THE CATHOLIC FOUNDATION

THE ADVISORS SERIES

Year-End Estate Tax Planning After the Election

Presented by
Jonathan G. Blattmachr

2020

THE CATHOLIC FOUNDATION

THE ADVISORS SERIES

For Estate and Wealth Management Professionals

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November 18, 2020

Dear Seminar Participant:

The Catholic Foundation welcomes you to the 14th Annual Advisors Series for Wealth and Estate Management Professionals. We are pleased to have Jonathan Blattmachr present his perspective on moving out of 2020 and into 2021 with your clients' best interests in mind.

Jonathan will present ***Year-End Estate Tax Planning After the Election -*** as now is a good time to encourage clients to consider implementing one or more currently available transfer tax planning techniques. The outcome of the November federal elections could have an effect on the $11.58 million wealth transfer tax exclusion; an increase in transfer tax rates; statutory and regulatory elimination of a wide array of planning techniques available under current law; and a possible imposition of a tax on unrealized appreciation at death or carry-over basis.

The Catholic Foundation greatly appreciates our returning presenting sponsors, **Foley & Lardner LLP** and **Carter Financial Management**, for their continued support. We extend a thank you to each of our sponsors – the companies and individuals that have made this program possible for 14 years. We offer a special thanks to our Advisory Council members Santo Bisignano, Jr., Daniel P. Novakov and Lora Davis for their expertise in planning this event.

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Thank you for joining us for this seminar today. We hope our 14th annual Advisors Series provides you with tangible tools and ideas to better serve your clients. We look forward to seeing you in 2021.

Sincerely,

Matt

Cheryl

J. Matthew Kramer
President and CEO

Cheryl Unis Mansour
Vice President of Development

PROGRAM

THE CATHOLIC FOUNDATION

THE ADVISORS SERIES

For Estate and Wealth Management Professionals

YEAR-END ESTATE TAX PLANNING AFTER THE ELECTION

November 18, 2020
12:00-2:15 p.m.

WELCOME	CHERYL UNIS MANSOUR Vice President Development The Catholic Foundation
REMARKS	J. MATTHEW KRAMER President & CEO The Catholic Foundation
INTRODUCTION	LORA G. DAVIS Davis Stephenson, PLLC
PRESENTATION	JONATHAN G. BLATTMACHR
PRESENTING SPONSORS	FOLEY & LARDNER LLP CARTER FINANCIAL MANAGEMENT
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Q&A	JONATHAN G. BLATTMACHR LORA G. DAVIS

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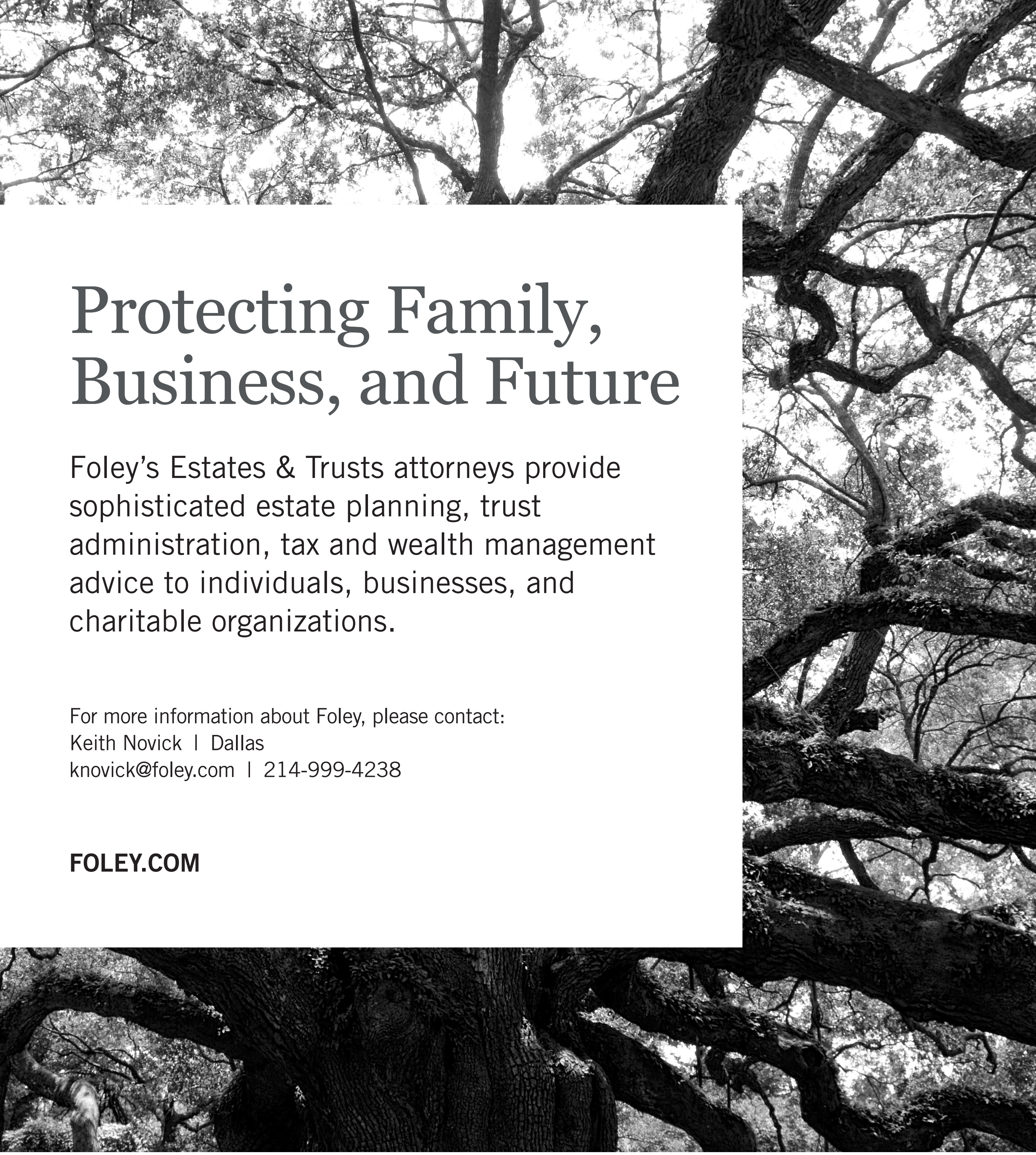

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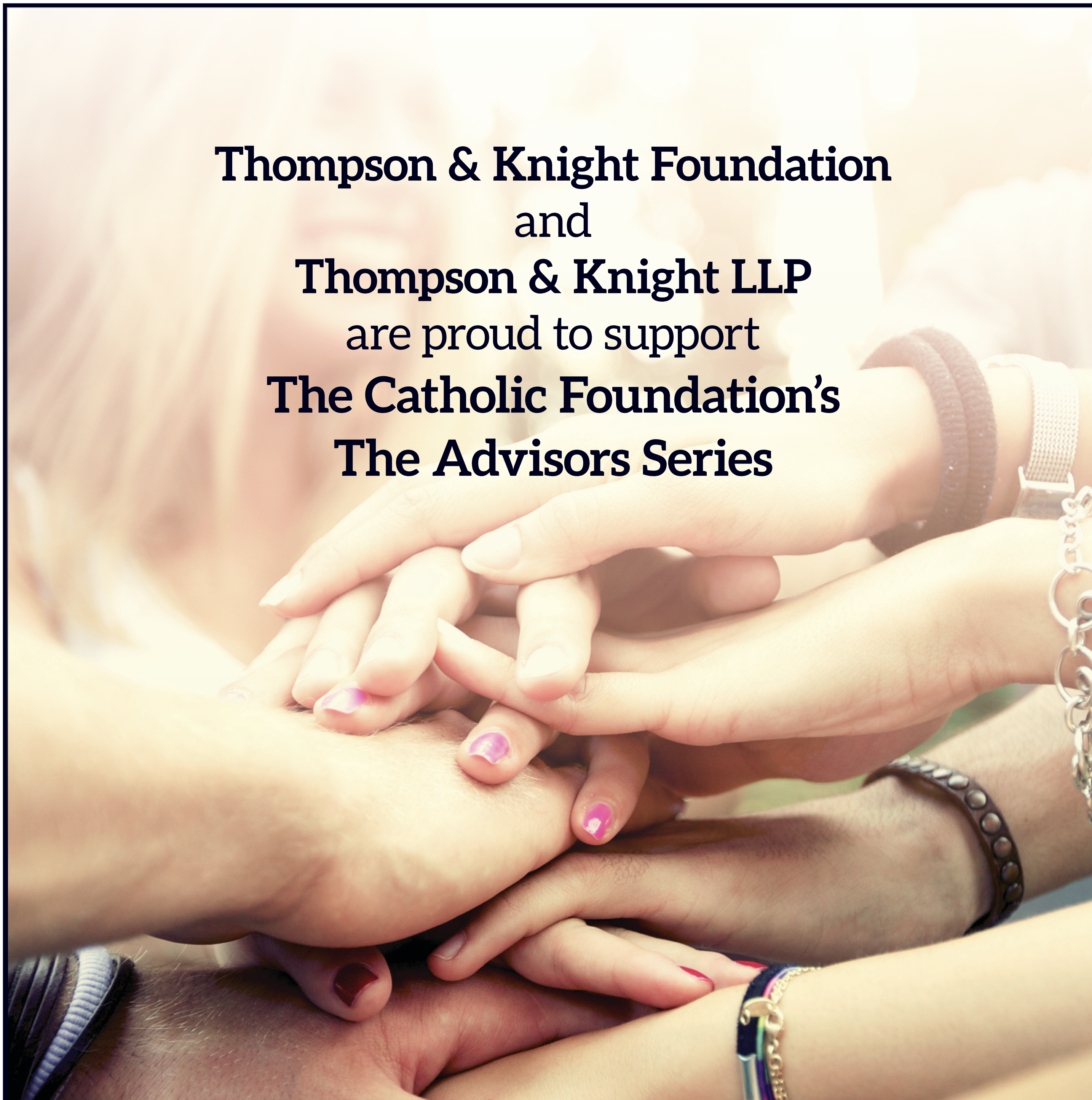

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JONATHAN G. BLATTMACHR

Jonathan G. Blattmachr

Jonathan G. Blattmachr has an extensive background in trust and estate law which spans almost five decades. He received his AB degree from Bucknell University where he majored in mathematics and he graduated cum laude from Columbia University School of Law where he was a Harlan Fiske Stone Scholar. Mr. Blattmachr then served in the United States Army from 1970-1972 where he became a captain and received the Army Commendation Medal.

Mr. Blattmachr started his career as an associate with Simpson Thacher & Bartlett LLP in New York from 1970-1977 and then became a partner at Milbank, Tweed, Hadley & McCloy LLP where he worked for 33 years in New York. He is a retired member of the Alaska, California and New York Bars. Mr. Blattmachr has co-authored nine books and over 500 articles on estate planning topics.

Mr. Blattmachr is the co-developer of Wealth Transfer Planning, a computerized system that is able to produce estate planning documents. He is the editor-in-chief of the Interactive Legal Systems and he is the Director of Estate Planning for the Alaska Trust Company. In addition, he was a lecturer-in-law at Columbia University School of law and served as an Adjunct Professor of Law at the New York University Law School in the Masters in Tax Program (LLM). Mr. Blattmachr has a vast list of professional activities which include, but are not limited to, his involvement as an Advisor on The American Law Institute, his involvement as a Fellow and Director of The New York Bar Foundation, as a Fellow of the American Bar Foundation and many more.

PRESENTATIONS

Introduction & Overview

Catholic Foundation November 18, 2020: Year End Estate Planning in Light of Some Uncertainty by Jonathan G. Blattmachr, Carlyn S. McCaffrey & Martin M. Shenkman

Introduction

- The Federal Government is likely to seek to raise taxes to avoid incurring further debt to pay for the economic cost of the COVID-19 epidemic, to boost the economy and to meet other needs (e.g., climate change).
- If this occurs, wealth transfer taxes may be increased.
- The scope of changes likely will turn on the outcome of the two Georgia senate seat elections.

With this uncertainty, why not just wait?

- The Supreme Court has ruled several times that tax law changes can be made retroactive.
- President Elect Biden has indicated he wants some tax changes to be retroactive.
- So if taxpayers would undertake planning steps if they were certain “adverse” changes would occur, why take the risk? Take the steps now unless the taxpayers would not take them if the changes were not going to be made. In that case, the question is:
- Is there a way to take the steps but “undo” them if the changes are not made?

What can be done to undone the steps?

- Make all transfers in trust.
- Provide that the trustee (or at least one trustee) may disclaim any transfer offered to the trust and have the trust provide that the disclaimed property will go back to the donor.
- Is that allowed? It should be if local law so permits. For example, Alaska Statute 13.70.030(b)(1) provides: “a fiduciary may disclaim, in whole or in part, any interest in or power over property, including a power of appointment, if and to the extent that the instrument creating the fiduciary relationship grants the fiduciary the right to disclaim.”
- This almost certainly can work even in a state that does not have such a statute unless state law prohibits such a provision.
- And this almost certainly will be respected by the IRS and the courts. Cf. *Estate of Hoenig v. Commissioner*, 66 T.C. 471 (1976).
- Alternatively, allow the primary named beneficiary to renounce on behalf of the trust.
- Hence, there seems to be no reason not to proceeds and to do so by year end.

What else could be done to undone the steps?

- Create a “QTIPable” trust described in Section 2523(f) for the property owner’s spouse (if a US citizen).
- If the property owner wants to use the gift tax exemption, do not elect for marital deduction treatment, which will mean exemption is used. This can be partial.
- One might want to see whether the assets transferred to the QTIPable trust have increased or deceased in value in determining whether to elect marital deduction treatment.
- It is doubtful a *Clayton*-type QTIP can be used for gift tax purposes. It has only been approved for estate tax purposes. (Treas. Reg. §20.2056(b)-7(d)(3)).
- If the taxpayer wants to “undo” the transfer, then elect for marital deduction treatment if it is anticipated that the trustee will invade the trust, who could transfer the assets to the beneficiary spouse who could return them to the grantor-spouse without any tax if the grantor is also a US citizen.
- This decision can be postponed until October 15, 2021.

Gifts

- Gifts in 2020 by donors who have not used their exclusion amounts should enable them to preserve the advantage of the current high exclusion amount even if it is reduced next year or in 2026.
- Note: You cannot preserve part of the exemption if you use as much as it is reduced to. Example.
- Gifts in 2020 of appreciated property will also avoid the risk of future treatment of gifts of appreciated property as recognition events.

If the client is sure the exemptions won’t be reduced before 2026, then why use them now?

- No one can be certain.
- Transferring assets now might protect against a gain recognition at death or by a later gift.
- Assets may grow in value. At 7% annual growth, $5 million of assets will grow to $10 million in 10 year, to $20 million in 20 years and to $40 million in 30 years. Property will more than double in the next five year (from 2021 to 2026) at 15% annual growth.
- Opportunities for estate tax savings helps secure asset protection.
- But can the donor continue to enjoy the benefits and control of transferred assets?

The Possible Downside of Gifts

- Depending on future circumstances, gifts in 2020 could result in higher future taxes.
- Loss of access to and control over gifted property.

Gifts

Two possible negative consequences:

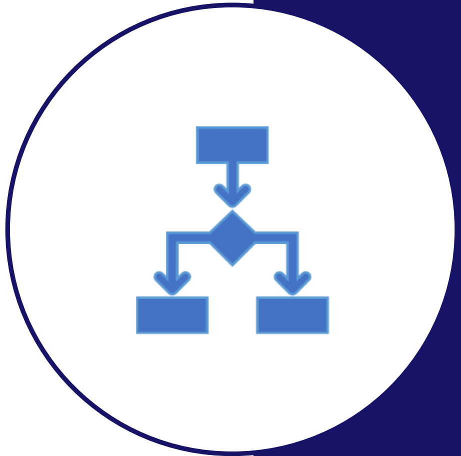
- The value of the gifted property could decline.
- Gift of appreciated property could fail to appreciate sufficiently to offset disadvantage of loss of basis step up at death.

Suppose we want the assets back into the donor’s estate to garner the step-up in basis?

Assets could be given back to the donor but exemption used would not be restored and the return could be a gift (although, perhaps not, if as a result of the exercise of a special power of appointment).

Instead do the following: transfer the property to a trust, expressly allow someone to grant the grantor a power of control described in Section 2038 (e.g., make the grantor a co-trustee). If the power is not granted to the grantor, there should be no estate tax inclusion by reason of the power to grant the power. But if the power is granted, there should be estate tax inclusion. Rev. Rul. 84-179.

There is also the “theory” that assets in a grantor trust receive the automatic change in basis under Section 1014 if grantor trust status ends by reason of the grantor’s death, as discussed in Blattmachr, Gans & Jacobs in the September 2002 issue of the Journal of Taxation. And cf. 2009 CCA (no step up) with PLR 2012 (step up for estate of foreign decedent).



Gifts

Making gifts without parting with assets:

- Donors without assets they are willing to part with or with only high basis assets could borrow funds to use to make gifts.
- In today's low interest rate environment, loans are not costly.
- In some cases, donors will be able to borrow from trusts of which they are beneficiaries

Gifts of Promises to Make Gifts

- An enforceable promise to make a gift not based on adequate and full consideration in money or money's worth is treated as a taxable gift.

- If not paid before death, no estate tax deduction will be permitted but Rev. Rul. 84-25 will remove the promised amount from the promisor's adjusted taxable gifts.

  See 33 PA Stat. 6:

  "A written release or promise, hereafter made and signed by the person releasing or promising, shall not be invalid or unenforceable for lack of consideration, if the writing also contains an additional express statement, in any form of language, that the signer intends to be legally bound."

  Have interest accrue on the "promise." Is AFR interest sufficient?

  Of course, make the promise to a grantor trust.

- Donor of enforceable promise to make a gift should not split gift with spouse in year of gift

Gifts:

Retaining possible benefits from gifted property:

- The intentionally defective preferred interest
- Spousal Lifetime Access Trusts
- Domestic Asset Protection Trusts
- Hybrid Domestic Asset Protection Trusts
- Special Power of Appointment Trusts

The Intentionally Defective Preferred Interest

- A donor can create an entity that has preferred interests that are not compliant with Section 2701 and participating interests.
- If the donor gifts or sells the participating interests to a trust for the donor's children, the donor will be treated as having made a gift of the value of the retained preferred interest without parting with any actual interest.

The Intentionally Defective Preferred Interest

- Donor and children create a preferred partnership where parent acquires a non-qualified preferred interest and children (or a GST exempt grantor trust) acquires the common. The parent will be deemed to have made a gift of the value of the preferred. Parent will own the preferred until death, getting preferred payments and the value should remain the same at death on account of a right to put the preferred for its acquisition price.
- If the donor retains the interest until death, its value will be included in the donor’s gross estate. Reg. 25.2701-5 will permit the estate to reduce the estate tax base by the value on the donor’s prior gift that was attributable to the application of Section 2701.

Dual SLATs – Spousal Lifetime Access Trusts

Benefitting Each Spouse Without Creditor Issues or Estate Tax Inclusion

Dual SLATs: How They Work

- Each spouse creates a trust for the other spouse, avoiding state law creditor and tax Reciprocal Trust Doctrines.

- This occurs by making the trusts sufficiently different so the doctrines will not apply.

- The trusts can be created at different times, with different assets and trustees, and with very different terms.

SLATs: How to Make Them Work

- In one trust, the beneficiary spouse can be entitled to distributions each year, have a lifetime broad special power of appointment, can change trustees (within Rev. Rul. 95-58 safe harbor), withdraw under HEMS.

- In the other trust, the beneficiary spouse would have no entitlement to distributions (perhaps, not even current beneficiary status), no power to change trustees, and no power of appointment, but could become eligible to receive a distributions only upon exercise by a trusted child of a power to add beneficiaries.

- Do not let child know of her right to receive distributions until after trust is created.

DAPTs – Domestic Asset Protection Trusts

No Longer Void Everywhere in the US

DAPTs: What They Were

- General rule throughout the US before 1987: any trust from which a distribution could be made to the Grantor by the Trustee is considered “self-settled” and the trust property was permanently subject to the claims of the Grantor’s creditors regardless of the motivation for creating the trust. It is just a rule.

- New York EPTL 7-3.1 says “A disposition in trust for the use of the creator is void as against the existing or subsequent creditors of the creator.”

- Section 548(e) of the US Bankruptcy Code pulls into the bankruptcy estate any self-settled trust or similar device if it was created to hinder, delay or defraud a creditor and bankruptcy is commenced within ten years of funding.

DAPTs: What They Are Now

- Alaska enacted AS 34.40.110 providing complete asset protection for a self-settled trust if the Grantor was not trying to defraud a known creditor (plus other requirements).
- Now nineteen states protect self-settled trusts from claims of the Grantor's creditors.
- Does this work in other states? It's not certain, but likely if all "Ps and Qs" are followed—e.g., all persons and assets involved are in a "DAPT" state.
- The trust should be excluded from the Grantor's gross estate if the gift to the trust is complete. See Rev. Rul. 76-103, Rev. Rul. 2004-64, and PLR 200944002 (not precedent). This may provide a complete "bullet proof" reason for creating the trust.

Hybrid DAPTs – A DAPT Without a Grantor as Beneficiary

Improving the Odds of Protection

Hybrid DAPTs: What They Are

- A DAPT created for other family members (e.g., Grantor's spouse and descendants) but with some ability to add the Grantor in as a beneficiary.
- The power to add can be conditional on the passage of time (e.g., only after 10 years in an attempt to avoid Bankruptcy Code 548(e), or when grantor is not married and living with another as the Grantor's spouse).
- Does it work? *Iannotti*, 725 NYS 2d 866 (2001) suggests not if the person who can add the Grantor (e.g., Trust Protector) is acting under a fiduciary duty.
- If you try this, make sure the person who can add is not acting under a fiduciary duty.

SPATs – Special Power of Appointment Trusts

A Safer Form of Domestic Asset Protection Trust

DAPT and Hybrid DAPT Limitations

- DAPTs are self-settled trusts, potentially subject to claims of the Grantor’s creditors, if the Grantor lives in a state which does not permit DAPTS and, therefore, potentially subject to estate tax.
- So why not avoid using a self-settled trust, which is a trust from which the trustee can make a distribution to the Grantor?
- Instead create a trust for the Grantor’s family that prohibits the trustee from ever making a distribution to the grantor or “Decanting” to a trust of which the grantor is a beneficiary.

