power to control the investment of the trust funds either by directing investments or reinvestments, or by vetoing proposed investments or reinvestments, to the extent that the trust funds consist of stocks or securities of corporations in which the holdings of the grantor and the trust are significant from the viewpoint of voting control; or (C) a power to reacquire the trust corpus by substituting other property of an equivalent value.

Provisions Triggering Grantor Trust Status

- Code § 676
 - The grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under any other provision of this part, where at any time the power to revert in the grantor title to such portion is exercisable by the grantor or a nonadverse party, or both.
 - Subsection (a) shall not apply to a power the exercise of which can only affect the beneficial enjoyment of the income for a period commencing after the occurrence of an event such that a grantor would not be treated as the owner under section 673 if the power were a reversionary interest. But the grantor may be treated as the owner after the occurrence of such event unless the power is relinquished.

Provisions Triggering Grantor Trust Status

- Code § 677
- The grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under Section 674, whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be—
 - distributed to the grantor or the grantor's spouse;
 - held or accumulated for future distribution to the grantor or the grantor's spouse; or
 - applied to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse (except policies of insurance irrevocably payable for a purpose specified in section 170(c) (relating to definition of charitable contributions)).
- This subsection shall not apply to a power the exercise of which can only affect the beneficial enjoyment of the income for a period commencing after the occurrence of an event such that the grantor would not be treated as the owner under section 673 if the power were a reversionary interest; but the grantor may be treated as the owner after the occurrence of the event unless the power is relinquished.

Provisions Triggering Grantor Trust Status

- Code § 677 continued
 - Income of a trust shall not be considered taxable to the grantor under Subsection (a) or any other provision of this chapter merely because such income in the discretion of another person, the trustee, or the grantor acting as trustee or co-trustee, may be applied or distributed for the support or maintenance of a beneficiary (other than the grantor's spouse) whom the grantor is legally obligated to support or maintain, except to the extent that such income is so applied or distributed. In cases where the amounts so applied or distributed are paid out of corpus or out of other than income for the taxable year, such amounts shall be considered to be an amount paid or credited within the meaning of Paragraph (2) of Section 661(a) and shall be taxed to the grantor under Section 662.

Article IV. – Funding the Grantor Trust – Who is the Grantor



- **Section 678** – Other people treated as substantial owner of the trust.
- A person other than the grantor shall be treated as the owner of any portion of a trust with respect to which:
 - such person has a power exercisable solely by himself to vest the corpus or the income therefrom in himself, or
 - such person has previously partially released or otherwise modified such a power and after the release or modification retains such control as would, within the principles of Sections 671 to 677 , inclusive, subject a grantor of a trust to treatment as the owner thereof.
- Subsection (a) above shall not apply with respect to a power over income, as originally granted or thereafter modified, if the grantor of the trust or a transferor (to whom Section 679 applies) is otherwise treated as the owner under the provisions of this subpart other than this section.

Funding the Grantor Trust – Who is the Grantor

- **Section 678 – continued.**
- **Subsection (a) shall not apply to a power which enables such person, in the capacity of trustee or co-trustee, merely to apply the income of the trust to the support or maintenance of a person whom the holder of the power is obligated to support or maintain except to the extent that such income is so applied. In cases where the amounts so applied or distributed are paid out of corpus or out of other than income of the taxable year, such amounts shall be considered to be an amount paid or credited within the meaning of Paragraph (2) of Section 661(a) and shall be taxed to the holder of the power under Section 662 .**
- **Subsection (a) shall not apply with respect to a power which has been renounced or disclaimed within a reasonable time after the holder of the power first became aware of its existence.**

Funding the Grantor Trust – Who is the Grantor

Drafting Tips and Samples



Drafting Tips and Samples

- **Be careful and thoughtful about whether grantor trust, or even an irrevocable trust, is appropriate to your situation. The tax consequences can be worse than a C corporation, so you need to be careful.**
- **Common grantor trust powers:**
 - **Substitution of assets; and**
 - **Power to borrow funds without adequate interest or adequate security – this should be given to a nonadverse party (but not a subordinate party in case power is attributable to the grantor).**

Questions?



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