SPATs: Safer for Asset Protection and Estate Tax Exclusion

- One or more individuals, who are not beneficiaries, are granted special "naked" lifetime powers of appointment, which can be exercised in favor of members of a class that includes the Grantor (such as descendants of the Grantor's mother).
- Make the power exercisable only with the consent of a trusted third party (e.g., the client's lawyer or cousin).
- Exercise should be made outright only and occur only if the Grantor has a need.
- See O'Connor, Gans & Blattmachr, "SPATs," Estate Planning (magazine) (Feb 2019)

Gifts Made With Borrowed Funds

- Donors without assets they are willing to part with or with only high basis assets could borrow funds to use to make gifts.
- In today's low interest rate environment, loans are not costly.
- In some cases, donors will be able to borrow from trusts of which they are beneficiaries.

Shifting Future Investment Returns

Devices that permit shift of future investment return on retained assets:

- Grantor Retained Annuity Trusts
- Split Purchase Annuity Trusts

GRATs – Grantor Retained Annuity Trusts

How They Work In Low-Rate Environments

GRATs: What and When Useful

- Background: Under Section 2702 a retained interest in a trust, or a split purchase, has zero value if family members hold the remainder interest.

- A special rule (not an exception) applies if the retained interest is an annuity, resulting in grantor retained annuity trusts ("GRATs").

- GRAT downside: (1) no GST Exemption leverage, (2) some estate tax inclusion potential (difficult to use for client with short life expectancy).

GRATs: What and When Useful

- Good news: low Section 7520 rates mean high value for the retained annuity interest, so a lower taxable gift.

- GRATs work only when the return is greater than the Section 7520 rate.

- Typical structure: Short-term Rolling GRATs. However, these could be effectively “outlawed” by requiring a minimum 10-year term and a gift of at least 25% of the value contributed to the GRAT.

GRATs: Should Structure Change?

- Consider whether longer term GRATs should be used instead of short-term.
- Consider laddered GRATS (e.g., 4, 6, 8, and 10 year)
- Will GRATs provide asset protection? Choose the jurisdiction carefully.
- Consider asset splitting GRATs, each started at a different date, with different duration, different annuity retention, and different remainder beneficiaries.

Illustration of a Successful 99 Year GRAT Continued

- Client funds GRAT with $ 1 Million when the Section 7520 rate Is .4% to pay $12,250 a year to the client or her estate for 99 Years. The value of the remainder Is nearly zero
- When the client dies, the amount included in her estate Is the lesser of the value of the trust or the $12,250 divided by the Section 7520 Rate In effect when she dies.
- Client dies when the Section 7520 Rate is .4 %. The amount includible is no more than $12,250/.004 ($3,062,500) or the value of the trust If less than that.

Illustration of a Successful 99 Year GRAT

- Client dies when the Section 7520 Rate Is 5%. The amount Includible is $12,250/.05 ($245,000) or the value of the trust If less than that).
- Client dies when the Section 7520 Rate Is 10%. The amount includible is $11,000/.1 ($122,500) or the value of the trust If less than that).
- If the Section 7520 Rates increase before death, the client could sell her annuity interest (without gift tax) for its then value. If she lives for at least 3 years after the sale, no portion of the GRAT should be included in her gross estate.

Split Purchase Annuity Trusts

How and When They Can Work

Split Purchase Annuity Trusts

- Background: Under Section 2702 a retained interest in a trust, or an interest in an asset acquired in a split purchase, has zero value if family members hold the remainder interest.

- A special rule (not an exception) applies if the retained or acquired interest is a qualified annuity within the meaning of section 2702.

Split Purchase Annuity Trusts

- GRAT downside: (1) no GST Exemption leverage, (2) some estate tax inclusion (difficult to use for client with short life expectancy).

- Good news: low Section 7520 rates mean high value for the retained ar
taxable gift.

Split Purchase Annuity Trusts

- GRAT estate inclusion risk can be avoided through a Split Purchase Annuity Trust.
- Client and a GST-exempt trust enter into an agreement by which client purchases an annuity for life (or a term of years) in an asset, and the GST-exempt trust purchases the remainder interest in the asset.
- Values are determined by standard actuarial tables meaning there is no gift if the underlying property is correctly valued.
- Because the Section 7520 rates are low, the client pays a significant amount for the annuity interest.

Split Purchase Annuity Trusts

- Can be used for clients with short life expectancy (if death is not imminent).
- No estate tax inclusion.
- GST exemption can be leveraged.
- Cannot “zero-out” the value of the remainder if annuity is retained for life.
- Value of the retained annuity will drop as the Section 7520 rates increase (as they are likely to).

Conclusions and Additional Information

Conclusions

- A wide array of strategies are ripe for planning now, particularly those that work well in low interest rate and low value environments.
- Be proactive with your clients.
- Remember, transactions can be structured to enable them to be reversed

Additional information

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Revising Trusts in Light of New Legislation – The SECURE Act by Jonathan G. Blattmachr & Teresa L. Bush

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Summary

The SECURE Act became effective in January and is perhaps one of the most significant changes to trust planning that estate planners have seen in years. The new law will have no impact on some client estate plans, but could have a huge impact on others, and produce unintended – and undesirable – results. In this presentation, we will examine how trusts are traditionally used in planning for retirement benefits, and how the SECURE Act changed this planning. The use of both accumulation and conduit trusts will be explored, including a discussion of which may be more appropriate when planning for a client's spouse, children, and others. We will discuss now to modify existing trust plans so that the client's objectives are still satisfied, and property isn't forced out of a trust earlier than expected. Additionally, we will describe some more advanced trust strategies for creating potentially better results than traditional planning now allows.

Overview

- Overview of planning for retirement benefits, and why it matters
- Overview of see-through trust planning
- Impact of the SECURE Act
- Changes to existing trusts
- Creative ideas for new trusts/planning
- Conclusions

Why Plan for Retirement Benefits?

Retirement Benefits Overview

- Retirement assets (IRAs, pension plans, etc.) are usually assets that have grown income-tax free during the lifetime of the account holder (the “participant”) and will be subject to ordinary income tax when distributed.
- Minimum distributions are required both during the participant’s lifetime – after a specific age is reached – and after the participant death.
- Deferring the income tax on retirement assets as long as possible will result in more wealth building up over time
- Because they grow tax-free, these assets provide a unique opportunity to build wealth.

Some Fundamentals of Financial Planning

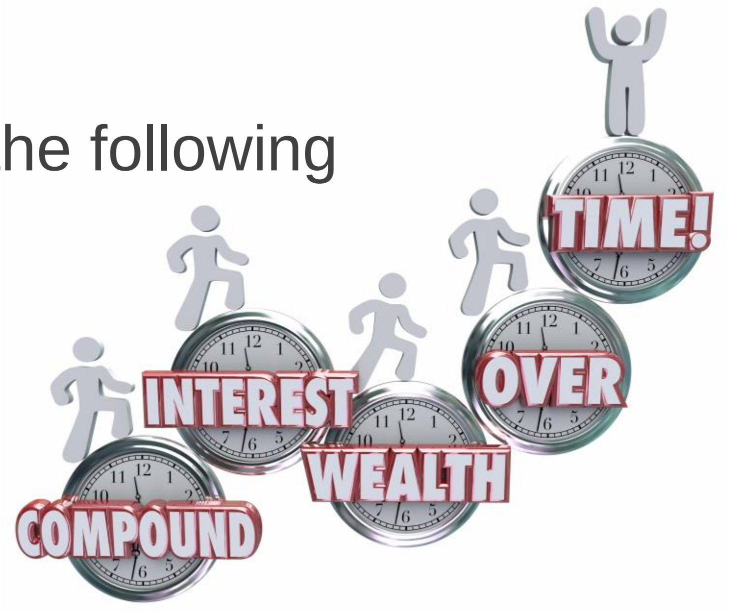
- Tax-free compounding is the most significant factor in successful financial planning - including income tax planning & estate tax planning
- Avoiding tax is the same as building wealth ("<u>A Penny Saved is a Penny Earned</u>" - *Benjamin Franklin*)
- The next best thing to avoiding tax is postponing tax
- Seeking to reduce or avoid income tax is sensible only if there is positive taxable income or gain
- The higher the return, the more important the avoidance of income tax becomes

Importance of Compounding

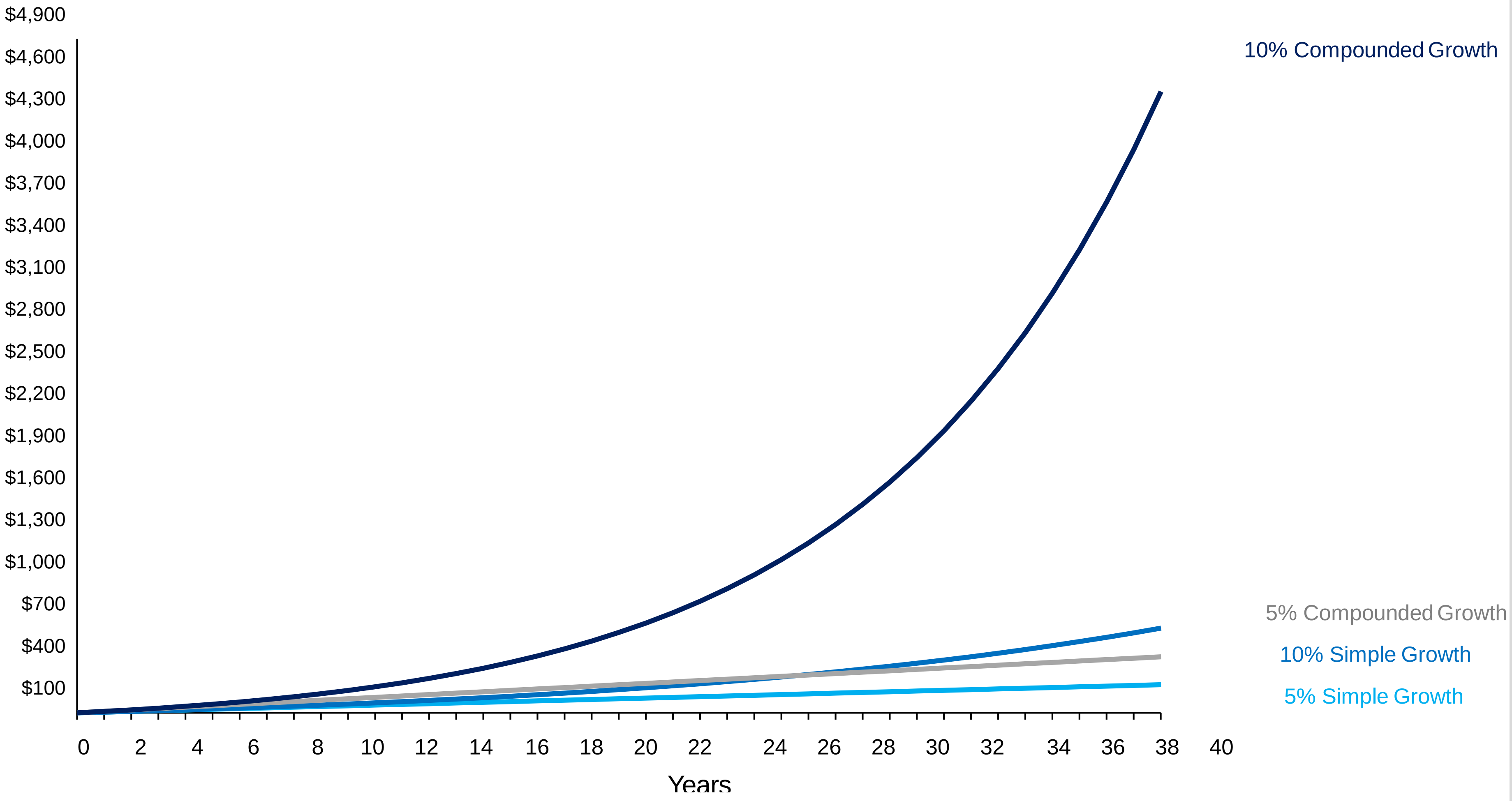
- Albert Einstein’s first theorem: compounding is the most powerful force in the universe
- Suppose my family has 2 descendants per generation (2 children, 4 grandchildren, 8 great grandchildren and so on)
- Suppose your family has 3 descendants per generation (3 children, 9 grandchildren, 27 great grandchildren and so on)
- In 20 generations, I will have 1 million descendants living.
- In 20 generations, you will have 3.5 billion descendants living, and your attributes overwhelm and wipe out mine

Compounding and Returns

- Level of returns - which return would you prefer: 5% compounded or 10% simple (non-compounded)?
- The longer the term, the greater the effect of compounding
- The higher the annual return, the greater the relative increase in wealth from Compounding
- Simple vs Compounded return – See Exhibit 1 on the following page

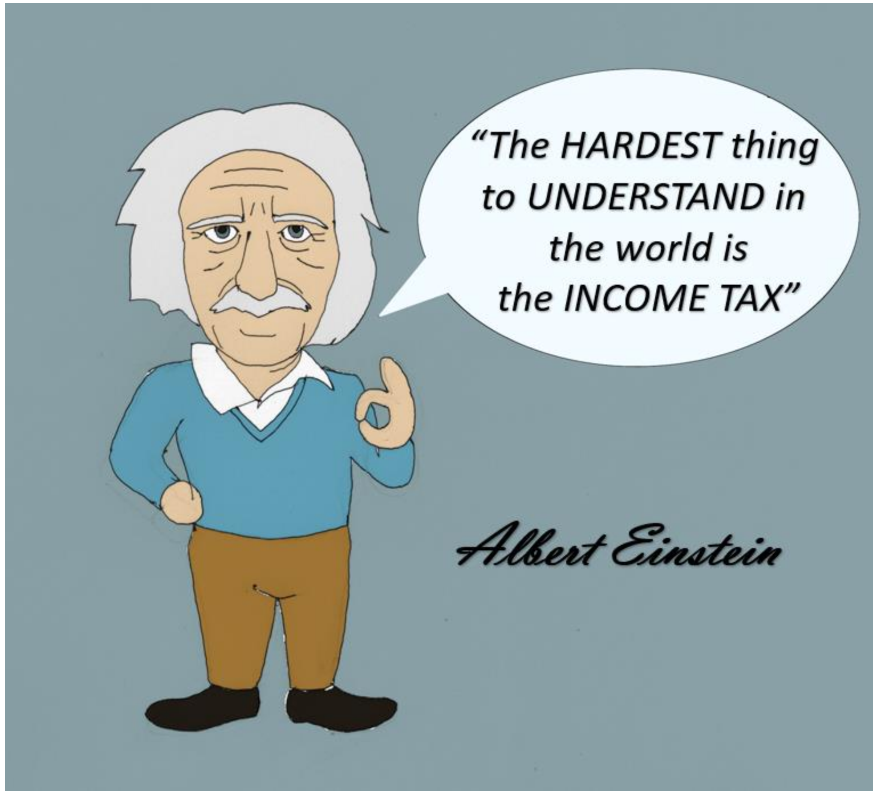


Simple vs. Compounded Return



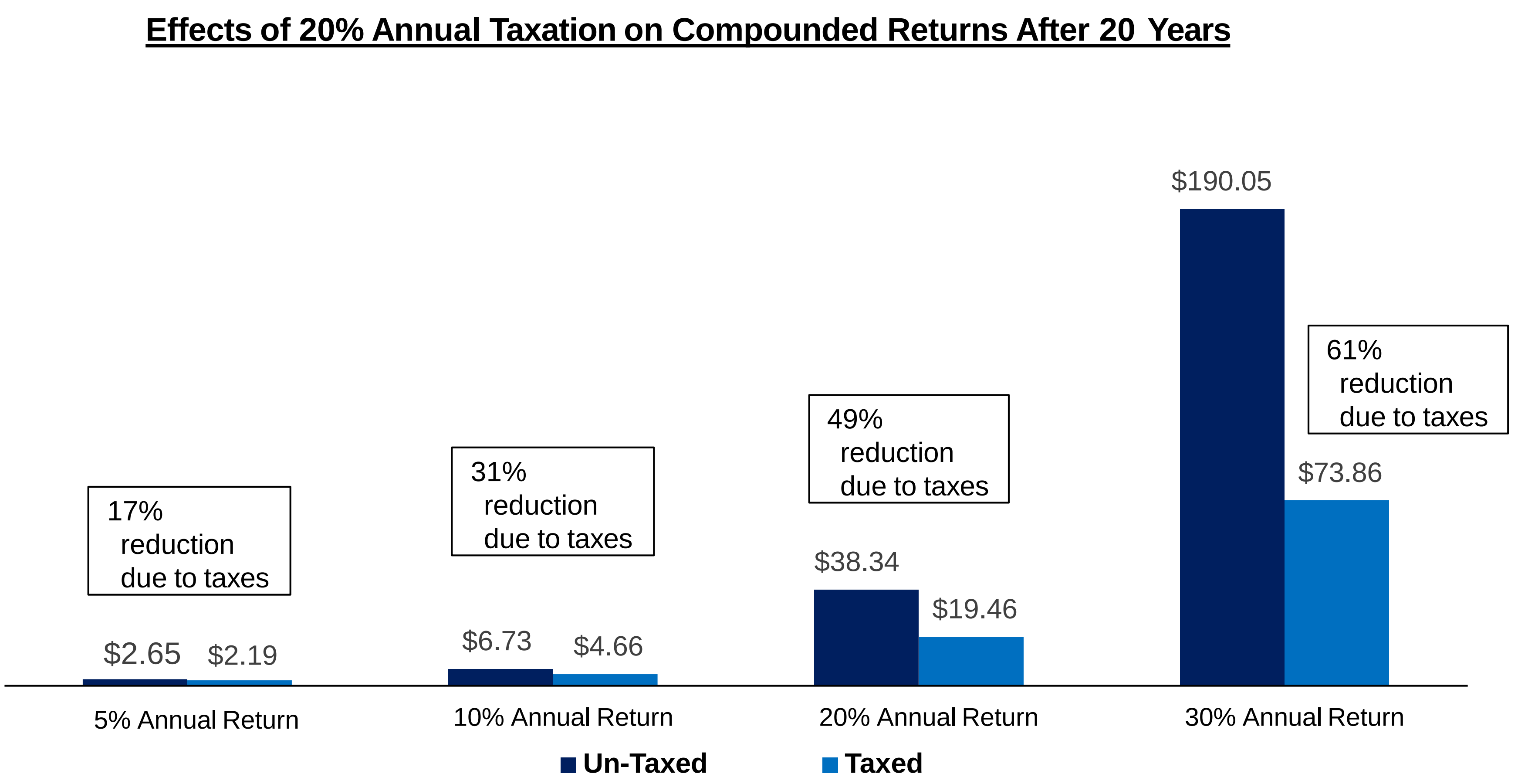
Compounding, Returns, and Taxation

- This leads to another theorem:

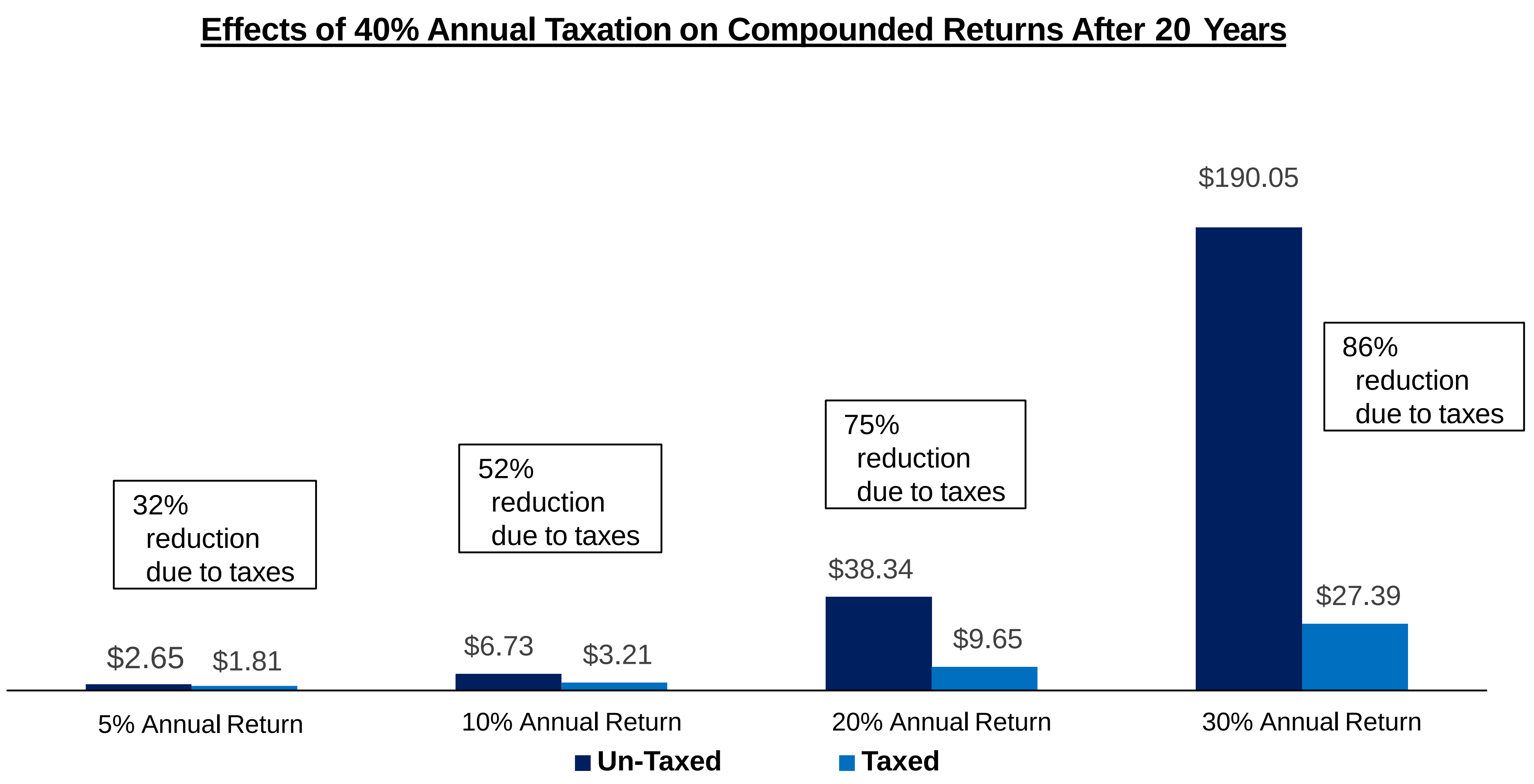


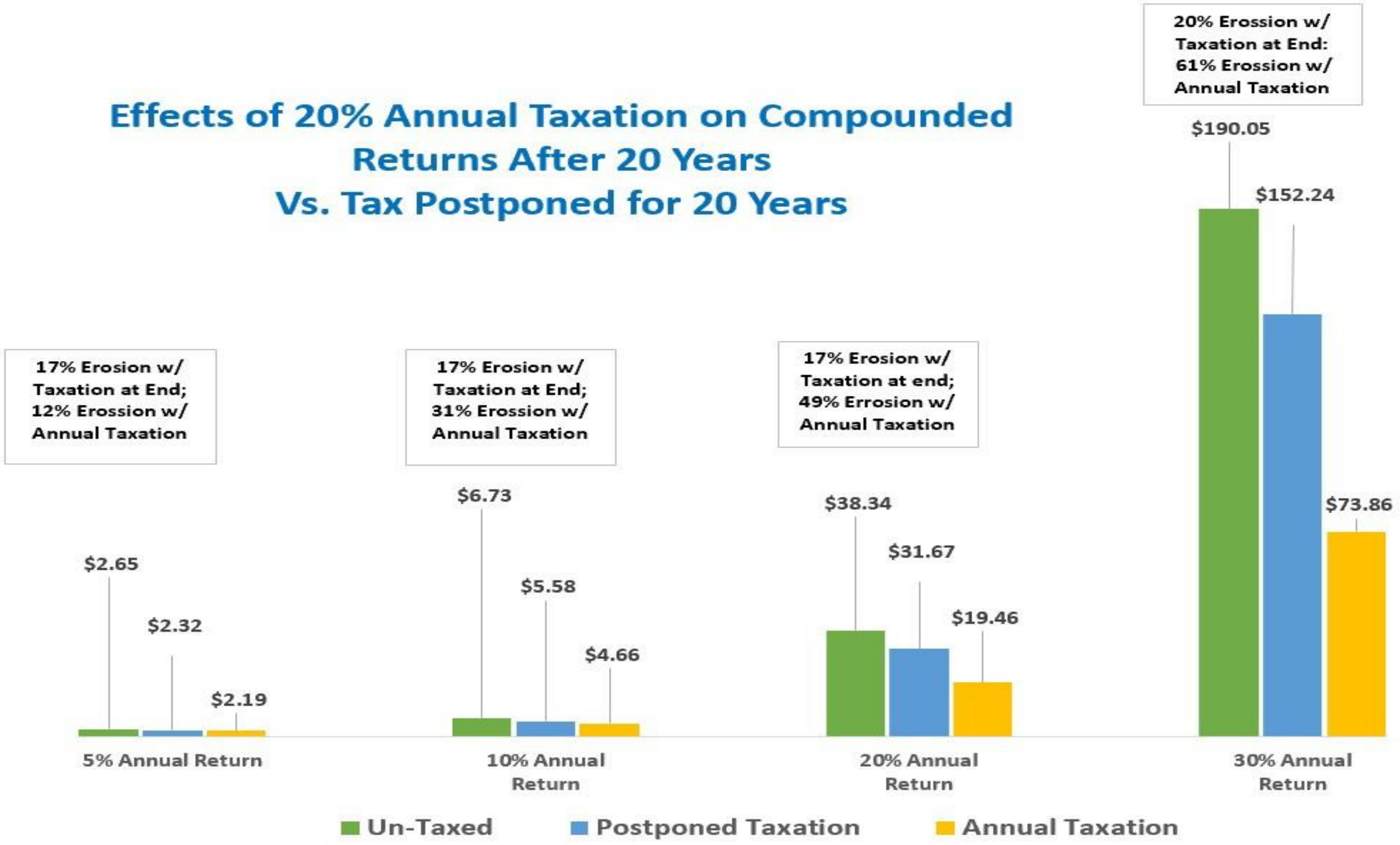
- Which leads us to consider the effects of taxation on compounded returns after 20 years – See Exhibits on the following screens.

Returns and Taxation – What the Numbers Tell Us



Returns and Taxation – What the Numbers Tell Us




Effects of 20% Annual Taxation on Compounded Returns After 20 Years
Vs. Tax Postponed for 20 Years
17% Erosion w/ Taxation at End; 12% Erosion w/ Annual Taxation
17% Erosion w/ Taxation at End; 31% Erosion w/ Annual Taxation
17% Erosion w/ Taxation at end; 49% Errosion w/ Annual Taxation
20% Erossion w/ Taxation at End: 61% Erossion w/ Annual Taxation
$2.65
$2.32
$2.19
$6.73
$5.58
$4.66
$38.34
$31.67
$19.46
$190.05
$152.24
$73.86
5% Annual Return
10% Annual Return
20% Annual Return
30% Annual Return
Un-Taxed
Postponed Taxation
Annual Taxation

Observations

- The higher the effective rate of annual taxation, the greater the erosion of wealth
- The higher the return, the more the return is eroded by current income tax
- Blattmachr’s Corollary: The Most Important Thing in Financial Planning Is Tax Free Compounded Returns

Conclusions, and Why this Matters:

- High compounded returns and low taxation are the keys to building wealth
- The greater the return, the more important the compounding
- The greater the return, the greater the erosion from taxation
- Which method is best to avoid/reduce tax is dependent upon several variables
- ***Retirement assets – because they grow tax free – are an ideal vehicle for wealth building, and should be allowed to grow tax-free as long as possible***
- ***The Big Negative: No Income Tax Free Step-Up at Death***

Overview of Planning for Retirement Benefits, Including “See-Through” Trusts

Retirement Benefits Planning

- As noted, the objective should be to allow retirement assets to grow tax-free for as long as possible. However, the law requires minimum distributions, both when the participant reaches a specific age, and after the participant dies.
- The default rule provides that a retirement plan must be distributed within five years after the participant's death, ***unless*** the participant names a designated beneficiary ("DB"), in which case the time period for required distributions can be extended.
- Under prior law, naming a DB allowed distributions from the retirement plan to be stretched out over the DB's lifetime, extending the tax-free (compounded!) growth. This was often called a "stretch-out" – or if the retirement asset was an IRA, a "stretch-IRA."

See-Through Trust Planning

- But what if the participant doesn’t want to give the retirement assets <u>outright</u> to the beneficiaries? Perhaps they want to shelter the retirement nest-egg from creditors or prevent them from being wasted by a potential spendthrift beneficiary. If so, using a trust would be ideal.
- Under prior law, if a properly drafted ***“see-through”*** trust was used, the same stretch could be obtained over the lifetime of a trust beneficiary – we could look through the trust and treat the trust beneficiary as the DB, allowing distributions over the DB’s lifetime.

Types of See-Through Trusts

- ***Conduit trusts*** require that all distributions from retirement plans be distributed directly (immediately) to the beneficiary of the trust.
- ***Accumulation trusts*** allow distributions from retirement plans to be accumulated at the trust level for later distribution to the trust beneficiary/beneficiaries.
- Because accumulation trusts allow distributions to be accumulated at the trust level, rather than forcing them out to beneficiaries as happens in a conduit trust, they are sometimes preferred.
- However, accumulation trusts are usually less tax efficient, because of the higher income tax rates and compressed income tax brackets applicable to trusts when income is accumulated at the trust level, rather than distributed to beneficiaries (who likely will pay less income tax).

Impact of the SECURE Act

Impact of the SECURE Act - Generally

- The SECURE Act's primary change is to eliminate the ability to have a retirement plan distributed over the lifetime of a DB, unless the DB is an ***eligible designated beneficiary*** ("EDB"), and instead require payout within **ten** years of the participant's death. The life expectancy payout is still available if the DB is an EDB, with a caveat for minor children.
- In other words:
  - Default rule – distribution within 5 years
  - DB – distribution within 10 years
  - EDB – lifetime payout (with caveat)
- See through trusts still work, but with different results in many cases. We now must consider whether the trust beneficiaries are EDBs or "regular" DBs, and adjust the trust language to match with how the SECURE Act operates.

Impact of the SECURE Act In More Detail

- The SECURE Act ***eliminated*** the ability of most beneficiaries (upon the death of the plan participant/IRA owner) to take distribution over the beneficiary's life.
- If the beneficiary is a DB (an individual) or a Conduit Trust or an Accumulation Trust for a DB's benefit, distributions must be taken by the end of the tenth calendar year following the year of the death of the participant. If the beneficiary is not a designated beneficiary (e.g., a corporation or a trust that is neither a Conduit nor an Accumulation Trust), distributions must be taken by the end of the fifth calendar year following the year of the death of the participant, although if the participant has reached the "Required Beginning Date," must use Ghost Life Expectancy ratable under the Uniform Life Table of Reg. 1.401(a)(9)-9 (the "at least as rapidly" rule), which will be longer than five year unless the participant was over 91 years old.
- However, if the beneficiary is an EDB (or a properly drafted trust for an EDB), the life expectancy payout is permitted, but (with exceptions for disabled/chronically ill person) not for an accumulation trust, only a conduit trust.
- Note that the combined federal and state estate and income taxes on Plans/IRAs can be over 85% (e.g., Washington state estate tax plus California income tax, as the proceeds are IRD)

Eligible Designated Beneficiaries

Who is an EDB?

- The participant’s surviving spouse
- A minor child of the participant (but only until the age of majority is reached, at which time the 10-year rule applies)
- A disabled beneficiary
- A chronically ill individual
- A person not more than ten years younger than the participant.

SECURE Act and See-Through Trusts

- Conduit Trusts
  - Life expectancy can be used if the conduit beneficiary is an EDB
  - Distribution required in 10 years if conduit beneficiary not an EDB
  - Identity of remainder beneficiaries is irrelevant (no change)
  - Cannot distribute retirement benefits to anyone other than conduit beneficiary during conduit beneficiary’s life (no change)
- Accumulation
  - Life expectancy can be used for disabled or chronically ill beneficiary (but *whose* life expectancy?)
  - Distribution required in 10 years for all others (does not seem possible to use life expectancy for other EDBs)
  - Still need to make sure all beneficiaries of retirement benefits are DBs

Changes to Existing Trusts and Planning with New See-Through Trusts

Existing Conduit Trusts

- There will now be accelerated payout for non-EDBs (all retirement plan assets in the hands of non-EDB beneficiaries distributed in ten years, instead of having those assets paid out over lifetime) – so some clients may want to switch to an accumulation trust. Note that unlike prior life expectancy payouts where distributions had to be taken each year, distributions can be postponed until the end of the tenth year. Could this be beneficial for some?
- An existing conduit trust for a surviving spouse may not need any revisions, since the spouse is an EDB
- Language may be subject to interpretation – or need revisions after SECURE:
  - Required Minimum Distributions (“RMDs”) are based on the Applicable Distribution Period (“ADP”), often defined in the trust as the conduit beneficiary’s life expectancy (which no longer applies unless the conduit beneficiary is an EDB)
  - However, savings language may provide for distribution of the RMD “or such greater amount ….to avoid penalty”

Existing Accumulation Trusts

- *<u>Previous language needs to be revised</u>*
  - References to “Measuring Life” are no longer relevant
  - Same issue as conduit trusts in definition of RMD/ADP
  - Needs to be tailored to contemplate new class of beneficiaries: disabled or chronically ill
  - Often, trust only applies to benefits that may be paid over the life expectancy of an individual beneficiary – which will no longer be the case for most
- ***Note: an accumulation trust for surviving spouse will not achieve life expectancy stretch*** (unless the spouse happens to be disabled or chronically ill)
- Accelerated distributions to the trust will result in faster depletion due to trust income tax rate/compressed brackets

Planning Tips: Best Practices

- No clear rule of thumb on which see-through trust to use – the recommend plan depends on the client's situation and goals
- Conduit Trusts
  - Advantages: Easier to explain; life expectancy stretch for EDBs; individual income tax rates
  - Disadvantages: Loss of creditor protection and financial management; loss of control after funds distributed to beneficiary
  - ADP: Life expectancy for EDB; 10 years for DB
- Accumulation Trusts
  - Advantages: Ability to control and protect assets
  - Disadvantages: Likely no life expectancy stretch except for disabled or chronically ill; trust income tax rates
  - ADP: 10 years for DB; 10 years for most EDBs; life expectancy for disabled or chronically ill

Planning Tips: Classes of Beneficiaries

- Outright is still an option; must weigh factors in favor of using a trust
  - EDB: Life expectancy
  - DB: 10 years
  - Estate, charity, non-DB trust: 5 years
- Trust planning
  - Surviving spouse: Conduit for life expectancy stretch, but need to consider blended families
  - Disabled or chronically ill EDB: Special rule seems to allow life expectancy stretch with accumulation trust (though technical question over life expectancy); likely better for preserving needs-based benefits
  - EDBs: Conduit trust achieves life expectancy stretch; accumulation provides better protection (but only works for certain EDBs)
  - Non-EDBs: Considerations same as before, but the best outcome is 10-year stretch

Planning Tip: Should we Still Use Trusts?

- Likely yes – benefits of asset protection, asset management, preventing the foolish or wasteful dissipation of wealth, avoiding loss of governmental benefits (such as Medicaid), and possibly avoiding state income taxation
- However, trusts and retirement assets are a complicated mixture
- A Conduit Trust permits the life expectancy payout to be used for an EDB (partial only for a minor) but all Plan/IRA distributions the trust receives must be immediately distributed to the EDB. Good News: Taxation at individual rates. Bad News: Creditor protection lost (including potential loss of government benefits like Medicaid)
- An Accumulation Trust will not permit life expectancy payout for an EDB other than a disabled or chronically ill person. Good News: Distributions may be accumulated so creditor protection and governmental benefits may be maintained. Bad News: Distributions are taxed at the trust’s compressed rates.

Individual vs. Trust Tax Rates (federal)

- Trusts hit the top rate (37%) for taxable income over $12,950 and enjoy only a $100 or $300 “standard” deduction (other than for Qualified Disability Trusts)
- Individuals hit the 37% rate only when taxable income exceeds $500,000 and enjoy a standard deduction of somewhere between $12,000 and $24,000.
- Examples (income not subject to Net Investment Income Tax (“NIIT”):
  - Tax due on $25,000 of income by Single Individual ($1.342) Married Couple ($60) Trust ($7,551)
  - Tax due on $100,000 of income by Single Individual ($15,247) Married Couple ($8,684) Trust ($35,301)
  - Tax due on $200,000 of income by Single Individual ($41,413) Married Couple ($30,493) Trust ($72,301)
- Over the years, this could make a ***huge*** difference in the level of wealth

How to Postpone Tax – But Is It Worth It?

- All DBs (individual beneficiaries) can postpone receipts until the end of the tenth calendar year (but if they do, the “bunched” income may be exposed to higher rates).
- Alternatively, a DB can take distributions in any manner during the ten years.
- An EDB (or a Conduit Trust for an EDB) must take annual payments over his or her life expectancy beginning the year after the participant dies.
- For a minor, life expectancy distributions are required until minor reaches majority when the ten year regime kicks in. So for a minor, you could have a maximum deferral of perhaps 28 years (for a newborn) or only 10 years, if the minor is already 18 (unless course of education may also be used to determine the age of majority – which could add a few years to the deferral).

Planning for Minors

- If you want the (modified) life expectancy payout, you can't use an Accumulation Trust for a minor EDB (unless disabled or chronically ill), because the ten-year payout regime will apply.
- Conduit Trusts require immediate distribution to the EDB upon receipt by the trust. A distribution to a custodian under UTMA for a minor beneficiary (whether or not an EDB) may not be treated as a distribution to the beneficiary - we just don't know. A guardianship? How else could it be done?
- Non-Conduit Trust/non-Accumulation will mean all must be withdrawn within ***five*** years (or if RBD has been reached, under the ghost life expectancy rule) and, unless distributed to the minor (or a Custodian under a UTMA law) will be taxed at the trust's compressed rates. Hence, double trouble: five year payout and trust income tax rates.

What is "Typical?"

- In our experience over the past six months, we generally see conduit trusts being used for spouses (if an outright gift is problematic), and accumulation trusts for descendants.
- However, many are still using conduit trusts for minors to extend the payout and allow more tax-free growth, particularly if the children are very young.
- The most common beneficiary designation is probably outright to the spouse, followed by accumulation or conduit trusts for younger descendants.
- Existing conduit or accumulation trusts, however, likely need revision to match up with the new provisions in the SECURE Act.

Creative Trust Planning Ideas

Charitable Remainder Trust

- Three Types: annuity trusts, unitrusts, and income only (or net income make-up) unitrusts (NIMCRUTs).
- All are required to pay out at least 5% annually except a NIMCRUT, which must pay the lesser of the unitrust percentage or fiduciary accounting income (“FAI”). To the extent FAI is less than the unitrust percentage, this can be made up when and if FAI exceeds unitrust amount in future years.
- Can’t violate the 5% probability of exhaustion test (only applicable to annuity trusts) or the 10% minimum value of the remainder requirement
- Bad News: Plan/IRA must be distributed within five years (or ghost life rule)
- Good News: No income tax due upon receipt of Plan/IRA distributions as CRTs are income tax exempt. Distributions from the CRT will be included in income – so income tax deferral continues.
- The additional time the trust is exempt from income taxation inside the CRT may not always offset the cost to individuals of the loss of the value of the remainder interest passing to charity upon the termination of the CRT
- It is always desirable for the remainder to be 10% and no greater--that is the price you pay for renting charity’s exemption from taxation (and you always want to pay the lowest rent)

Charitable Remainder Annuity Trust

- Charitable Remainder Annuity Trusts (CRATs):
- Good News: Annuity is paid regardless of investment performance
- Bad News: No participation in growth inside the trust. Keep in mind that, over time, stocks have, in general, grown in value. The value of the (fixed) annuity will be eroded, overtime, by inflation. At 3% annual inflation, a dollar is worth only 73 cents in ten years.
- The 5% probability of exhaustion and the 10% minimum value of the remainder tests are determined by the size of the annuity and the Section 7520 rate. The lower that rate, the greater the risk these tests will be violated. A CRAT for life cannot be used if the rate is 2% or less and cannot be used for someone younger than 57 if the rate is 4% or less.
- We cannot know ahead of time what the Section 7520 rate will be at death. Hence, a deathtime CRAT for life is risky. (Can use a formula to switch to a term of year CRAT if one for life would violate one of the tests.)
- Conclusion: Don't plan on naming a deathtime CRAT for life to be a Plan/IRA beneficiary.

Charitable Remainder Unitrust

- Charitable Remainder Unitrusts (CRUTs):
- Bad News: Unitrust payments will decline if value of trust declines.
- Good News: Direct participation in growth occurring inside the trust, which means there is an inflation hedge. No real concern about 5% probability of exhaustion test with a CRUT. 10% minimum value of the remainder will be met (regardless of Section 7520 rate) if the trust is to pay an 11% unitrust amount each year for 20 years. Can pay 5% a year for life for anyone at least 28 years old.
- Question: If you anticipate that the investments inside the CRUT will decline, what should you do?
- Answer: Get a new investment adviser.
- Bottom Line: The CRUT will “work” well whenever the annual taxable income earned inside the trust exceeds the current payout: tax free (deferred) compounded will be experienced.

Net Income Make-up Charitable Remainder Unitrust

- Charitable Remainder Income Only Unitrusts (NIMCRUTs):
- Bad News: Again, unitrust payments will decline if value of trust declines. Beneficiary will receive less if FAI is lower than the unitrust amount. Can be made up in later years to the extent FAI exceeds unitrust payment then due.
- Good News: By keeping FAI to a minimum, the trust will grow income tax free. Tax character (e.g., long-term gains) is retained for later payouts. (For Plans/IRAs it is all ordinary income). Hence, tax-deferred compounding continues, perhaps until just before the trust ends and the make-up amounts are paid—e.g., 20 year end of the NIMCRUT vs. end of 10 years for the Plan/IRA.
- How to control amount and timing of receipt of FAI: Invest through an entity (such as a limited partnership). Note the person controlling distributions from the entity should not be the grantor, the beneficiary, the trustee or anyone related or subordinate to any of them. Rev. Proc. 97-23. Consider adding a FLIP provision to switch to a straight CRUT.
- The NIMCRUT seems to be the best of all three for maximum wealth build up.

Are Individuals Better off with a CRT?

- It depends.
- Consider anticipated needs of the beneficiary; anticipated growth; anticipated income taxation; consider when the trust will end. A necessary question: Is giving the remainder to charity worth the additional stretch, etc.? Perhaps, consider a wealth replacement trust (life insurance) but how long will the beneficiary live? Is the beneficiary uninsurable?
- A CRT is less likely to be better for an EDB who can use life expectancy payout (limited for a minor child of the Participant until majority but then 10 more years).
- Run the numbers. Disclaimer might be considered to switch over to a CRT. Consider a conditional disposition ("If the transfer to the following CRT for my daughter, Jacqueline, would not violate the 5% probability of exhaustion test or the 10% minimum value of the remainder trust, then… If it would, then…").
- Consider a conversion just before death to a Roth IRA.

NIMCRUT Example 1

- $1 million IRA payable to a NIMCRUT to pay the lesser or FAI or 11% for 20 years.
- Assume the trust will grow at 6% a year and no unitrust payments are made for the first 19 years because there is no FAI and the NIMCRUT will be worth$3,207,135.
- If instead, the beneficiary received the amount in the plan or IRA in ten years (which would be $1,790,847 or $1,128,234 after a 37% income tax) and that were invested at 6% taxable each year (or 3.78% after a 37% tax) for another ten years, the beneficiary would then have $1,635,068.
- With the NIMCRUT if no unitrust payments were made until the end of 20 years, the recipient would have faced total shortfalls for the first 19.
- The CRT in 20 years at 6% annually would then be worth $3,207,135.

NIMCRUT Example 2

- The increase in value from the inception would be $2,207,135 and if that entire amount were paid out at the end of the 20-year term and all of it was FAI, the beneficiary would net $1,390,495 after a 37% income tax. Perhaps, it would be possible for the trust to pay more of the shortfall to the unitrust recipient (although, again, never more than the $3,201,135 in the trust), so that, after a 37% income tax, the recipient would have more than $1,635,068. That obviously would mean charity would get after 20 years less than $1,000,000.
- Indeed, if the charitable remainder beneficiary received $150,000 at the end of 20 years that would represents a 2% compounded growth for the 20 years on the $100,000 value of the remainder at inception of the trust.
- So, if $3,057,000 FAI were received in the 20th year and paid to the unitrust recipient and subjected to a 37% tax, the recipient would have $1,926,000 significantly more than if the NIMCRUT were not used.

CRT plus an LLC or LP

- The IRA would fund the NIMCRUT (although it could be formed before death) and the trustee would add it to a partnership or LLC. Alternatively, it could be made payable to a single member LLC which the NIMCRUT owns--in that case, the estate would still get the estate tax charitable deduction for 10% of the IRA. I didn't factor that in.
- But of course, if it is factored in, the "cost" of giving the remainder to charity would be 6% rather than 10 percent of the $1million IRA. Actually, it would be more than 6% because there would be more in the trust. For example, if the $1 million IRA is subject to a 40% estate tax, there would be only $600,000 of the IRA left. But with a 10% charitable deduction, only about
- $360,000 rather than $400,000 of estate tax would be due so there would be about $640,000 would be in the CRT (net of the estate tax).
- So that would be a $64,000 charitable interest in the NIMCRUT at inception which would grow at, say 3% a year, for 20 years, so charity should receive $115.600 after 20 years, which is when I've assumed the NIMCRUT would end.
- Bottom line: a NIMCRUT may produce more wealth at the end of the day. Of course, this assumes the beneficiary can wait. By the way, the trustee could be given discretion as to whom the unitrust payments could be made from any class you want, such a regular trust or any descendants, if the CRT must end in 20 years

Sale of an Interest in a CRT

- Does the sale of the unitrust/annuity interest result in long term capital gain as per Rev. Rul. 72-243?
- Or does the substitution of ordinary income doctrine apply? See, e.g., *Lattera v. Commissioner*, 437 F.3d 399 (3d. Cir. 2006) (proceeds of sale of winning lottery ticket is ordinary income, which the lottery winner would have received, and not capital gain).
- Would the result be different if the CRT sold off the right to the IRD?
- Even if there is conversion into capital gain, compare the delay of ordinary income to up-front capital gain?
- This probably should be viewed as an aggressive strategy.

Could a Section 678 Trust Be Better?

- Only consider this if a trust will help accomplish important goals, such as asset protection, maintenance of entitlement to government benefits, better asset management, avoiding foolish/unwise dissipation of wealth or some other goal.
- How could a Section 678 Trust (aka BDIT) help?
- A Section 678 Trust is one of the deemed owner trusts under the so-called “grantor trust” rules of subpart E (Sections 671 to 679). Under Section 678, the beneficiary with a right to withdraw everything from a trust is essentially treated as though she were the trust’s grantor for grantor trust purposes. So all income, deductions and credits are directly attributed to the beneficiary.
- But first, why doesn’t a Conduit or Accumulation Trust produce great results?
  - A Conduit Trust must distribute all Plan distributions to the trust beneficiary of a trust causing a loss of trust benefits although distributions are taxed at individual rates.
  - An Accumulation Trust can preserve the benefits of a trust but the distributions will be taxed at the compressed trust rates (e.g., 37% for income above $12,950).

Section 678 Trusts - Continued

- Under Section 678, the beneficiary will be taxed on all Plan/IRA distributions at the individual rates (but state income tax may be avoided with a trust).
- Creditor protection will be lost in many states (so create the trust elsewhere—Alaska; South Dakota)
- The Section 678 Trust likely will be included in the beneficiary’s gross estate.
- The withdraw power could be partially released or modified but retain Section 678 status. (PLR 200944002, not precedent). But even in that case, a five year period of ineligibility for government benefits (e.g., Medicaid) will arise.
- Is a Section 678 Trust a type of “see through” trust? To ensure the ten year payout (rather than five), the Section 678 Trust should be structured as a ten year payout Accumulation Trust. If is unclear how, if at all, the “at least as rapidly” rule applies to the ten-year payout rule.
- A lifetime payout Accumulation Trust which is a Section 678 Trust may be used for a Disabled or Chronically Ill person (but with a likely five year ineligibility).
- A lifetime Accumulation Trust may not be appropriate for surviving spouse or minor as it likely will trigger the ten years payout. So the critical issue is whether taxation at individual rates more than offsets a more rapid payout and other detriments (like loss of benefits, such as Medicaid).

What About a QSST?

- The income of an S corporation is taxed to the shareholders. The “flavor” of the income generally remains the same so NIIT is avoided on retirement plan/IRA distributions paid to the corporation.
- Only US individual taxpayers, their estates, and certain trusts can be S corp shareholders.
- A QSST is a trust where the beneficiary (who is not the grantor) elects to be taxed under Section 678 on the S corporation income as though she were the shareholder. The trust can have only one beneficiary (a US individual taxpayer) and must be required to pay, or does in fact pay, all of its FAI to the beneficiary. It is likely distributions must be taken by the S corporation under the five-year rule (or if the RBD has been each, ratably under the Uniform Life Expectancy rule).
- There will be no FAI unless the S corporation pays a dividend.
- No requirement for the S corporation to have a business purpose and no risk of PHC or Accumulated Earnings tax .
- Trustee can use dividends to pay the beneficiary’s income tax liability so dividends are protected from creditor claims ,and any such payment is not treated as a resource for government benefits such as Medicaid.

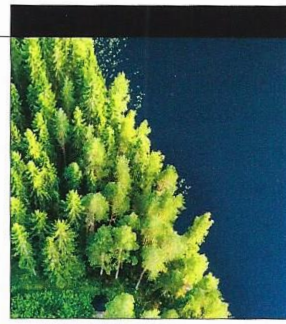
Conclusions

Conclusions

- The SECURE Act greatly reduced the power of compounding by limiting most income tax deferral to ten years.
- The elimination for most beneficiaries of the lifetime stretch means greater income taxation of Plan/IRA proceeds.
- Most will face a ten year payout regime. They can wait until the tenth year but that will bunch income into one year, probably meaning a higher tax rate. It may be difficult to determine if that is better. (“A tax dollar delayed may never be paid”)
- If using trusts for retirement benefits, the trust language likely needs to be updated to obtain the longest available deferral – ten years for most beneficiaries; lifetime for a select few – rather than triggering the default five-year rule.
- Planners using trusts must consider the distribution requirements of certain trusts along with their (possibly disadvantageous) income tax consequences

Conclusions - continued

- Consider creative trust strategies – a NIMCRUT, a Section 678 Trust or a QSST may provide opportunities to delay income taxation. But, in effect, each comes with a price.
- For a NIMCRUT, the price is the value of the remainder passing to charity.
- For a Section 678 Trust, the price is the potential loss of creditor protection (but not if created in some jurisdictions) and there will likely be at least a five-year loss of government benefits (e.g., Medicaid). Also, the five-year payout rule (or ghost payout rule) may apply.
- A QSST may be a good choice for some although the five-year payout regime (or if RBD has been each the Ghost Life Expectancy rule) likely must be used, which makes the comparison more difficult.
- Consider "running the numbers" but the future tax system (including rates) is an uncertainty.



The SECURE Act, Trusts, Corporations and CRTs

Consideration of the various options to reduce the impact of the SECURE Act's elimination of the "stretch IRA."

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This article discusses some of the complications that have arisen because the SECURE Act[1] eliminated so-called "lifetime stretch" payments from a qualified (retirement) plan or an IRA (each a "Plan") for most beneficiaries, especially where it is desirable to have the payments made to and possibly kept in a trust. Specifically, among alternatives considered is the possibility of creating a trust described in Section 678 ("Section 678 Trust") for the individual intended to be benefited by the Plan. Another possibility is naming an S corporation the beneficiary of a Plan where the shareholders of the S corporation include or consist exclusively of one or more qualified subchapter S trusts[2] ("QSSTs") for the individual or individuals intended to be benefitted by the Plan. At least one of the reasons for these potential beneficiary designations is so that Plan distributions will be subject to income tax at the rates applicable to individuals rather than at the compressed rates that apply to non-grantor trusts[3].

A Section 678 Trust may hold significant promise for some although it may raise issues not confronted when using a QSST. Nonetheless, as discussed in detail below, if a QSST is used, it seems that the Plan benefits might be required to distributed by the end of the fifth calendar year following the year of the death of the IRA owner or employee of a qualified plan (each a "Plan Holder") rather than at the end of the tenth calendar year following the Plan Holder's death.

Some Benefits and Burdens of Trusts

Trusts serve many purposes including providing asset protection and avoiding unwise dissipation of wealth.[4] In addition, trusts may provide the best opportunity to reduce estate, gift and generation-skipping transfer tax.[5] Trusts also may offer the most efficient platform for income tax planning as a result of the ability to shift income from the trust to its beneficiaries[6] and to do so within 65 days after the close of the trust's tax year,[7] and to avoid state income taxes.[8] Income which is taxed to the trust will likely face high federal income taxes. In 2020, the taxable income of a trust above $12,950 will be taxed at the highest federal rate (37% on ordinary income) and gen-

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erally subjected to the net investment income tax under Section 1411 of 3.8%, although this latter tax does not apply to Plan distributions.[9] Individuals face those rates essentially only when their incomes exceed $500,000 and $200,000, respectively.[10]

Impacts of SECURE Act Changes on Trusts

The SECURE Act has ended the ability, for many beneficiaries, to "stretch" distributions from a Plan over a long period of time, based upon the fixed (unrecalculated) life expectancy of an identified individual beneficiary (called the "Designated Beneficiary"), either directly or through a so-called "see-through trust" for the individual.[11]

Under the SECURE Act, see-through trusts may continue to be used for any Designated Beneficiaries, but the Plan must be entirely distributed not later than the end of the tenth calendar year after the calendar year of the death of the IRA owner or plan participant, except where the beneficiary falls in one of five categories of individuals called "Eligible Designated Beneficiaries" or "EDBs." [12] Payments may also be made over the remaining life expectancy of the Plan Holder who dies after reaching his or her required beginning date ("RBD"), which is when he or she must begin withdrawing required minimum distributions ("RMDs") or face extra taxes imposed by Section 4974.

See-through trusts consist of what are called "Conduit Trusts" and "Accumulation Trusts" and are commonly referred to as "see-through trusts" because one may look through the trust to find the Designated Beneficiary.[13] A Conduit Trust is one that mandates that all Plan distributions be paid out immediately to the identified individual beneficiary of the trust. An Accumulation Trust may pay or accumulate Plan Distributions although all beneficiaries of the trust must be identified individuals (by name or description) and are called "Designated Beneficiaries."

Here is a key takeaway: If the Plan Holder wants the Plan proceeds to pass into and stay in trust for asset protection or other reasons, an Accumulation Trust may be used; however, all the Plan proceeds must be distributed within ten years after the year of the death of the Plan Holder (unless the individual trust beneficiary is in a certain category of EDB, as discussed below).[14]Moreover, it is virtually certain, in almost all cases, that if a non-grantor trust is the direct recipient of the Plan proceeds and does not distribute them, the trust will face higher federal income taxes under the compressed trust rates than would an individual beneficiary.[15] Thus, if a trust is desired, the question might be whether a trust taxable under Section 678, with an individual deemed owner of the trust, or an S corporation, with a QSST shareholder, may be used to mitigate the income tax burden of Plan proceeds distributed in trust and accumulated.

1 The "SECURE ACT" is the nickname for Section 401 of Title IV – Revenue Provisions of "Division O" (Setting Every Community up for Retirement Enhancement) of the Further Consolidated Appropriations Act, 2020, signed into law on December 19, 2019.

2 Such a trust is described in Section 1361(d).

3 A non-grantor trust is one that is not a deemed owner trust (commonly called a "grantor trust)" under the provisions of subpart E of part 1 of subchapter J of Chapter 1 of the Internal Revenue Code of 1986 as amended ("Code").

4 See Blattmachr and Blattmachr, "Even Without Estate Tax, the Right Answer Still Is: Put It All In Trust," Alaska Trust Company Newsletter (June 2011).

5 Blattmachr, "The Right Answer: Put It All In Trust," Trust & Investments, (Sept/Oct 1998), republished in 10 NYSBA Elder Law Attorney 12 (Winter 2000).

6 See Sections 651-652 and 661-662.

7 See Section 663(b). There are many other distinctions between the taxation of trusts and other entities such as the allowance of an income tax deduction for a trust under Section 642(c); see, generally, Blattmachr, Boyle, and Fox, "Planning for Charitable Contributions by Estates and Trusts," 44 Estate Planning 3 (January 2017).

8 See, generally, Blattmachr and Shenkman, "State Income Taxation of Trusts: Some Lessons of *Kaestner*," 46 Estate Planning 3 (Oct 2019); Gans, "*Kaestner* Fails: The Way Forward," 11 Wm. & Mary Bus. L. Rev. 651 (2020). State income taxation may be avoiding by using an electing small business trust described in Section 641(c). See, generally, Boyle, Blattmachr, and Gans, "Planning Opportunities with ESBT's: Saving State and Local Income Taxes," 129 Journal of Taxation 20 (July 2018).

9 Section 1411(b)(5) and see, generally, Blattmachr, Gans, and Zeydel, "Imposition of the 3.8% Medicare Tax on Estates and Trusts," 40 Estate Planning 3 (April 2013).

10 Sections 1 and 1411, respectively.

11 See Section 401(a)(9) before and after the effective date of the SECURE Act.

12 This means that payments may be received, in general, over 11 calendar years. For example, if the Plan Holder dies in 2021, the tenth calendar year following the death is 2031, so there are 11 calendar years, including the year of death, to receive payments under the ten-year rule. Similarly, there will be six calendar years to receive Plan Distributions under the five-year rule discussed in the text. However, if the Plan Holder dies late in a calendar year, it likely will not be possible to receive a distribution in that year.

13 For a thorough discussion of these trusts, see Choate, Life and Death Planning For Retirement Benefits, 8th Ed., at 6.3.05 and 6.3.07.

14 If payable to a Conduit Trust, the Plan distributions need not be made for ten years (if the 10-year rule applies) but the distribution must be distributed immediately to the individual trust beneficiary foiling the premise of keeping them in trust. If the life expectancy rule applies (because the beneficiary is an EDB), distributions must commence the year following the date of the Plan Holder. See Choate, "Drafting See-Through Trusts After the SECURE Act," 159 Trusts & Estates 36 (April 2020).

15 If Plan proceeds are payable to a beneficiary, or to a see-through trust for the benefit of a beneficiary (such as a Conduit Trust or, for a Disabled or Chronically Ill person an Accumulation Trust), who will not reach the age of least 19 (or 24 if still a student) during the year, the so-called Kiddie Tax provisions may apply if, among other conditions, the beneficiary has at least one living parent at the end of the year. Section 1(g)(4)(C). The Tax Cuts and Jobs Act of 2017 provided for unearned income of children under the age of 19 (or 24 if the child were still in school as specified in Section 1) to be taxed at the compressed rates applicable to estates and trusts, which reach the maximum income rate and net investment income threshold once taxable income exceeds $12,950 (inflation adjusted). The SECURE Act repealed this provision and goes back to pre-TCJA provisions (but only through 2025) so the unearned income of such a child is taxed at the parents' marginal rates. Under these Kiddie Tax rules, the unearned income of the child not only will be taxed at the parent's marginal rates (which may still be below the top rate the trust would reach for income above $12,950), the parent can opt, under certain conditions, to include that income as the parent's own and pay the tax on that income. The parents do that only if the unearned income consists of interest and dividends (including the Alaska Permanent Fund Dividends). Section 1(g)(7).

Eligible Designated Beneficiaries

EDBs consist of (1) the surviving spouse of the Plan Holder (again, the plan participant or IRA owner); (2) chronically ill persons defined in Section 7702B(c)(2); (3) disabled persons as defined in Section 72(m)(7); (4) persons not more than 10 years younger than the Plan Holder;[16] and (5) minor children of the Plan Holder.

An EDB is permitted to withdraw Plan assets over his or her fixed (unrecalculated) life expectancy which must begin in the calendar year following the year of the Plan Holder's death, except in the case of the Plan Holder's surviving spouse or minor child. A surviving spouse may delay taking RMDs until the year after the year of the Plan Holder's death or, if later, the year in which the Plan Holder would have reached age 72. However, the only way the surviving spouse may delay taking RMDs until the surviving spouse's own RBD is if the surviving spouse rolls over the benefits to the surviving spouse's own IRA, which the surviving spouse may only do if the surviving spouse is named outright as the beneficiary of the Plan; a Conduit Trust for the surviving spouse does not permit such a rollover. If the Plan proceeds are left to the spouse outright, and the spouse rolls them over to an IRA, the surviving spouse may then take withdrawals (starting at age 72) using the Uniform Lifetime Table (ULT), as opposed to using the surviving spouse's recalculated life expectancy.[17] The ULT is a joint life table which is more favorable than the single life table applicable to a Conduit Trust. If the Plan proceeds are left to an Accumulation Trust, RMDs may not be based upon the life expectancy of the surviving spouse, and instead, the 10-year payout rule will apply.[18]

In the case of Plan proceeds payable to a minor child, the 10-year payout rule also will not apply until the minor child reaches the age of majority. Once the minor child reaches the age of majority, the 10-year rule will commence.[19] If an Accumulation Trust is used from inception, the Plan proceeds must be distributed under the 10-year payment rule because the minor child would not be treated as the sole beneficiary of the Plan (unless Disabled or Chronically Ill).

Non-Designated Beneficiaries

Just as was the case before the SECURE Act, if any of the Plan distributions must or may be paid to a person which is not a Designated Beneficiary (e.g., a corporation, an estate, a partnership or any trust that is not a see-through trust), all Plan distributions must be taken out by the end of the fifth calendar year following the year of death of the Plan Holder.

Bunching of Income and Other Problems

In all cases, distributions may be delayed until the end of whichever of the ten-year or five-year payment rules applies. Delaying income taxation often is beneficial, but it may be preferable to take Plan distributions over more than one year to spread out the income over several tax years, which may reduce the applicable tax rates.[20]

In order to comply with the special stretch rules for an EDB, the Plan distributions, in general, must be made directly to the EDB or to a Conduit Trust for him or her. Only a Disabled or Chronically Ill EDB

16 Section 401(a)(9)(E)(ii).

17 See Choate, "Drafting See-Through Trusts After the SECURE Act," 159 Trusts & Estates 36 (April 2020) for a discussion of these rules as they exist after the SECURE Act changes.

18 Id.

19 Some advisers think that, perhaps, if a Conduit Trust is used for a minor child, the trust may convert to an Accumulation Trust when the minor child attains majority. However, this seems inconsistent with Reg. 1.401(a)(9)-5, A-7(c)(3) although that regulation was enacted prior to the SECURE Act.

20 For a Roth IRA, described in Section 408A, it usually will be best to wait until the end of the period as distributions generally will not be included in gross income and leaving Plan proceeds in the Roth IRA will permit further tax-free accumulation.

21 See Choate, "Drafting See-Through Trusts After the SECURE Act," supra.

22 See note 15.

23 A grantor trust is one the income, deductions, and credits against tax of which are attributed to the grantor or other income tax owner. See Sections 671-679. A trust that is not a grantor trust is taxed as a separate taxpayer under special rules primarily under subchapter J of Chapter 1 of the Code.

24 See Choate, Life and Death Planning for Retirement Benefits, 8th Ed., at 6.3.05.

25 The income and asset value levels are relatively low, subject to exceptions and special rules. See, generally, Feke, "Medicaid Eligibility: MAGI and Your Assets," available at https://www.verywellhealth.com/your-assets-magi-and-medicaid-eligibility-4144975.

26 See Section 1(e) and Sections 651, 652, 661, and 662. If the EDB is disabled, the trust possibly could be structured as a Qualified Disability Trust (QdisT) within the meaning of Section 642(b)(2)(C) which is entitled to a personal exemption of $4,250 (inflation adjusted). Moreover, it may be especially helpful if the beneficiary is a child whose unearned income would otherwise be taxed at the marginal rates of the child's parent(s) under the Kiddie Tax. A QdisT not only enjoys a personal exemption of $4,150 (inflation adjusted) through 2025 but, by making distributions of the balance of the income to the child, could be taxed at the child's rate (because the Kiddie Tax does not apply to distributions from a QdisT as they are treated as earned income of the child who is the beneficiary) and essentially using a $12,000 standard deduction because the income from a QdisT is considered earned income. This all will be beneficial unless the child has extremely high income (essentially, more than $500,000), although state income taxes also should be considered. A QdisT is available only if the beneficiary is under age 65 when it is created, and the beneficiary has been determined by the Commissioner of Social Security to be disabled for some portion of the year. The definition of disabled is the same for the SECURE Act as it is for a QdisT. As indicated, to the extent the QdisT makes distributions of its taxable income to the beneficiary to have income taxed at the beneficiary's lower rates, creditor protection and government benefits may be lost.

27 Although such deemed owner trusts are almost universally called "grantor trusts" that is not what the Code provides. Rather, Section 671 specifies that the grantor, when the conditions set forth in Sections 673 to 677 and 679 are met, or a trust beneficiary who is not the trust grantor, when the conditions set forth in Section 678 are met, will be treated as the owner of the trust.

28 See Rev. Rul. 85-13, 1985-1 CB 184, and especially Example 5, Treas. Reg. 1.1001-2 ("C, an individual, creates T, an irrevocable trust. ... T is a 'grantor trust'... and therefore C is treated as the owner of the entire trust. ... Since ... C was the owner of the entire trust, C was considered the owner of all the trust property for Federal income tax purposes ....").

29 See Choate, Life and Death Planning for Retirement Benefits, 8th Ed., at 6.3.10 ("If an individual

may receive Plan distributions over the beneficiary's life expectancy using an Accumulation Trust.[21] If the Plan distributions are made directly to the individual, then they will be taxed to the individual (and, because they do not represent interest or dividends, the tax on them cannot be paid by the parents of a Disabled or Chronically Ill beneficiary under the Kiddie Tax rules[22]). An individual, in general, will face lower income taxes (at least Federal income taxes) than would a non-grantor trust.[23] If the Plan Distributions are paid to a Conduit Trust for the EDB, each Plan distribution (whether or not it is a RMD) must in turn immediately be distributed to the EDB who is the trust beneficiary and will be taxed to the beneficiary (unless the distribution is from a Roth IRA described in Section 408A) just as if the Plan distribution had been payable directly to him or her without a trust.

Although it seems that an Accumulation Trust may be used for a Disabled or Chronically Ill EDB with Plan distributions made over his or her life expectancy, that is not the case for a surviving spouse of the Plan Holder, a minor child of the Plan Holder, or a beneficiary who is not more than ten years younger than the Plan holder. Instead, to obtain the benefit of a "stretch" payment over the life expectancy of the surviving spouse, minor child, or beneficiary who is not more than ten years younger, the Plan distributions must be paid directly to them or to a Conduit Trust which will be required immediate payment of all Plan distributions over to the beneficiary.[24]

Paying the Plan distributions directly to the EDB or to a Conduit Trust for the EDB may cause a Disabled or Chronically Ill EDB to lose government benefits because the EDB may then have reached the income/asset threshold that will cause benefit ineligibility.[25] Therefore, an Accumulation Trust is permitted for a Disabled or Chronically Ill EDB. This seems to be the case even if the income of a minor Chronically Ill or Disabled beneficiary is taxed at the parents' rates under the Kiddie Tax rules of Section 1(g). However, if Plan distributions are paid to an Accumulation Trust for the EDB, the distributions will be taxed to the trust at the highest income tax rate to the extent taxable income exceeds $12,950 if not distributed or treated as distributed to or for the benefit of the EDB.[26]

A Section 678 Trust Might Help

It has been the official position of the IRS and the Treasury for decades that the existence of a grantor trust (a so-called "deemed owner" trust[27]) is ignored and the deemed owner is treated as owning the assets held by the trust for Federal income tax purposes.[28] Thus, if Plan proceeds are payable to a trust taxed as a deemed owner trust under Section 678, the Plan should be treated as owned by the trust's deemed owner.

However, the IRS has never issued any ruling on the application of the grantor trust rules to Plans.[29] It seems that a see-through trust (that is, a Conduit Trust or, with respect to a Disabled or Chronically Ill beneficiary, an Accumulation Trust), whether or not it is a deemed owner trust, should qualify for the ten-year payment rule or for EDBs for an even more extended period. The IRS has at least once endorsed a statement that a grantor trust could not own a Plan, although the situation apparently involved a grantor trust during the Plan Holder's lifetime.[30] Still, it seems virtually certain that making a Plan payable to a Section 678 trust for a person who would be a DB should qualify for the ten-year payout rule by reason of the trust's see-through status.

To be a so-called Section 678 trust, the beneficiary must have a unilateral right to withdraw the entire trust estate,[31] meaning creditor protection almost certainly will be lost, at least in many states.[32] Also, if the beneficiary is disabled and entitled to government benefits, even if the power of withdraw is allowed to lapse (or is released) the withdrawal power will cause a period of ineligibility for the beneficiary

U.S. citizen- or resident-trust beneficiary is deemed the owner of all of a trust's assets under 678(a)(1), then retirement benefits payable to such trust *should* be deemed paid 'to' such beneficiary for purposes of the minimum distribution rules, and the 'all beneficiaries must be individuals' test would therefore be met. However, there is no ruling on point." Compare discussion in Horwitz and Damicone, "A Decent Proposal," 150 Trusts & Estates 46 (Nov. 2011).

30 See PLR 201129045(not precedent), stating without analysis or citation that an IRA will lose its tax deferred status if contributed to a grantor trust; but, cf., CCA 201334021 (which seems critical of the statement in the private letter ruling). Neither a private letter ruling nor a chief counsel advisory (CCA) may be cited or used a precedent. Section 6110(k)(3).

31 See Blattmachr, Gans, and Lo, "A Beneficiary as Trust Owner: Decoding Section 678." 35 ACTEC J. 106 (2009).

32 "Although the Restatement of the Law Third, Property, Wills and other Donative Transfers and the Uniform Powers of Appointment Act, both provide that property subject to a presently exercisable general power of appointment is subject to claims of the powerholder's creditors to the same extent that it would be subject to those claims if the property were owned by the powerholder, Alaska statutorily adopted the position of the Restatement of the Law Second of Property: Donative Transfers section 13.2 cmt. a (1986). The Restatement Second adheres to the common-law rule that the powerholder's creditors cannot reach appointive assets covered by an unexercised general power of appointment until such time that the power is exercised. The rationale is that until the powerholder exercises the power, the powerholder has not accepted sufficient control over the appointive assets to give the powerholder the equivalent of ownership of them." Unpublished article by Stephen E. Greer of Anchorage, Alaska. The Alaska Statute 34.40.115 reads: Subjecting Appointed Property to Claims of Donee's Creditor. The property that a donee of a power of appointment is authorized to appoint is not subject to the claims of the creditors of the donee except to the extent that a donee of an inter vivos or testamentary power of appointment (1) is permitted by the donor of the power to appoint the property to the donee, the creditors of the donee, the donee's estate, or the creditors of the donee's estate; and (2) effectively exercises the power of appointment in favor of the donee, the creditors of the donee, the donee's estate, or the creditors of the donee's estate. Other states have similar rules protecting property from the claims of creditors of the power holder who holds an unexercised power of withdrawal.

of those benefits, in most cases.[33] If the power to withdraw is partially released or otherwise modified, and does not entirely disappear, the trust will remain a Section 678 trust.[34] Hence, if the beneficiary is permitted to and does modify the power (perhaps, so it can only be exercised only with the consent of another person or only for supplemental needs), it should mean the trust is still a Section 678 trust, so that the beneficiary, and not the trust, will be taxed on all Plan proceeds at the beneficiary's rates, but without the need to actually make Plan distributions to the beneficiary.[35]

Thus, using a Section 678 trust would likely produce the best overall income taxation although it does raise creditor rights issues. It also raises the specter of possible estate tax inclusion for the beneficiary although this may be of secondary importance to the potential immediate reduction of income taxation on the Plan proceeds, particularly if the trust otherwise would be subject to transfer tax (e.g., generation-skipping transfer tax) on the beneficiary's death.

One final thought about Section 678 trusts. Although the deemed owner of the Section 678 trust (just as in the case of the grantor of a grantor trust) is deemed for all income tax purposes to own the assets of the trust, it does not mean with complete certainty that the deemed owner is the sole beneficiary of the trust for purposes of Section 401(a)(9). So, if a Disabled Person is the deemed owner under Section 678 of the trust that is the Plan beneficiary, it does not mean with certainty that the payout over the life expectancy of the Disabled Person will apply. However, it seems that if the trust is structured as an Accumulation Trust for any designated beneficiary (whether or not an EDB), it will qualify for the ten-year payout rule whether or not Section 678 is applicable.

A Qualified Subchapter S Trust May Help Even More

Only US individual taxpayers, their estates and certain trusts may hold shares in an S corporation, the income of which is taxed directly to its shareholders.[36] A QSST is a permitted S corporation shareholder. To be a QSST, the trust must have only one beneficiary who is a US individual income taxpayer, must be required to or does, in fact, distribute all of its fiduciary accounting income (FAI), within the meaning of Section 643(b), each year to that beneficiary, and the beneficiary must elect to be treated as the income tax owner under Section 678 (essentially as though it were a grantor or deemed owner trust as to the beneficiary) of the portion of the trust that consists of the qualifying S stock and, thereby, be treated as its shareholder.[37] One of the effects of a QSST is that the income of the S corporation is treated as being that of the shareholder (in this case, the beneficiary of the QSST), although this rule does not apply to taxable income resulting from the sale of the S corporation stock.[38]

Plan proceeds can be made payable to an S corporation[39] which has a QSST as its shareholder, where the Plan Holder wants the individual trust beneficiary to benefit from the Plan proceeds. That means the Plan proceeds will be income of the S corporation and thereby will be included in the gross income of the trust beneficiary. This income will be taxed to the trust beneficiary whether or not she receives anything other than trust FAI and the S corporation's income will not be in FAI unless the S corporation makes a distribution that constitutes FAI (as most dividends would[40]). Note that this may mean that the Plan proceeds will be taxed to the QSST individual beneficiary (as noted they cannot be taxed to his or her parent as they will not constitute interest or dividends for purposes of the Kiddie Tax), which may well be at

33 First party special needs trusts are ones created by the beneficiaries for themselves. Third party special needs trusts do not have a specific statutory exemption but POMS SI 01120.200(D)(2) provides that, if the beneficiary does not have the legal authority to revoke or terminate the trust or to direct the use of the trust assets for his or her own support and maintenance, the trust principal is not the individual's resource for social security benefit purposes.

34 See Section 678(a)(2) and PLR 200944002 (not precedent). Note that if the power to withdraw lapses or is release, the powerholder may be treated as making a transfer to a so-called "self-settled" trust which, under the law of a majority of states, means the property will be subject to the claims of his or her creditors. However, that is not the case currently in 19 states. See ACTEC Comparison of Domestic Asset Protection Trust Statutes (Shaftel, ed.), available at Shaftellaw.com. Hence, at least general creditor protection may be available for a beneficiary who allows the power over the Section 678 Trust to allow it to lapse or to modify it but, as mentioned in the text, may cause a long period of disallowance to government benefits.

35 Under Section 678(d), the section is not applicable if the powerholder renounces the power within a reasonable time after learning of the power. Hence, the beneficiary should be advised of it.

36 See, generally, Blattmachr and Boyle, Blattmachr on Income Taxation of Estates and Trusts (Practicing Law Institute 17th Ed.), Chapter 8.

37 Perhaps, a beneficiary would welcome the opportunity to make the election if it will reduce overall income taxes even if the beneficiary is not guaranteed to receive trust payments. It seems the trust could provide for a particular individual to be a trust beneficiary only if she makes the election and provide that she would cease to be a beneficiary if she seeks to revoke it.

38 Reg.1.1361-1(j)(8).

39 It does not seem that an S corporation, to be respected as such, need be formed for a business purpose. See Rev. Rul. 75-188, 1975-1 C.B. 276.

40 See, e.g., section 409(b) of the Uniform Fiduciary Income and Principal Act.

41 Note that income earned in an S corporation that is taxed to its shareholders retains its tax character pursuant to Section 1366(b), so Plan Distributions will not be treated as interest or dividends and will fall under the exemption from the net investment income tax under Section 1411, foreclosing the ability for the parents to treat the income as their own.

42 See PLR 9014008 ("We... conclude that if the income of any trust is distributed to a grantor trust rather than to the individual beneficiary himself, then the trust will no longer be a QSST") (not precedent).

43 See, e.g., Section 1366(d) and (f).

44 The calculations of income tax were run for a single individual taxpayer, who did not itemize deductions, assuming no other income, and is not subject to state income taxes, using the Federal Tax Calculator available at https://smartasset.com/taxes/income-taxes.

a lower rate than if they were taxed to a non-grantor trust.[41]

Although it seems contrary to the official position of the IRS and the Treasury Department that the assets in a grantor (or deemed owner) trust are treated as owned for income tax purposes by trust's deemed owner, the IRS has ruled that the payment of the FAI to a grantor trust with respect to the QSST beneficiary will cause the trust to lose its QSST status.[42] That seems somewhat strange not only because to be a QSST, the beneficiary must elect to be treated as the deemed owner of the S corporation income under Section 678 (a grantor trust provision), but also because any shareholder which is a grantor (or deemed owner) trust as to a US income taxpayer is, under Section 1361(c)(2), an eligible S shareholder. The PLR may simply reflect the view that all FAI must be distributed directly to the individual beneficiary of any QSST and not merely have it attributed for income tax purposes to the beneficiary. Maybe that position does not really matter. Under Section 1361(c)(2), a trust that is a grantor trust with respect to a US individual taxpayer is a permitted shareholder of an S corporation. So logically, even though the trust might not be considered a QSST, the corporation should maintain its S corporation status, as long as the trust is a deemed owner trust under Section 678.

Suppose an individual were the shareholder of an S corporation which was made the beneficiary of a Plan. Would that arrangement be treated as though the individual were the Plan beneficiary for payout purposes? As discussed above, because the IRS has held a decades long and official position that an individual who is the deemed owner of a trust (such as one described under Section 678) owns the assets of the trust for income tax purposes, it seems the individual deemed owner should be treated as the Plan beneficiary. However, unlike the treatment of a deemed owner of a grantor or Section 678 trust, the shareholder of an S corporation, while having the income of the corporation made his or her income, there are limitations and special rules, which prevent the shareholder from viewed as the owner of the assets of the corporation.[43] Accordingly, just having Plan distributions included in the gross income of an individual does not seem sufficient to cause that taxpayer to be treated as the Plan beneficiary. Indeed, it seems even more uncertain whether a beneficiary of a QSST will be treated as being the Plan beneficiary when the S corporation is named as that beneficiary. Hence, in planning, one probably should assume that the five-year payout rule will apply if an S corporation is made the Plan beneficiary. However, making an S corporation with a QSST shareholder as the Plan beneficiary may, in some cases, be preferable to naming Accumulation Trust where the ten-year pay rule will apply.

Plan proceeds will be taxed to the QSST individual beneficiary, which may well be at a lower rate than if they were taxed to a non-grantor trust.

Can Using a QSST Be Beneficial If the Five-Year Rule Applies?

The answer to that question depends upon several factors (or variables) such as the amount involved, rates of return and the tax rates applicable to the income. For example, assume \$1,000,000 is in a Plan and it grows at 1% a year to \$1,051,010 in five years without current taxation. If it is then distributed to a single individual taxpayer and subject to a 33.4% income tax, \$699,972 will be netted.[44] If that amount then grows at 1% a year, but subject to an annual assumed effective 20% tax (so the annual growth is .8%), it will grow in five years to \$728,422.[45] On the other hand, if the \$1,000,000 Plan grows at 1% untaxed for ten years, it will grow to \$1,104,622. If it is then subject to a 37% tax, it will net \$695,912 to the Plan beneficiary. So, postponing the tax for ten years instead of only five year was not beneficial. It depends on the applicable tax rates after distribution, and it is even less beneficial if the growth is taxed from year five to year ten at an effective tax rate less than 20% as it would be if the beneficiary has no other taxable income, that is, all other things being equal.

The outcome will not necessarily be the same (that is, postponing the tax to year ten may be beneficial) if the rate of return is higher. For example, \$1,000,000 in a Plan will grow at 5% a year to \$1,276,282 in five years without current taxation. If it is then distributed to a single individual taxpayer and subject to a federal income tax of approximately 34%, \$842,346 will be netted. If it then grows at 5% a year, but is subject to an annual 8% tax, as it would be (approximately) if the beneficiary has no other income (so the annual after-tax growth is approximately 4.6%), it will grow in another five years to \$1,054,766. If the \$1,000,000 Plan grows at 5% a year and is untaxed for ten years, it will grow to \$1,628,895 but if it is then subject to a trust rate of approximately 37%, it will net \$1,026,203, which is less than the net amount if the proceeds were distributed within five year and thereafter taxed to a single individual taxpayer.

On the other hand, if the net Plan proceeds after being taxed to an individual following a five year deferral then grow at 5% a year, but are subject to an annual tax of 20% (so the annual after-tax growth is 4%), the proceeds will grow in another five years to only $976,510 (that is, in year ten), which is less than $1,026,203 that would be available if, after a ten year deferral, the Plan proceeds were distributed to a trust. So, postponing the tax to year ten instead of only to year five in that case was beneficial. The point being that it is not only the years of deferral that matter, it also matters at what rate the income on the Plan proceeds will be taxed after leaving the Plan.

If the Plan is smaller, the postponement to year ten will be less beneficial all other things being equal. The opposite will be true if the Plan is large. Postponement also likely will be beneficial if the beneficiary is in a high income tax bracket. In other words, the lower the income tax rate on the net amount of Plan proceeds, the less beneficial postponement of taxation will be.[46]

Potentially, the best of all possible worlds is for the Plan proceeds to be paid to a QSST so that the Plan proceeds are taxed to the QSST beneficiary, but are accumulated inside the S corporation, thereby also receiving several of the benefits of trusts (such as freedom from claims of creditors).[47]

Funding the Income Tax Liability of a QSST or Section 678 Beneficiary

If the S corporation's income is attributed to the QSST beneficiary, he or she presumably will need cash to pay the income taxes on the S corporation income attributed to him or her pursuant to the QSST election.[48] Having the S corporation pay a dividend to the QSST which, in turn, is paid to the beneficiary (as it must be if it is FAI, as it probably would be[49]) means the beneficiary may have more income and resources so as to cause possible disqualification for government benefits and, perhaps, otherwise make the dividends subject to creditor claims. However, the trustee of the QSST, rather than distributing the S corporation dividend to the beneficiary, could instead apply it in satisfaction of the beneficiary's income tax obligation. According to PLR 8907010 (not precedent) that should be treated as being a payment to the beneficiary, as a QSST is required to do. Yet, that discretionary payment by the QSST of the beneficiary's income tax liability will not count as income or as a resource for at least most governmental benefit programs.[50]

The trustee of the QSST, rather than distributing the S corporation distribution to the beneficiary, could instead apply it in satisfaction of the beneficiary's income tax obligation.

Therefore, the S corporation can pay a dividend to the QSST in the amount of the beneficiary's income tax liability (which will be based at least on the S corporation's income imputed to the QSST beneficiary), and the trust can pay the income tax liability of the beneficiary and will be treated as distributing that amount (which may be FAI) to the beneficiary so the status as a QSST will not be lost and the risk of causing the beneficiary to lose governmental benefits will not arise.[51]

The trustee of a Section 678 trust could be authorized to pay the beneficiary's income tax liability (limited, if otherwise appropriate, to the tax on the income imputed to the beneficiary from the S corporation). If the trust is discretionary and spendthrift, this authorization likely will not make the trust, at least in most states, subject to the claims of the creditors of the beneficiary.[52] Nor is the payment to the tax authorities likely to be attachable by other creditors of the beneficiary.[53]

Should a QSST Be Considered for an EDB?

If the person whom the Plan Holder wishes to benefit is an EDB, then using an S corporation and a QSST may not be beneficial, if the Plan proceeds would otherwise be received by a trust but taxed at the rates applicable to the trust beneficiary because a Conduit Trust is used. That may be the case if naming the S corporation will require that all Plan distributions must be paid within five years, as discussed above. Because that almost certainly would be adverse, a QSST probably should not be used for an EDB without a ruling or clarification from the IRS that the EDB will be treated as receiving the Plan distributions.

Of course, for a surviving spouse, while rolling the Plan into the spouse's own IRA may be the most efficient tax step to take, it would give the spouse complete access to the amount in the IRA. A Conduit Trust for the spouse may be a better choice if there is concern about the spouse having unlimited access to the Plan itself. A Conduit Trust will allow a relative long "stretch," although not be quite as long as if the spouse did roll it all over to his or her own IRA.

For a minor child EDB, the stretch may not be much longer than 10 years using anything but a direct beneficiary designation or a Conduit Trust. Almost certainly, overall federal income taxes will be lower if Plan proceeds are taxed to the minor child over the limited (until majority is reached) life expectancy of the minor plus ten years, all other things being equal. But they may not be equal, such as where the Plan Holder does not want the minor child to receive the Plan proceeds so they are made payable to an Accumulation Trust and taxed at the compressed rates and paid out under the ten-year rule and not the special rule for minor children of the Plan Holder. In such a case, perhaps making an S corporation, with a QSST shareholder, the Plan beneficiary may make some sense.[54]

Some Comparisons: Running the Numbers

Suppose the annual Plan distributions will be $12,000 each year. If the QSST beneficiary has no other income (as she might not if she were disabled), she would enjoy a $12,000 standard deduction and no income tax would be due (assuming the Kiddie Tax did not apply). If instead, the $12,000 were taxed to a trust for a DB, about $3,000 of income taxes would be payable. Note, that comparison is incomplete, assuming, as likely will be the case, the entire amount in the Plan may have to be distributed within the fifth year following the death of the Plan Holder. Even though the Plan distributions would be more bunched together if payable to an S corporation than if they were paid over the life expectancy of an individual beneficiary or over a ten-year payment period, they likely would be taxed at lower rates than if paid and taxed to a trust. Another factor is that, as long as Plan distributions are not made, the Plan will continue to grow income tax free. A further complication arises if the beneficiary is subject to state income tax when payments to a trust may be structured to avoid state income tax.

Suppose further that the Plan at the death of the Plan Holder has a balance of $1.2 million and is withdrawn in equal payments each year for six years[55] under the five-year regime at $200,000 a year,[56] putting aside income and growth. If the Plan distributions are taxable to an unmarried beneficiary (directly or through a QSST) who has no other income, the beneficiary will owe about $41,048 each year in income tax for a total tax bill of approximately $246,288. That is about a 21% erosion of the Plan proceeds from taxes. Assume, alternatively, that the payments are taken ratably over 24 years ($50,000 annually) by an Accumulation Trust for a Disabled EDB. That trust will owe about $16,821 each year in income taxes or $403,776 total income taxes. That is almost a 34% erosion. Nevertheless, that comparison is incomplete. It does not take into account, among other things, that, if the Plan Distributions are made over an EDB's lifetime or for ten years rather than five years, earnings inside the plan or IRA will continue to grow for a longer time income tax free. Of course, that assumes there will be growth inside the Plan, which may not occur. Furthermore, it is a political certainty that the income tax laws, including rates, will change which will directly and indirectly affect Plans and their distributions.

However, one may create an excel spreadsheet to run some comparisons using assumed rates of taxation, growth within and outside the plan, and taking Plan distributions over a number of years or at one time (probably the last year under either the five-year or ten-year payout regimes.). A key factor is determining the relative benefit of keeping assets inside the Plan to grow tax free compared to the benefit of spreading Plan distributions over time to reduce the effective rate of income tax. Of course, the need for Plan proceeds for lifestyle or other reasons may compel a beneficiary to take Plan distributions even if that is not the most tax efficient strategy.

What About a C Corporation or a CRT as Beneficiary?

A so-called C corporation also could be the Plan beneficiary. A C corporation is subject to income tax at only a 21% rate. That almost certainly will be below the rates a trust

45 If the one percent return were the individual taxpayer's only income, no federal income tax would be due (unless the Kiddie Tax applied).

46 There are a number of ways to reduce the effective income tax rate. Probably the most common is to postpone the sale of appreciated assets. Another is to acquire life insurance because, as a general rule, income earned "inside" a life insurance policy is not currently and may never be taxed. See Lipkind and Blattmachr, "Income Tax Aspects of Variable Life Insurance Policies," 125 Journal of Taxation 52 (February 2015).

47 The beneficiary of the QSST probably should not have the power to control distributions from the corporation as her creditors might argue that such a power means all the corporate assets should be treated as belonging to the beneficiary.

48 The beneficiary must affirmatively elect for the trust to be a QSST and may revoke the election only with the consent of the Commissioner. Reg. 1.1361-1(j)(11).

49 Section 409(b) of the Uniform Fiduciary Income and Principal Act.

50 SSA – POMS: SI 00815.400 available at https://secure.ssa.gov/apps10/poms.nsf/lnx/0500815400.

51 An alternative to using a QSST is to use an electing small business trust defined in Section 641(c) which is an eligible S shareholder, under which all of the S corporation's income is taxed to the trust at the highest federal income tax rate and without the ability to shift the income to a trust beneficiary. However, that may provide a way to avoid state income tax.

52 See, e.g., New York EPTL 7-3.1(d).

53 There may be a special state law to provide this protection, as in Alaska. See discussion in Blattmachr, Chapman, Gans, and Shaftel, "New Alaska Law Will Enhance Nationwide Estate Planning-Part 1, 40 Estate Planning 3 (Sept. 2013).

54 "A *minor's* consent is *made* by the *minor, legal representative* of the *minor*, or a natural or adoptive parent of the *minor*...." available at https://www.google.com/search?tbm=bks&hl=en&q=who+is+a+minor%27s+legal+representative+for+making+a+QSST+election.

55 See note 12 for an explanation of why there are six calendar years in which Plan distributions may be made under the five-year rule.

56 As mentioned above, if the beneficiary of the plan or IRA is not an individual or a see-through trust, the entire Plan must be distributed not later than the end of the fifth calendar year following the calendar year of the Plan Holder's death or, in other words, over six years. The Plan Distributions can be taken ratably over that six-year period or delayed in total until the end of that sixth calendar year.

would face (except on very small distributions). But the five-year distribution rule will apply. Moreover, when the accumulated Plan Distributions, after the 21% corporate tax, are distributed as a dividend, they will probably be subject to income tax, under today's law, as long-term capital gain.[57] If that rate is 23.8%, the total tax rate would be 39.8% [21% + (23/8% x 79%)].

A so-called C corporation also could be the Plan beneficiary, but the five-year distribution rule will apply. Moreover, when the accumulated Plan Distributions, after the 21% corporate tax, are distributed as a dividend, they will probably be subject to income tax, under today's law, as long-term capital gain.

But that effective rate does not take into account the ability to postpone the taxation of the Plan proceeds. Of course, the C corporation could accumulate and not distribute the Plan proceeds, but it is possible that it would face the personal holding company tax under Section 541 or the accumulated earning tax under Section 531. Neither of those apparently applies to an S corporation.

A charitable remainder trust (CRT) defined in Section 664 can receive Plan proceeds entirely free of income tax because the trust is income tax exempt. Although it is beyond the scope of this article to discuss the matter in any significant detail, an income only with make-up CRT is, perhaps, the best way to postpone the taxation of interests in a Plan. A detailed article about that was published in the May 2020 issue of this magazine.[58]

Conclusion

The loss of the so-called stretch option for Plan distributions likely means more immediate and possibly higher taxation of Plan proceeds. Those beneficiaries who are EDBs may continue to enjoy longer term payments which will allow more tax-free growth of amounts in a Plan and reduce distributions which may result in an overall reduced effective tax rate than if Plan distributions were bunched into a shorter number of years. A surviving spouse of the Plan Holder also may continue to enjoy stretch benefits, as well as a delay in the obligation to commence taking distribution. A minor child of the Plan Holder enjoys "stretch" payments only until reaching majority, following which the ten-year payout period must begin. A "not more than ten years younger" EDB may get a few extra years of "stretch" payments but likely, in most cases, not significantly more than under the ten-year payout rule. Disabled or Chronically Ill EDBs can enjoy the same stretch as under prior law. However, if the distributions are made to them directly, they may lose government benefits if the distributions cause them to exceed income or resource levels for those benefits Also, just to complicate things, they may have to be paid to a guardian (or other fiduciary), if the EDB is incompetent.[59]Hence, an Accumulation Trust for such EDBs should be considered. Although the Plan distributions received by the Accumulation Trust will likely be taxed at very high rates, avoiding state income tax may be a significant offsetting factor.

Making Plan distributions payable to an S corporation which has a QSST as its shareholder may be appropriate to consider for some beneficiaries, even if the five-year payout period[60] must be used (which seems likely although, perhaps, not certain). The Plan distributions will be income of the S corporation but included in the gross income of the beneficiary who may be in much lower tax brackets than a trust. Distributions of the Plan proceeds need not be made from the S corporation to the QSST. The QSST need not make any distribution to its beneficiary (other than FAI) and the trustee may pay the income tax liability of the beneficiary without disqualifying the trust as a QSST and without causing the beneficiary to lose qualification for certain governmental benefits.

A so-called Section 678 Trust or BDIT may be best of all from an income tax perspective but it raises certain creditor and governmental benefit issues which the QSST may not.

Comparing the numbers is appropriate but over a ten-year period, taxation will change, perhaps radically, making it very challenging to determine what is the best strategy to use. ■

57 See IRS Publication 550 for the meaning of qualified dividend (which is taxed as long-term capital gain under Section 1). *Cf.* Reg. § 1.312-6(b).

58 Blattmachr, Blattmachr, and Fox, "Using a Charitable Remainder Trust as the Recipient of a Qualified Plan or IRA," 46 Estate Planning 8 (May 2020).

59 Note that the commissioners of uniform laws rejected making custodian accounts maintained under the Uniform Transfer to Minors Act spendthrift. In any case, any spendthrift protection provided by such an account presumably would lose all protection when the minor reaches majority and the entire account must be distributed to her. See the last paragraph of comment to Section 11 of the Uniform Act.

60 Under the "at least as rapidly rule" under Reg. 1.401(a)(9)-5, A-5(a)(2), if the Plan Holder dies after the RBD and there is no Designated Beneficiary, distributions must be taken over her his or remaining life expectancy under the Single Life Table under Reg. 1.401(a)(9)-9 and the five-year payout period does not apply. An individual has more than a five-year remaining life expectancy until after age 91. It is uncertain how any "at least as rapidly" rule will be applied where the ten-year payout rule otherwise would apply.

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NIMCRUT/Qualified Plans

Using a Charitable Remainder Trust as the Recipient of Qualified Plan and IRA Interests[1]

In light of the changes to qualified plan distributions under the SECURE Act, charitably minded individuals may want to consider naming a charitable remainder trust as a beneficiary to ensure deferred income tax payment.

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There are currently approximately 28 trillion dollars of assets in the United States that are held in pension type plans,[2] such as Section 401(k) and 457 plans and individual retirement accounts (IRAs). These arrangements provide at least three significant benefits.[3] The first is protection from claims of creditors of the plan participant or IRA owner, subject to certain exceptions. The second is that the amount of earnings contributed to the plan or account is generally not subject to income tax. The third is that the earnings realized inside the plan or account are, in general, not subject to income tax. This allows the earnings to grow tax-free, one of the most powerful phenomena in financial planning.[4] Deferral of taxation of earnings can last until the plan participant or IRA owner reaches their mandatory beginning date to receive distributions. Typically, this is April 1 following the year the individual reaches the age of 72, at which point the participant will be required, so as to avoid excise tax (in the nature of a penalty) under Section 4974, to take required minimum distributions (RMDs) over the participant's recalculated life expectancy.[5]

Prior to the effective date of the Setting Every Community Up for Retirement Enhancement Act (the SECURE Act),[6] once the plan participant or IRA owner died, the law required the property in the plan or account to be distributed by the end of the fifth calendar year following the death of the participant or owner (unless the plan or account was left to an identified individual, known as a “Designated Beneficiary” or a so-called “see-through” trust, in which case RMDs could be taken over the unrecalculated (or fixed at death) life expectancy of the identified individual.[7] There were, and even after the effective date of the SECURE Act are, two types of “see-through” trusts. One was and is called a “conduit trust” which mandates that all distributions received by the trust from the plan or account be distributed immediately to the Designated Beneficiary; essentially, for RDMs, the trust is treated as if it were that individual. The other see-through trust was and is called an “accumulation trust” which, as the name indicates, need not make any distributions to any beneficiary, only has beneficiaries who are identifiable individuals, and may take RMDs over the unrecalculated life expectancy of the oldest individual beneficiary of the trust.

Plans and IRAs in the Context of Estate Planning[8]

Except for distributions from a Roth IRA,[9] distributions from plans and IRAs following the death of the participant or owner constitute income in respect of a decedent described in Section 691(a) and, therefore, are included in the gross income of the recipient. They may also be subject to estate tax in the estate of the participant or owner. The combined taxes may be very significant, especially if there are state estate and income taxes. For example, in the state of Washington, the top state estate tax rate is 20%.[10] State death taxes imposed on property included in the federal gross estate are deductible, under Section 2058, for purposes of determining the federal taxable estate, meaning, for example, where the state rate is 20%, that only 80% of what otherwise would be the taxable estate is exposed to the 40% federal estate tax rate. 40% of 80% is 32% which then is the effective federal estate tax rate, in such a case. When that is added to a 20% state estate tax, the combined effective estate tax rate is 52%. The 32% federal estate tax rate is deductible, pursuant to Section 691(c), for purposes of determining the amount that is subject to income tax on distributions from a plan or IRA. So only 68% of the plan or IRA distributions may be subject to income tax. The top federal income tax rate on plan or IRA distributions is 37%. State income tax can be as high as 13% (in California) meaning a potential combined income tax rate of 50% which if applied to the 68% of the distributions, after the Section 691(c) deduction, produces a net income tax on the distributions of 34% which, when added to the possible state and federal estate taxes, could bring the combined taxes to 86%.[11]

In addition, a transfer of an interest in a plan causes acceleration of the income except where it is transferred pursuant to a QDRO.[12] There is at least some question whether an interest in an IRA may be transferred by the owner prior to death without causing the account to lose its tax-exempt status.[13] Hence, interests in plans and IRAs are often the most difficult assets to deal with in the estate plan. And, as indicated, if estate tax cannot be reduced, it may make sense to try to reduce the present value income tax burden on a plan or IRA. Before the SECURE Act, that was somewhat possible by having plan or IRA distributions spread over a long period of time. However, the Act, as described below, has curbed that in many situations. Nonetheless, using a charitable remainder trust (CRT) as the receptacle for them may help reduce the burden in some cases.

Brief Overview of the SECURE Act

The SECURE Act, signed into law in December 2019 and effective at the beginning of 2020, made significant changes to qualified (retirement) plans (“plans”) and IRAs. Probably the most significant change was the elimination of the ability of most beneficiaries (upon the death of the plan participant or IRA owner) to take distributions, without additional tax (in the nature of a penalty) under Section 4974, over the successor beneficiary's life expectancy. Except for five categories of individuals (known as “Eligible Designated Beneficiaries” or “EDBs”) and except with respect to a plan participant or IRA owner who at death was taking distributions over his or her life expectancy, beneficiaries must take the entire amount from the plan or account by the end of the fifth calendar year or, if there is a Designated Beneficiary (essentially an identifiable individual) or a conduit or accumulation trust, by the end of the tenth calendar year following the calendar year of the death of the participant or owner.

Perhaps, the two most important impacts of such changes are (1) to shorten the period following the death of the participant or owner of tax-free compounding provided by the use of the plan or IRA (the so called “stretch”) and (2) to shorten the period that the plan or IRA interests may remain free from the claims of creditors, although using a trust may provide significant creditor protection for the beneficiary or beneficiaries.

The five categories of EDBs, who may continue to use their life expectancies for payouts from a plan or IRA, are (1) the surviving spouse or (2) a minor child of the participant or owner, (3) an individual who is not more than ten years younger than the participant or owner, and an individual who at the death of the participant or owner is (4) disabled or (5) chronically ill within the meaning of Sections 72(m)(7) or 7702B(c)(2), respectively. Note that the life expectancy of a minor child of the participant or owner may be used only until the minor reaches majority, when the ten-year payout rule commences. Just as under prior law, if there is no Designated Beneficiary (whether or not also an EDB), the entire plan or account must be distributed under the same five-year payout regime as under prior law (or, if the participant died after commencing required minimum distributions, over the participant's remaining life expectancy).

Unless the beneficiary is an EDB, the proceeds payable to an individual (or to a conduit or a see-through accumulation trust) must be withdrawn in their entirety by the end of the tenth calendar year following the calendar year of the death of the plan participant or IRA owner, so as to avoid the additional tax (in the nature of a penalty) under Section 4974. There are no annual minimum distributions required for individual beneficiaries (who are not EDBs) as there were under prior law. Rather, a non-EDB individual need take nothing from the plan or IRA, so income tax deferral may continue for that ten-year period.

Power of Tax Deferred Compounding

Probably, the most important factor in efficient financial planning is tax-free compounding. Next best is tax-deferred compounding. The longer the period of deferral the better for building wealth, all other things being equal.[14] Indeed, the inability to use the ten-year payout regime (which has been substituted for the life expectancy regime except for the plan participant or owner, and for EDBs), in which case the five-year payout regime must be used, retards the accumulation of wealth, all other things being equal.

Here is a comparison. Taxpayer at death has a $1 million IRA. If it grows 20% a year, it will be worth $2,488,000 in five years[15] and is then subject to an assumed 37% income tax,[16] which would leave $1,567,000 at the end of five years. If that amount then grew at a rate of 12.6% (the net after-tax net earnings of a 20% a year return taxed at 37%) for five more years, the taxpayer would have $2,837,000. If, instead the ten-year regime applies and the IRA grows income tax-free for ten years (instead of only five years), the IRA would be worth $6,191,000 in ten years when it is subject to an assumed 37% tax, leaving about $3,900,000. So, the postponement of taxation from five years to ten years would produce a significant financial benefit: $3.9 million vs. $2.837 million. This analysis, however, assumed a very high rate of return (20% a year). Suppose instead the annual return (before any income tax) were only 1% a year. After five years, the IRA would be worth $1,051,000 when it would be subject (it is assumed) to a 37% income tax, leaving $662,000. That amount then grows for five more years at a 1% rate or .63% after tax (that is .0063 annual growth after tax) to $683,000. If the IRA grows income tax-free for ten years (instead of five years) at 1% annually, it would be worth $1,104,000 before tax and $696,000 after a 37% income tax. So, tax deferral is always better (all other things being equal, like growth inside and outside the IRA or plan and income tax rates being the same on all amounts) if, but only if, there is growth. What can be gained by a slower payout is a longer time for tax-deferred compounding, again all other things being equal. This is attributable to attaining tax-deferred earnings on the income tax postponed - it is, in theory, the primary reason taxpayers contribute to plans and IRAs.[17]

So, the question naturally arises: what can a taxpayer do to extend the period of tax-free compounding? The answer, for some, is to have the plan or IRA paid to a CRT described in Section 664 which will receive the proceeds free of income tax (because a CRT is exempt from such tax under Section 664(c)(1)) and distributions from the CRT may be made, if certain actuarial requirements are not violated, over the life of one or more individuals or for a fixed term of up to 20 years and not just within the ten-years provided by the SECURE Act. However, because the remainder interest of the CRT must pass to charity, the additional time the trust is exempt from income taxation may not always offset the cost to individuals of the loss of the value of the remainder interest passing to charity upon the termination of the CRT. In effect, when using a CRT, the taxpayer is renting the trust's exemption from income taxation. The price paid is the value of the remainder interest that must be committed to charity. Of course, for individuals who are charitably inclined, including those wanting to fund their own private foundations, the “price paid” in this context may be of no real consequence, particularly since (as discussed further below) the minimum actuarial value of the remainder interest need only be equal to 10% of the value contributed to the CRT.

There are many distinctions between CRTs and plans and IRAs that one must consider. A CRT is subject to a 100% excise tax under Section 664(c)(2) on any unrelated business taxable income (UBTI) it receives. A plan or IRA, on the other hand, simply pays the corporate tax rate on any UBTI received. All distributions from a plan or IRA (other than a Roth IRA) are taxed as ordinary income. Under Section 664(b), distributions from a CRT retain their tax character (*e.g.*, as ordinary income, capital gain, or tax-exempt income), although the highest taxed income a CRT receives is deemed to be distributed until an income subject to a lower (or no) tax is deemed distributed. Those distinctions make the comparison of using a CRT more complicated.

In any event, as indicated below, it will be rare for a CRT to be the best choice for a surviving spouse of the participant or owner who otherwise would have the proceeds pass directly to the survivor. Similarly, it will be rare to have a CRT be the best choice for a Roth IRA.

Brief Discussion of CRTs

As virtually everyone who deals with them knows, a CRT described in Section 664 must either be a charitable remainder annuity trust (CRAT) or charitable remainder unitrust (CRUT) as described in that section.[18] A CRAT must provide each year for a minimum annuity payment, to and for the life or lives of identified living individuals or to or for an individual or a groups of persons (including charity although at least one person must not be a charity) for a fixed-term of not more than 20 years, of a minimum of 5% and a maximum payment of 50% of the value of the assets contributed to the trust at the time of their contribution. A CRUT must provide each year for a minimum annual payment to an individual or a group of persons of 5% and a maximum payment of 50% of the annual value of the assets then held by the trust. A CRUT may also provide for annual payment of the lesser of the 5% minimum/50% maximum or the trust's fiduciary accounting income (FAI), described in Section 643(b) and its regulations thereunder, and may provide that, if the FAI is less than the unitrust amount for any year, the “short fall” may be made up in a later year if and to the extent the FAI for the subsequent year exceeds the unitrust amount for that year.[19] This latter type of unitrust is commonly called a “net income with make-up charitable remainder unitrust” or “NIMCRUT.”[20] In addition, the actuarial value of the remainder, which will pass ultimately to or for charity, must be at least 10% of the actuarial value of the assets at the time of their contribution to the trust.[21] Moreover, there cannot be more than a 5% probability that the trust will be exhausted by the payments,[22] which as a practical matter cannot happen with a CRUT as the unitrust payments will diminish if the value of the trust declines.[23]

The value of the remainder of a CRT is determined by how long the trust is expected to last, and the required payout (for a CRUT that limits payments to FAI, the calculation will be based upon the unitrust percentage even if that is greater than the assumed rate of FAI to be earned in the trust).[24] For an annuity trust, the value will depend on the Section 7520 rate that must be used to value interests in CRTs. Except for the timing during each year when the unitrust will be paid, the value of the remainder in a CRUT will not be affected by the Section 7520 rate.[25] Also, the probability of exhaustion of the trust by payments cannot be greater than 5%.[26] This may occur for a CRAT but probably not a CRUT as previously stated. Whenever the Section 7520 (which is the assumed annual rate of growth the CRAT will experience) is less than the annuity percentage used (which as mentioned earlier cannot be less than 5%), the trust may exhaust. Even if the Section 7520 rate is the same as the annuity rate, the 10% value of the remainder test may not be met. For example, if both the Section 7520 rate and the annuity rate are 5%, the trust will fail the 10% value of the remainder test if the annuitant (for life) is under age 25. If the annuity is limited to 5% and the Section 7520 rate is at least 5.4%, the test will be met. In fact, the higher the Section 7520 rate, the higher the annuity can be without violating the 10% value of the remainder test or the 5% probability of exhaustion test. As the Section 7520 rate increases, the value of the remainder increases, all other things being equal. Unfortunately, this violates the premise of using a CRT: renting the trust's exemption from taxation and paying the lowest rent possible, which is the value of the remainder. Ideally, this would be 10% of the value of what is being contributed to the trust and not more.

For CRUTs, the analysis may be quite different. Unlike an annuitant of a CRAT, a unitrust recipient will receive more if the value of the trust increases. For example, at a 5% unitrust, the recipient will receive more if the trust grows more than 5% a year. For example, if the trust starts at $1 million and grows to $1,050,000 by year end, when the unitrust amount of $50,000 is paid, the unitrust recipient will receive a $50,000 payment if the 5% unitrust payment is calculated at the beginning of each year. The trust will then drop back to $1 million and the unitrust amount for the second year will also be $50,000. However, if the trust grows at 6% a year, there would be $1,010,000 at the beginning of the second and year producing a $50,500 for the second year. That does not seem like much of a difference, but over time it could grow significantly and that may be especially important in later years when the value of a fixed (annuity) payment may be eroded by inflation. Of course, if the trust assets grow at a much higher rate (as equities historically have[27]), the difference will be quite stark.

Benefit of Exemption from Income Taxation

There seem to be some “truths” about CRTs. First, for many taxpayers, the most significant benefit of a CRT is its exemption from income taxation.[28] Although distributions to taxable beneficiaries (*e.g.*, an individual who is the annuitant or unitrust recipient) will be included in the recipient's gross income to the extent the trust has experienced and is not treated as already having distributed taxable income (with the highest taxed class of income being deemed distributed first), the CRT itself is not subject to income tax under Section 664(c)(1). When someone creates a CRT, he or she (or it) may (indirectly) benefit from the CRT's exemption from taxation to the extent, if any, the trust has taxable income in excess of the amount currently payable to an annuitant or unitrust recipient. That is because the next best thing to avoiding income tax is postponing income taxation, as a general rule.[29] This often occurs when a taxpayer holds appreciated property that the taxpayer decides to sell (or is compelled to sell). Subject to exceptions,[30] a taxpayer must pay income tax on gain recognized, leaving a smaller base of wealth to generate future earnings. By contributing the appreciated assets to a CRT, the trust may sell them without paying income tax because the trust is exempt from such taxes[31] so the amount in the trust is not eroded by taxes as a result of the sale, even though the sale would otherwise be subject to tax if sold outside the confines of a CRT.

For an annuity trust, that may not be important. For example, a taxpayer holds an asset that produces little current income and is worth $1 million with a zero basis. She anticipates that if she sells it, she will pay a 24% tax on the gain, leaving her only $760,000. Instead, she intends to contribute the asset to a CRT with the hope that trustee will sell it.[32] She wants to receive an annuity of $50,000 each year for her life. Before we even begin to look at the “economics” of that move and consider alternatives, it is appropriate to note that she will violate the 5% probability of exhaustion test if she is under age 72 with a Section 7520 rate of 2%. Even at a 4% Section 7520 rate, she will violate the test if she is under 56. Moreover, at younger ages, she will also violate the 10% value of the remainder requirement. Also, she cannot provide for a payment of less than $50,000 a year so the 10% minimum value of the remainder and 5% probability of exhaustion tests will not be violated as a CRAT must pay an annuity equal to at least 5% (5% of the $1 million is $50,000). Although if the Section

7520 rate is at least 5%, a 5% CRAT can be created without violating the 5% probability of exhaustion test, the grantor who creates a CRAT at death will not be able to know what Section 7520 rate might apply.[33] Note, however, that the remainder value may vastly exceed 10% so the taxpayer will have paid very high rent for the trust's exemption from taxation.

Consider that if she sold the asset and paid the 24% tax and there are no earnings on the $760,000, the after tax wealth will be exhausted before the 16th year. Of course, she will have received the annuity payment of $50,000 for 15 years free of any income tax which, if reinvested, may grow in value. With the CRAT, even if it never grows in value, the $50,000 annual payments will last 20 years, but each annuity payment will be subject to income tax. The same result presumably would occur by simply selling $50,000 of the property each year for 20 years. Perhaps, the CRAT is preferable if the property must be sold and gain recognized. Although an installment sale might be considered, such a sale can be complicated from both a management and tax perspective.[34]

The major advantage of a CRAT is that the same payments continue (unless and until the trust is exhausted) even if the trust diminishes in value each year. With a CRUT, the payments will decline for each year the trust decreases in value. But, as mentioned below, a taxpayer may be better off acquiring a commercial annuity if he or she believes there will be no increase in the value of the funds.

Of course, with a CRAT, an increase in value of the assets in the trust does not benefit the noncharitable beneficiary except to ensure the payments will continue beyond the payment of the amount of the original corpus. For example, if the original corpus is $1 million and the CRAT provides for annual payments of $100,000 for ten years, the payments will cease by the end of tenth year (and if the Section 7520 rate is less than 2.6%, the trust will not meet the minimum 10% value for the remainder requirement). Even if the Section 7520 rate is above 2.6%, the beneficiary may fail to receive the payments for ten (10) year if the assets decline in value while in the trust.

With a CRUT, the taxpayer participates with growth in the assets and the trust should never be exhausted by payments (although it could be if the assets' investment performance decline in value to zero, which would also mean a loss of all payments from a CRAT as well). In any case, the beneficiary of a CRUT will receive more than a beneficiary of a CRAT, all other things being equal, if the trust increases in value (after making the required annual payments) over the life of the CRT. Note that if the annuity percentage, unitrust percentage, and the Section 7520 rate are the same, the tax value of the payments and the remainders will be the same. Of course, in the real world, the return almost certainly will not remain the same for the life of the trust.[35] If the property owner is concerned that value of the trust will not increase, then consideration likely should be given to acquiring a commercial annuity as that likely will provide greater payments[36] than the CRAT would. For example, the taxpayer could buy a commercial annuity[37] to receive an annual payment that would at least equal the amount to be paid from the CRAT and contribute a smaller amount to the CRAT. However, to buy a commercial annuity the taxpayer would have to sell the assets. Nonetheless, the commercial annuity may well pay more than a CRAT even if the CRAT can pay 5% for life.[38] It might not even be possible to create a $1 million CRAT to pay $50,000 a year, if the Section 7520 rate is below the 5% payout. For example, the exhaustion test will be violated with a 5% annuity (payable at year end), if the Section 7520 rate is below 3.8%. In fact, even if both the payout and Section 7520 rate are 5%, the 10% value of the remainder will not be met if the annuity is to be paid for life for someone under the age of 24 years. In any case, as explained, even if the actuarial tests are not violated, the value of the remainder may exceed 10%, which means too high of a price has been paid to rent the trust's exemption from income tax.

Historically, stocks do increase in value over time.[39] "According to historical records, the average annual return since its inception in 1926 through 2018 is approximately 10%. The average annual return since adopting 500 stocks into the index in 1957 through 2018 is roughly 8% (7.96%)."[40]

As explained, a taxpayer seems to benefit very little from the trust's exemption from income tax when creating a CRAT but may receive considerably more with a CRUT, if it increases in value. For example, with a $50,000 a year CRAT payment, the annuitant will receive $1,000,000 over 20 years ($50,000 × 20). With a CRUT, a unitrust recipient entitled to a 5% unitrust payment each year would receive approximately $1,650,000 over the same 20 year period if the assets grow at 5% a year (much lower than then S&P 500 returns for any 20 year period in modern times).

In effect, the taxpayer is "renting" the exemption from taxation of charity and is paying for it by committing the remainder of the CRT to charity. In a CRT, that must be at least 10% percent of the value of the assets donated to the trust (the minimum the law allows). Note if a taxpayer wants charity to get more, the taxpayer should limit the value of the remainder of the CRT to 10% and simply donate more directly to charity.

The postponement of the taxation of income earned inside the CRT may or may not be beneficial for the taxpayer. For example, as indicated, for a CRAT, it seems that other than locking in the base of wealth with no tax, the beneficiary really does not benefit from the tax exemption from the trust. But for a CRUT, the beneficiary may benefit from the trust's exemption from income tax in the same way the participant in a qualified plan does (at least to the extent growth and income each year exceed distributions to the unitrust recipient for the year).

If a CRT could be a good receptacle for an IRA or plan, it may be best to name a non-see-through accumulation trust with discretionary beneficiaries which include a CRT. The IRA or plan proceeds will have to be entirely distributed by the end of the calendar year following the year of the death of the owner of participant. Even if the trustee chooses to distribute all proceeds to the CRT, there will be no requirements for distributions from the CRT until it receives the proceeds, adding to flexibility. In fact, making the plan or IRA proceeds payable to such a non-see through accumulation trust with both a CRT and those individuals whom the owner or participant wishes to benefit as the beneficiaries will allow the trustee to wait to see where it would be best to dedicate the proceeds including, perhaps, in whole or in part, to the CRT. However, that structure, compared to naming the CRT as of death, means no charitable estate tax deduction will be allowed.

A NIMCRUT May Be Best

Another option with a unitrust is to make it an “income only with make-up” (a NIMCRUT).[41] By investing, for example, in growth stocks that pay little (if any) dividends, no significant distributions need be made. At the appropriate time, the trustee may be able to change the investments so receipts do constitute FAI and are well in excess of the unitrust amount for the year of the change. For example, the trust may have been invested in growth stocks that pay no dividends. The stock can be sold without income tax (because the NIMCRUT is income tax exempt) and then invest in bonds, for example, with a yield more than the unitrust amount. There are some restrictions, however, imposed by the regulations on converting corpus into FAI for purposes of this strategy. For example, although having gain treated as FAI is permitted in an income-only unitrust, any gain arising from a sale or exchange of assets contributed to the trust may be treated as FAI only to the extent the assets have appreciated in value, such that pre-contribution gain cannot be taken into account in computing FAI.[42] Similarly, gain arising from a sale or exchange of assets later acquired by the trust may be treated as FAI only to the extent they have appreciated after acquisition.[43]

Some states have statutes which seem to permit significant flexibility in controlling the amount and timing of FAI. For example, Alaska's income and principal act, which is based upon the uniform act, provides essentially that there is no accounting income merely by the imputation of tax income to a trust. So, a NIMCRUT trust must report all income imputed or allocated to it for income tax purposes, such as where the trust is a partner in a partnership (or LLC treated as a partnership for income tax purposes). Partnerships are 'flow-through' entities. Flow-through taxation means that the entity does not pay taxes on its income. Instead, the owners of the entity pay tax on their 'distributive share' of the entity's taxable income, even if no funds are distributed by the partnership to the owners.”[44] Hence, if a NIMCRUT is a partner, it will report as its income any income of the partnership properly allocated to it, but if the trust received no FAI from the partnership, none of the partnership (imputed) income will be distributable to or taxed to the unitrust recipient.

Alaska law, essentially limits FAI from a partnership to be limited to distributions only of money (except for reinvested dividends) and then only if the money was

> (1) money received in one distribution or a series of related distributions in exchange for part or all of a trust's interest in the entity,
>
> (2) money received in total or partial liquidation of the entity, or
>
> (3) money received from an entity that is a regulated investment company or a real estate investment trust if the money distributed is a short-term or long-term capital gain dividend for federal income tax purposes.

Money is deemed received in a partial liquidation to the extent, and presumably only to the extent,

(1) the entity, at or near the time of a distribution, indicates that it is a distribution in partial liquidation, or

(2) the total amount of money and property received in a distribution or series of related distributions is greater than 20% of the entity's gross assets, as shown by the entity's year-end financial statements immediately preceding the initial receipt.[45]

Hence, if an Alaska NIMCRUT invests in a limited partnership, nothing will be distributable to the unitrust recipient based purely on imputed income from the partnership. Hence, if the NIMCRUT receives no FAI, the share of income it earns (through the partnership) essentially will accumulate in the NIMCRUT income tax free.[46] If and when the trustee wishes to generate FAI, it could seek a distribution in cash from the partnership that is not indicated to be of a partial liquidation and is not a distribution as part of related distributions consisting of greater than 20% of the entity's gross assets, which would cause the money received to be treated as corpus under the act. This can be made more certain by having the trust itself provide that distributions of profits experienced by the entity shall be FAI and that only a distribution that the partnership advises is in partial liquidation of the partnership shall be considered principal. This almost certainly would be respected for tax purposes. Reg. 1.643(b)-1 provides, in part, that FAI “means the amount of income of an estate or trust for the taxable year determined under the terms of the governing instrument and applicable local law. Trust provisions that depart fundamentally from traditional principles of income and principal will generally not be recognized.” Until the Uniform Income and Principal Act was promulgated (in 1997) there was little, if any, developed law on how distributions from business entities (such as a limited partnership) were to be treated for income and corpus purposes. Indeed, common entities used today, such as LLCs, just did not exist.[47] Hence, it is very difficult to see how specific provisions on how receipts from such an entity could depart fundamentally from *traditional* principles of income and principal.

Expressed IRS Concern on NIMCRUTs.

However, the Internal Revenue Service has indicated some concern over the ability of a NIMCRUT to “manipulate” what is income (FAI) and principal. For example, although the Uniform Act permits a trust to pay a unitrust amount (generally, of between 3% and 5%) and for it to be treated as FAI for tax purposes, Reg. 1.664-3(a)(1)(b)(3) provides that “trust income may not be determined by reference to a fixed percentage of the annual fair market value of the trust property, notwithstanding any contrary provision in applicable state law. Proceeds from the sale or exchange of any assets contributed to the trust by the donor must be allocated to principal and not to trust [accounting] income at least to the extent of the fair market value of those assets on the date of their contribution to the trust. Proceeds from the sale or exchange of any assets purchased by the trust must be allocated to principal and not to [fiduciary accounting] income at least to the extent of the trust's purchase price of those assets.”

Shoemaker and Jones, "Charitable Remainder Trusts: The Income Deferral Abuse and Other Issues", IRS exempt Organizations CPE Textbook 1997-139, discusses other possible manipulation of distributions from NIMCRUTs. That report did not make specific proposals, and none has yet to be implemented after more than 20 years. In Rev. Proc. 97-23, 1997-1 CB 654, the IRS announced it would not issue rulings on whether an income only CRT qualifies under Section 664 where the grantor, trustee, beneficiary, or a person related or subordinate to any of them controls the timing of the CRT's receipt of trust income from a partnership or a deferred annuity contract. It is understood the IRS was studying whether other investments might disqualify the trust as a CRT. Again, it has been more than 20 years since the revenue procedure and the Shoemaker report were issued. And in National Office Technical Advice Memorandum (TAM) 9825001 (not precedent), the IRS ruled that the acquisition by a NIMCRUT of deferred payment annuities (which avoid the current generation of FAI) was not an act of self-dealing under Section 4941,[48] and would not prevent the trust from being a "qualified" CRT. Perhaps, more important, after the issuance of the Shoemaker report and Rev. Proc. 97-23, the Treasury revised the CRT regulations and basically only inhibited controlling the amount of FAI by prohibiting the allocation of proceeds of sale or exchange to FAI to the extent not in excess of the value of the assets when contributed to or purchased by the NIMCRUT and by prohibiting the use of a unitrust percentage to determine FAI of an income only CRT.[49]

Hence, it seems that managing a NIMCRUT to produce minimum or maximum FAI is permitted (subject to the prohibitions just mentioned).[50] Nonetheless, if a partnership, LLC, or other entity will be used to control the amount of FAI the NIMCRUT receives, the person in control of the distributions from the entity should be someone other than the grantor, trustee, beneficiary, or a person related or subordinate[51] to any of them.

Are Individual Beneficiaries Better Off with a CRT?

The answer is: it depends. If the ability to postpone income taxation of the plan or IRA proceeds is desirable (for example, to have tax deferred growth), the answer may well be yes. As demonstrated above, postponement of taxation of the proceeds from a plan or IRA may produce overall greater wealth if the assets grow in value. Due to the fact that, except for EDBs, plan and IRA proceeds must be distributed essentially within ten years of the death of the plan participant or IRA owner, a mechanism to postpone their taxation for a longer period may also be beneficial.

For example, a taxpayer may create a CRUT to pay 11% a year to a beneficiary for 20 years (the maximum fixed period for a CRT) without violating the 10% value of the remainder requirement. If it is assumed that the trust will grow at 6% a year and no unitrust payments are made for the first 19 years because there is no FAI, the NIMCRUT will be worth $3,207,135. If instead, the beneficiary received the amount in the plan or IRA in ten years (which would be $1,790,847 or $1,128,234 after a 37% income tax) and that were invested at 6% taxable each year (or 3.78% after a 37% tax) for another ten years, the beneficiary would then have $1,635,068. With the NIMCRUT, if no unitrust payments were made until the end of 20 years, the recipient would have faced total shortfalls for the first 19 and a unitrust payment for year 20 of $ 4,289,200. The CRT would then be worth $3,207,135. Note that, although the shortfall in unitrust payments are nearly $4.3 million, the CRT is worth only about $3.2 million and, obviously, no more than the trust's value could be transferred to a beneficiary.

The increase in value from the inception would be $2,207,135 and if that entire amount were paid out at the end of the 20-year term and was FAI, the beneficiary would net $1,390,495 after a 37% income tax. Perhaps, it would be possible for the trust to pay more of the shortfall of $4,289,200 to the unitrust recipient (although, again, never more than the $3,201,135 in the trust), so that, after a 37% income tax, the recipient would have more than $1,635,068. That obviously would mean charity would get after 20 years less than $1,000,000. But that result is not unfair or constitute "cheating" of the charitable remainder beneficiary, which was to receive a present value interest, at inception, of $100,000 (that is 10% of the $1,000,000 account). Indeed, if the charitable remainder beneficiary received $600,000 at the end of 20 years that would represent a 9% compounded growth for the 20 years on the $100,000 value of the remainder at inception of the trust. So, if $2,607,135 of FAI were received in the 20th year and paid to the unitrust recipient and subjected to a 37% tax, the recipient would have $1,642,495, slightly more than if the CRT were not used. Even if only part of the increase in value in the trust (from inception) constitutes FAI, the unitrust recipient may receive more if the growth in the trust is greater. For example, if the trust grew not at 6% annually but at 11% a year (the same as the 11% unitrust percentage), the unitrust recipient would receive approximately $4.5 million after income tax compared to approximately $3.5 million after tax if the plan or account grows tax free at 11% annually for ten years, is then withdrawn subject to a 37% tax and reinvested at 11% (6.39% after a 37% tax) for another ten years.

NIMCRUT for Life

A NIMCRUT may provide for payments for the life of an individual. However, to avoid violating the 10% minimum value of the remainder, no one younger than 23 years of age may be the unitrust recipient (and then only with a 5% unitrust payout and having the percentage applied and paid after 12 months from the funding of the trust). The older the unitrust recipient the higher that unitrust percentage may be for life. For example, an 11% unitrust payout can be provided for life for someone 51 years of age or older, the same maximum percentage for a fixed 20-year term unitrust.

With a unitrust for life of someone relatively young, the tax-free compounding inside a NIMCRUT can also mean more ultimately for the unitrust recipient. For example, if the beneficiary received the amount in the plan or IRA in ten years (which would be $1,790,847 if it earned 6% a year or $1,128,234 after a 37% income tax) and that were invested at 6% taxable each year (or 3.78% after a 37% tax) for 30 more years, the beneficiary would then have $3,434,070. If instead, the beneficiary received no distributions from the NIMCRUT for 40 years and it grew at 6% a year, the unitrust recipient would receive $10.2 million (on account of the shortfalls in FAI during the years), leaving approximately $6.5 million after tax and having the original $1 million corpus pass to charity at that time, which represents an approximate 6% compounded growth in the $100,000 value of the remainder for 40 years. An alternative would be not to make up payments made to the unitrust recipient but to convert the NIMCRUT to a standard CRUT at some time.

Another Option to Build In: A Flip Unitrust

For a variety of reasons, one of which may be that the amount of FAI generated each year is insufficient from what the beneficiary will desired and that a “standard” unitrust would have been preferred as payments would not be limited to FAI. Reg. 1.664-3(a)(1)(i)(c) permits the conversion of an income only unitrust to a standard unitrust (one that pays the unitrust amount each year regardless of the amount of FAI the trust receives). Once the conversion occurs, the beneficiary will receive the amount of the unitrust determined without regard to the amount of FAI. The conversion has to occur at a date certain which the regulations call a “triggering event,” a single event whose occurrence is not discretionary with or within the control of the trustee or any other person. Regulations specifically provide that the sale of unmarketable assets,[52] or the marriage, divorce, death, or birth of a child with respect to any individual may be such a triggering event.

What About for EDBs?

Whether a CRT is suitable for an EDB depends on facts and circumstances. For the surviving spouse of the participant or IRA owner, it likely is best to name the spouse or a conduit trust for the spouse as the beneficiary on account of the unique options the spouse has such as rolling the plan or IRA into his or her own IRA (or adding it to his or her employer's plan). That will permit RMDs to be taken over the recalculated life expectancy of the surviving spouse. Unless the survivor wants the proceeds never to be taxed (or to be taxed at a much later time), a CRT may not be the best choice. However, if a CRT is not used, the spouse (or conduit trust for the spouse) will have to take distributions over his or her recalculated life expectancy. The survivor may delay taking RMDs until the survivor reaches his or her required beginning date (RBD) but only if survivor is named as the “outright” beneficiary (and not through a conduit trust) and rolls the benefits owner to his or her own IRA (in which case the survivor may take RMDs under the Uniform Lifetime Table, which is a joint life table which is more favorable than the single life table which would be applicable to a conduit trust). If a conduit trust for the spouse is named as the beneficiary (or the spouse is named but does not rollover the funds to his or her own IRA), RMDs must commence no later than the later of

(1) the year of the participant's death or

(2) the year the participant would have reached age 72.

If the spouse is quite young, naming the spouse as the outright beneficiary and having him or her rollover the proceeds to his or her own IRA may be the best move (having the spouse delay payments until his or her RBD) rather than paying the proceeds to a CRT. The survivor will get the benefit of a long stretch where the entire plan or account can continue to grow tax-free. This seems especially beneficial for a Roth IRA as the survivor can delay taking any distributions during the balance of his or her lifetime, greatly benefitting from long term tax-free (not just tax-deferred) compounding.

A minor child of the participant or owner does not have the same flexibility as does the surviving spouse. The minor need not take distributions out under the ten-year regime but can wait until he or she reaches majority[53] when the ten-year payout rule will commence. During minority, however, it seems the minor does need to take RMDs based on his or her (long) life expectancy (account balance divided by life expectancy). Once he or she reaches majority and the ten-year rule kicks in, the minor can wait until the end of the tenth calendar year following the year of majority. This treatment of minor children of the participant or owner is complicated.

Some might feel a CRT for the life of the minor is best, but as explained above, a CRUT cannot be created for the life of anyone under the age of 25 and, as also explained, usually a CRUT is better than a CRAT (which could be created for a minor if the Section 7520 rate is high enough, something very difficult to forecast very far into the future). If the plan participant or owner does not want the child to receive much of the proceeds early in life, there is little, it seems, that can be done if the participant or owner want to use the special treatment for a minor who is an EDB. Although, a conduit trust for the minor could be used once he or she reaches majority, the entire amount in the plan or account will have to be taken by the trust within the ten year period after majority is reached and then immediately distributed outright to the former minor. While not absolutely certain, it does not seem that an accumulation trust may be created for a minor of the participant or owner and have the minor treated as an EDB so payment during his or her lifetime can be made under the RMD rules until he or she reaches majority when the ten year rule must be used.

One possible option is to have the conduit trust be a grantor trust as to the minor by granting him or her a unilateral right described in Section 678 to withdraw everything in the trust for a time and then having it be withdrawable only with the consent of a non-adverse party, such as the trustee.[54] This would be similar to a so-called “Crummey Trust” with a so-called “hanging power.”[55] Even assuming such a trust may be used, it may be subject to the claims of creditors in some jurisdictions and presumably the trustee would at least distribute to the minor (or former minor) an amount equal to the income tax he or she will owe on the income attributed to him or her under the grantor trust rules.

For an EDB, who is not the spouse of the participant or owner, and not more than ten years younger than him or her (such as a sibling or significant other whom the participant or owner does not marry), unrecalculated life expectancy can be used. A conduit trust can be used but probably not an accumulation trust. Depending upon the age, health and financial needs of the beneficiary, a charitable remainder trust may be considered (at least for part of the proceeds of the plan or IRA).

It seems virtually certain that an accumulation trust may be used for a beneficiary who is chronically ill or disabled if the person is the only one to whom the trustee may make distributions during his or her lifetime. This should provide maximum asset protection for the beneficiary including entitlement to government benefits (for which such a beneficiary may well be entitled). Although the trustee will be required to take RMDs based upon the beneficiary's unrecalculated life expectancy, the accumulation trust may be drafted so no distributions are required to be made from the trust to the beneficiary. Of course, that will mean the RMDs will be subject to tax at the highest rate of income taxation (which for a trust occurs when the trust has nearly $13,000 of income). A CRT might be considered for such a beneficiary as payment of plan or IRA proceeds received by the trust would not be subject, upon their receipt by the trust to any income tax. It could be created for a class so distributions would not be required to be made to that beneficiary, but could be made to others (such as a sibling of the beneficiary) who could apply the CRT distributions to benefit the disabled or chronically ill person. Or, as mentioned above, a NIMCRUT could be created for him or her and managed to produce little if any FAI until a need for a trust distribution is appropriate keeping in mind that the receipt of too much property may disqualify the beneficiary from certain government benefits such as Medicaid which may be critical for him or her.

Conclusion

Interests in plans and IRAs often are the most complicated assets with which to deal in an estate plan. They may be subject to both estate tax and to income tax. It seems that little lifetime planning can be done with such plans or accounts during lifetime to reduce estate tax on them. Except for Roth IRAs, distributions from a plan or IRA (both before and after death) almost always will be subject to income tax as ordinary income. Because deferring income tax is a powerful income tax planning tool, individuals often sought to have payments from plans and IRAs stretch over as long as period as possible. The SECURE Act has significantly reduced that ability by generally requiring that all plan or IRA interests be distributed by the end of the tenth calendar year following the death of the plan participant or IRA owner. In order to delay the taxation of distributions, some individuals may wish to consider paying the plan or IRA to a charitable remainder trust where distributions can be paid over a 20-year period or, in some cases, for the life or lives of individual beneficiaries. In some case, the beneficiaries will succeed to more wealth over time with a CRT than if one were not used. A careful analysis of the CRT option should be undertaken for some taxpayers. In doing that, we think the following generalities should be considered:

- The next best thing to income avoidance is income tax deferral which is why individuals contribute to qualified (retirement) plans and IRAs.
- The principal benefit to the non-charitable beneficiaries of a CRT is the trust's exemption from income taxation.
- This benefit will occur whenever the CRT has tax income greater than the amount payable each year.
- This benefit essentially is the renting for the individual beneficiaries of the CRT of the trust's exemption from income taxation.
- Individuals wish to pay the lowest rent possible when renting and, with a CRT, that rent is the minimum allowed value of the remainder (10%).
- Because property tends to increase in value over an extended period of time, a CRUT almost always will be superior to a CRAT and a carefully administered NIMCRUT may be best of all.

[1] Portions of this article are derived from Blattmachr, "Using Charitable Remainder Trusts as Asset Management, Estate Planning and Private Retirement Plansm Tools," The Chase Review (July 1989). The authors greatly thank Natalie B. Choate, Esq., probably the leading expert on estate planning for retirement plans, Professor F. Ladson Boyle, and Lawrence Macklin for reviewing a draft of this article. However, any errors contain in the article are to be attributed solely to the authors.

[2] *See* https://www.pionline.com/article/20180621/INTERACTIVE/180629958/u-s-retirement-assets-at-28-trillion-in-q1-little-changed-from-end-of-2017

[3] *See*, generally, Choate, Lifetime and Testamentary Planning for Retirement Plans, 8th Ed. (Tax Plan 2017), available at Ataxplan Publications c/o Nutter McClennen & Fish LLP 155 Seaport Blvd. Boston MA 02210-2604, (617) 439-2995, nataliechoate@cs.com.

[4] The importance of this phenomenon is highlighted in Glickman & Blattmachr, "High Returns and Tax -Free Compounding: Important Goals in Building Wealth," 43 Estate Planning 11 (May 2016).

[5] Although someone of a particular age has a fixed (definite) life expectancy (or a specified time when such a person is expected to die), the longer the person lives, the later the age at which he or she is expected to die. Recalculation means that the individual's life expectancy is extended for each additional year he or she lives. Essentially, this allows the plan participant or IRA owner to continue to receive payments from the plan or account without the imposition of tax under Section 4974, regardless as to what age he or she lives.

[6] The SECURE Act is part of the Further Consolidated Appropriations Act, 2020 (P.L. 116-94, 12/20/2019), which was signed into law by the President on 12/20/2019. The SECURE Act significantly modifies many requirements for employer-provided retirement plans, IRAs, and other tax-favored savings accounts.

[7] For the surviving spouse of the participant or owner, distributions could be taken over the spouse's recalculated life expectancy in some cases.

[8] *See* Choate, supra, for a thorough discussion of this topic.

[9] *See* Section 408A.

[10] In many other states, it is 16%.

[11] The result could be worse after 2025 when the deduction limitation under Section 68 is restored.

[12] Section 414(p).

[13] Cf. Horwitz & Damicone, "A Decent Proposal," 150 Tr. & Est. 46 (November 2011) with CCA 201343021 ("PLRs 20117042 and 201129045 appear to conflict with Rev. Rul. 85-13. PLRs 20117042 and 201129045 were issued by IRS Employee Plans, and *state that an individual retirement account (IRA) cannot be transferred to a grantor trust of the IRA owner.* The conflict between these rulings and Rev. Rul. 85-13 was noted in Beers, Deborah M., 'IRS Issues Two Seemingly Contradictory Rulings on Effects of Transfer of IRA to Special Needs "Grantor" Trust', 36 Tax Mgmt. Est. & Tr. J 230 (2011) and Jones, Michael J., 'The Economy and other Retirement Mysteries', Trusts & Estates, January 2012, at 35. Both articles mention prior PLRs issued by the same office appearing to accept that the owner of a grantor trust is the owner of its assets, which may include an IRA. See PLRs 200620025, 200826008, and 201116005." Emphasis added.)

[14] These concepts are explained in detail in Glickman & Blattmachr, supra.

[15] Under the five-year regime, the payout period could be somewhat longer than five years as the account must be fully distributed, to avoid the tax under Section 4974, by the end of the fifth calendar year following the year of death.

[16] The highest income tax rate is 37%. The net investment income tax imposed by Section 1411 does not apply to plan or IRA proceeds. See Section 1411(c)(5). This avoidance of the NIIT for plans and IRAs applies if and when the proceeds are payable to a trust and then treated as distributed to a beneficiary of the trust, including a charitable remainder trust. *See* Blattmachr and Boyle, Income Taxation of Estates and Trusts (PLI 2019), at section 4:7.3

[17] It, perhaps, is even more obvious that the longer assets are held in a Roth IRA (described in Section 408A) the better, as they not only grow income tax-free but are not included in gross income, in most cases.

[18] For a further discussion of CRATs and CRUTs, including their governing instruments, see Fox, A Guide to the IRS Sample Charitable Remainder Trust Forms, 33 Estate Planning 01 (Jan. 2006).

[19] Adjustments are required for any "short" year and the percentage payout for either a CRAT or a CRUT may not vary from year-to-year.

[20] If the governing instrument does not provide for the make-up of the short fall, the trust is typically called a "net income charitable remainder unitrust" or a "NICRUT."

[21] Section 664(d)(1)(D) and (d)(2)(D).

[22] Rev. Rul. 77-374, 1977-2 CB 329.

[23] For a discussion of the 5% probability test, see Fox & Blattmachr, “IRS Provides Guidance to Avoid 5% Probability Test for Charitable Remainder Annuity Trusts”, 94 Journal of Taxation 246 (June 2017).

[24] Treas. Reg. section 1.664-4. In essence, that regulation requires that the charitable remainder (and the annuity or unitrust interest or interests that precede it) must be determined using the rate in effect under Section 7520. (Section 7520(a) provides that if an income, estate, or gift tax charitable contribution deduction is allowable for any part of the property transferred, the taxpayer may elect to use such Federal midterm rate for either of the 2 months preceding the month in which the valuation date falls.) The Section 7520 rate is equal to 120% of the applicable federal midterm rate (determined under Section 1274) rounded to the nearest even two-tenths of one percent. Since the Section 7520 rate has been in effect (beginning in May 1989), it has reached a high of 11.6% and a low of 1.0%. http://www.leimberg.com/software/7520rate.

[25] This is explained in detail in Blattmachr & Hastings, “Valuing Certain Split Interests,” 123 Trusts & Estates 27 (June 1983).

[26] Rev. Rul. 77-374, supra.

[27] *See* https://www.macrotrends.net/2526/sp-500-historical-annual-returns.

[28] A CRT is subject to a 100% excise tax on any unrelated business taxable income attributed to it. Section 664(c)(2). It seems this income will form the pool of taxable income that may be taxed to the trust's annuitant or unitrust recipient which may cause the UBIT to be subject to overall taxation of more than one hundred percent (100%).

[29] Just Google it. And note that the trillions of dollars that are in qualified retirement plans and individual retirement accounts (IRAs) got there based upon that assumption. *See*, also, Glickman & Blattmachr, supra.

[30] *See*, *e.g.*, Sections 1033 and 1244.

[31] However, a CRT is liable for 100% excise tax on any unrelated business taxable income it has. See Section 664(c)(2).

[32] At least in some circumstances, gain experienced by a CRT will be attributed to the trust's grantor. *See* discussion in Blattmachr & Hastings, “Charitable Remainder Trusts,” The Chase Review (October 1988).

[33] In valuing the interests in a CRT, the taxpayer may use the Section 7520 rate in effect when created (which will be the date of death for one created at death) or either of the two preceding months. Section 7520(a). Hence, for an individual who is known with medical certainty that he or

she will die within the next two months, he or she can be morally certain of what type of CRAT will qualify. Also, a formula may be used. See the CRT forms available at InterActive Legal.

[34] The creditworthiness of the buyer must be considered although sometimes an escrow may help eliminate that concerns. And *see* Sections 453, 453A and 453B.

[35] Even if the trust purchases a bond that pays each year interest equal to the Section 7520 rate used to value interests in the trust for tax purposes, the value of the bond will change over time and that will affect the unitrust payments in future years.

[36] "According to Fidelity, a $100,000 deferred income annuity today that is purchased by someone at age 60 would generate $671.81 a month ($8,061.72 a year) in income for a woman and $696.89 a month ($8,362.68 a year) in income for a man," available at https://money.usnews.com/money/blogs/the-best-life/2013/07/09/when-to-convert-your-savings-into-an-annuity. For a $1 million payment, that would be $83,627 a year not $50,000. Charity might be better off as well—for example, giving $100,000 to charity now and using $900,000 for the annuity which based upon the same assumptions would produce an annual payment of $75,264 each year.

[37] There may be an income tax advantage to a commercial annuity compared to a CRAT. All ordinary income is first treated as coming out of the CRAT, then long term gain, then tax free return of basis. With a commercial annuity, the payments will be deemed to consist proportionately of ordinary income (interest), gain, and corpus until original basis is exhausted.

[38] For example, if the $1 million is sold, leaving $760,000 and $100,000 is given to charity, a commercial annuity purchased with the remaining $900,000 for the 60 year old male would be about $55,000 a year, more than the $50,000 sought annually from the CRAT.

[39] See https://www.macrotrends.net/2526/sp-500-historical-annual-returns.

[40] https://www.investopedia.com/ask/answers/042415/what-average-annual-return-sp-500.asp

[41] Although an income only CRUT need not provide for the make-up payments for years when FAI exceeds the unitrust payment for the year (such a trust is commonly called a "net income charitable remainder trust" or "NICRUT"), there seems to be little downside in using the NIMCRUT design. However, it the taxpayer wants insure no "leaking" out of the trust for the long haul, the NICRUT may be best. The taxpayer may be waiting to convert (or flip) the income only trust to a regular CRUT until a later time.

[42] Reg. 1.664- 3(a)(1)(i)(b)(3).

[43] Id.

[44] Id., and Google "taxation of partners."

[45] There is a further limitation: Money is not received in partial liquidation, and it may be taken into account as a partial liquidation only to the extent that it does not exceed the amount of income tax that a trustee or beneficiary must pay on taxable income of the entity that distributes the money.

[46] As mentioned above, the trust will have to pay a 100% excise tax on any UBIT it must report. See Section 664(c)(2).

[47] “In 1977, when the state of Wyoming first passed legislation allowing a new type of company called a Limited Liability Company (LLC), hardly anyone noticed. Today, over two-thirds of all new companies formed are LLCs.” Search “How long have LLC been around?” at www.quora.com.What-was-the-first-known-Limited-Company.

[48] Section 4941 imposes an excise tax on what it describes of acts of self-dealing.

[49] See Treasury Decision 8791.

[50] The IRS has ruled (privately) that plan proceeds may be made payable to a CRT. PLR 199901023 (not precedent) and PLR 9634019 (not precedent); and see PLR 9919039 (not precedent).

[51] A related or subordinate person is defined in Section 672(c).

[52] A related or subordinate person is defined in Section 672(c).

[53] There is some uncertainty what majority means. It may be the age under the minor's domicile that determines it (which in almost all but not all states is 18) or, for some, when the child completes a “specified course of education” within the meaning of Section 409(a)(9)(F).

[54] Cf. PLR 200949012 (not precedent).

[55] These concepts are discussed in detail in Blattmachr & Graham, “The Extra Crummey Trust SM: Maybe the Best Annual Exclusion Vehicle Around,” 22 Probate & Property, No. 4, (July/August 2008).

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The Estate Planning Tsunami of 2020[1]

By

Jonathan G. Blattmachr and Carlyn S. McCaffrey

Now is a good time to encourage clients to consider implementing one or more currently available transfer tax planning techniques.[2] Depending on the outcome of the November federal elections, the current $11.58 million wealth transfer tax exclusion, which is scheduled to be cut in half in 2026, could undergo an earlier and more substantial reduction starting as early as 2021. Election results could also lead to an increase in transfer tax rates, statutory and regulatory elimination of a wide array of planning techniques available under current law, and a possible imposition of a tax on unrealized appreciation at death or carry-over basis.

The confluence of low interest rates, depressed asset values,[3] and the real possibility of a reduction in the availability of planning opportunities, is likely to cause a late-year rush of clients seeking to implement strategies designed to (1) take advantage of the current high exclusion levels and relatively low transfer tax rates, (2) assign valuation discounts to transferred assets, and (3) implement various techniques for shifting expected future increases to lower generations. Estate planners saw a similar phenomenon in the last months of 2012 when clients rushed to use the $5 million wealth transfer tax exclusion that was scheduled to be reduced to $1 million starting in 2013.

This article describes the principal planning techniques that are currently available including those that have been the target of proposed reform for more than a decade, the risks individuals may face when they implement these techniques, and ways to reduce these risks.

I. Available Estate Planning Techniques

A. The Basics

An important goal of most estate tax planning techniques is the removal of existing wealth and expected future wealth from an individual's transfer tax base either without paying transfer taxes or by paying those taxes at lower rates than those that are expected to be in effect at the individual's death.

Existing current wealth can be removed from an individual's transfer tax base in one of the following ways:

1. Gifts
2. Creation of grantor trusts

[2] By transfer taxes, we refer to the estate, gift, and generation-skipping transfer taxes.
[3] Although the S&P 500 Index had risen by more than 6% in 2020 by the end of August , the increase is largely attributable to increases in the stock prices of the 5 largest internet companies, which now make up about 26% of the index. The prices of more than half the stocks in the index have actually declined in 2020, many by 40% or more.

3. Gifts or sales of fractional interests in property
4. Sales of assets for lifetime annuities

Expected future wealth can be diverted from an individual's transfer tax base by:

1. Gifts or sales of property expected to produce income or to increase in value.
2. Loans at interest rates lower than the rate of return the lender would expect to receive from his or her investment of the funds.
3. The use of devices that permit the shift of future investment return on assets retained by individuals.

B. Removing Existing Wealth from the Transfer Tax Base

If the transfer tax exclusion remains the same, a gift will ordinarily not result in the removal of existing wealth from the donor's transfer tax base because the value of the gifted property at the date of the gift will be included in the donor's estate tax base as part of his or her adjusted taxable gifts. If, however, the gift is protected from gift tax by the currently high applicable exclusion amount allowed under Section 2010[4] and that exclusion amount is reduced before the donor's death, the gift should result in a tax free removal of value from the donor's estate tax base to the extent of the reduction in the exclusion amount. The current exclusion is $11.58 million and can be double that amount if a donor's spouse is willing to treat one-half of the donor's gifts as having been made by him or her. Under current regulations, if the exclusion is reduced, the donor's estate will be able to use the exclusion amount the donor used against lifetime gifts if that amount is higher than the amount available at death.[5] In addition, if the donor is willing to pay gift tax, and if the donor lives for at least three years after the gift, the gift will have removed the amount of the gift tax from the donor's transfer tax base, effectively reducing a 40% transfer tax rate to 28.57%.[6]

Gifts made to grantor trusts, trusts deemed owned by their grantors under Section 671, have the potential for removing even greater amounts from the donor's transfer tax base because the donor will be obligated to pay income tax on the trust's income. If, for example, a donor creates a $10 million grantor trust that produces annual income for 10 years at a 7% annual rate and that income is subject to tax, 50% at long term capital gains tax rates and 50% at ordinary income tax rates, more than $3 million of additional value will have been removed from the donor's gross estate.

Arranging for the division of property into fractional interests, the value of which will be determined using various discounts, such as discounts for lack of marketability and lack of

[4] References to "Section" in this article refer to a section of the Internal Revenue Code of 1986, as amended (the "Code").
[5] Reg. 20.2010-1(c) permits the estate of a decedent whose life time gifts were protected from gift tax by an applicable exclusion amount higher than the applicable exclusion amount in effect at his or her death to apply the sum of the exclusion amounts used against gift tax against his or her estate tax. References to "Reg" in this article refer to regulations under the Code promulgated by the Internal Revenue Service and the Treasury Department.
[6] If the donor dies within three years of his or her gift, the amount of the gift taxes will be included in his or her gross estate under Section 2035(b).

control, is another technique for removing value from a donor's transfer tax base. A donor who owns a $6 million parcel of real estate, for example, could give a 1/3rd tenants-in-common interests in the parcel to trusts for each of the donor's children. Because fractional interests in real estate are difficult to market and because the owner of the fractional interest cannot compel the sale of the whole, the value of each of the gifts is likely to be substantially less than $2 million. If, for example, the appropriate valuation discount was 25%, the donor would have removed $2.5 million from his or her transfer tax base. Fractional interest discounts for investment assets are potentially achievable if they are transferred into an investment entity such as a limited liability company. Minority interests in the entity can then be given or sold to members of the donor's family or trusts for their benefit.

Finally, for individuals who have existing grantor trusts with substantial value and an expected life span less than the Internal Revenue Service's mortality expectations, there is the possibility of selling assets to the trust in exchange for a lifetime annuity.[7] A 65-year old individual, for example, could sell $10 million worth of assets to a grantor trust that had at least $17 million of assets[8] in exchange for the right to receive an annual payment of $598,070. When the individual dies, the right to receive future payments terminates. If death occurs within the next several years, significant value will have been removed from the individual's transfer tax base.

C. Removing Future Wealth from the Transfer Tax Base

A gift of property will remove all of the income and appreciation generated by the transferred property after the transfer from the donor's transfer tax base. A sale will accomplish the same thing but only if the transferred property produces a rate of return greater than the rate of return generated by the cash or other property received as consideration for the sale. If the consideration is in the form of a note bearing one of the low interest rates permitted under Section 7872, the sale will likely have the effect of removing value.[9] A loan at a low Section 7872 interest rate to a family member or trust will have the same effect if the interest paid on the loan is less than the return the lender would have generated if he or she had not loaned the funds.

Finally, there are at least two forms of transfers that will remove some portion of the future investment return on transferred property from an individual's transfer tax base, an entity freeze transaction and a grantor retained annuity trust (a GRAT). An entity freeze transaction requires dividing the economic interests in an asset between an interest that will receive a fixed return

[7] An individual who is known to have an incurable illness or other deteriorating physical condition and has at least a 50% probability of dying within one year may not use the Internal Revenue Service's assumed mortality expectations. Reg. 25.7520-3(b)(3). The sale to a grantor trust rather than a nongrantor trust will prevent the sale from tax recognition treatment and the treatment of a portion of each annuity payment as taxable income. Rev. Rul 85-13, 1985-1 C.B. 184.

[8] For this technique to work, there must be sufficient assets in the trust, including the assets contributed in exchange for the annuity, to pay the annuity for the duration of the donor's life if he or she lives to 110 using the assumption that the trust assets will be invested to earn a return equal to the rate prescribed under Section 7520 for the month in which the transaction takes place. Reg. 25.7520-3(b)(2). The Section 7420 rate in effect in September 2020 is .4%.

[9] Interest rates permitted under Section 7872 in September 2020 are .14% for loans of 3 years or less, .35% for loans of more than 3 years but no more than 9 years, and 1% for loans of more than 9 years.

with a small additional profit participation and an interest that will receive the balance of the return. The first interest is retained by the senior family member; the second interest is given or sold to other family members or the trusts for their benefit. A GRAT is a trust that is required to pay an annuity to its grantor for a specified number of years with the remaining property to be paid to the grantor's family members or a trust for their benefit. The annuity payable can be structured to have a value equal to or almost equal to the value of the property the grantor transferred to the GRAT. Its value will be determined using the rates established each month by the Internal Revenue Service under Section 7520. This rate is .4% in October 2020. Equivalent or nearly equivalent value permits use of this technique with little gift tax consequences. In each case, the investment return generated by the property, to the extent it exceeds the donor's share of the return, should pass free of transfer tax to family members or to trusts for their benefit.

II. Threatened Techniques

The outcome of the November elections is difficult to predict at this time. But there is certainly a chance of a regime change in the Federal Government. Although, as with all other legislation, tax changes are a matter of political compromise, if there is a Democratic administration significant tax changes are likely to be proposed as part of a budget reconciliation act, which cannot be filibustered in the U.S. Senate. Even though significant tax changes may not be adopted, some changes almost certainly will occur. Those changes could well include reductions in the current exclusion amount as well as increased transfer tax rates.[10] Other changes that have been proposed by Democrat members of Congress and Democrat candidates include the elimination of the income tax free basis adjustment at death, the treatment of gifts and death as tax recognition events, and the inclusion of gifts and inheritances in gross income.[11] A continued Republican administration could also bring changes. President Donald Trump, for example, has called for an elimination of the tax-free basis adjustment at death although he has also proposed the elimination of the estate tax.[12]

Proposals have also been made that would eliminate the effectiveness of GRATs by requiring the value of the taxable remainder of the trust be equal to at least 25% of the value of property contributed to it and requiring the annuity terms to be at least ten years but no longer than ten years after the estimated life expectancy of the trust's grantor. In 2016 during the Obama administration, the Treasury Department and the Internal Revenue Service published a notice of proposed rulemaking under Section 2704 relating to restrictions on the liquidation of an interest in a corporation or a partnership that significantly reduced the availability of minority and other fractional valuation discounts.[13] In 2017, during the Trump administration, the proposed regulations were withdrawn.[14]

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[10]Many proposals are contained in S.309 introduced in 2019 by Senator Sanders. *§§*"Bernie Sanders's new plan to supercharge the estate tax, explained," available at https://www.vox.com/2019/1/31/18205294/bernie-sanders-estate-tax-99-percent.
[11] *See* https://taxfoundation.org/joe-biden-tax-plan-2020/.
[12] *See* https://taxfoundation.org/details-analysis-donald-trump-tax-plan-2016/.
[13] 81 FR 51413.
[14] FR Doc. 2017-22776 Filed 10-17-17.

Finally, some have proposed requiring the inclusion of a decedent's grantor trusts in his or her gross estate and subjecting the assets in a grantor trust to the gift tax if grantor trust status ends during the grantor's life. The use of grantor trusts has been a mainstay of estate tax planning for decades. Installment sales to grantor trusts,[15] GRATs, personal residence trusts, the use of private annuities,[16] and many other arrangements are all built on a platform of grantor trusts.

III. Options for Action Now

If any one or more of the changes described above is enacted or administratively implemented next year, the changes could be retroactive to the beginning of 2021 (if not before).[17] Because of this possibility, those individuals who have considered using any of the threatened techniques should consider implementing them before year end. Gifts made in 2020 should be protected by the current $11.8 million exclusion amount, should be subject to a 40% gift tax rate if a donor's cumulative gifts exceed the exclusion amount, and should be eligible for fractional interest discounts. Gifts of appreciated property should not be treated as tax recognition events. And a donor should be able to protect his or her transfers to a GRAT from gift tax no matter how small the value of the GRAT remainder. It is also possible that a rule subjecting grantor trusts to gift or estate tax enacted in the future might not apply to grantor trusts in existence at the time of enactment.

IV. Use the Exclusion Amount and Make Taxable Gifts Now

A. Advantages and Disadvantages

The easiest and most direct way for an individual to preserve the advantage of the current exclusion amount, favorable gift tax rates, and the ability to make gifts without triggering a tax realization event is to make gifts now to irrevocable grantor trusts[18] – both gifts that are protected by the exclusion amount and those that will attract a gift tax. There are some drawbacks and practical difficulties. Gifts, for the reasons discussed below, could actually prove to be counterproductive. Even if gifts prove to be tax efficient, donors may be reluctant to lose control over assets that are given away and to lose the possibility of benefitting from them, and some donors may not have assets that they are willing to part with.

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[15] *See* discussion at ¶1304.5 in Blattmachr, "Adventures in Partial Interest Transfers: Avoiding the Legacy of Zero Valuation Under Section 2702," 45 Major Tax Planning – University of Southern California's Annual Institute of Federal Taxation ¶1300 (1993).

[16] Prop. Reg. 1.72-6(e) and 1.1001-1(j) would make the transfer of appreciated assets in exchange for a private annuity immediately taxable, as discussed in Josephs, "Watch Out for Private Annuities," Jl of Accountancy (Jul 1, 2008), but there would be no income generated if the obligor were a grantor trust as to the annuitant. Rev. Rul. 85-13, 1985-1 C.B. 184.

[17] *See United States v. Carlton*, 512 U.S. 26 (1994).

[18] *See* Blattmachr, "The Right Answer: Put It All In Trust," Trust & Investments 16 (Sept/Oct 1998), republished in 10 NYSBA Elder Law Attorney 12 (Winter 2000).

B. The Potentially Negative Consequences of Gifts and How to Guard Against Them

1. In general.

Gifts can result in negative tax consequences for at least three reasons. First, the value of the property could decline. Second, if the gift is a gift of appreciated property and fails to appreciate sufficiently, the estate tax savings on the appreciation could be less than the income tax loss attributable to the basis step-up at death that would have been available if the gift had not been made. Finally, the estate of a New York domiciled decedent who dies within three years of making the gift may pay more total estate taxes as a result of making the gift than would have been due if the gift had not been made. Each of these possibilities is explained further below.

2. The value of the gifted property declines.

A decedent's estate tax is calculated on an estate tax base that consists of his or her taxable estate and his or her lifetime taxable gifts that are not included in his or her gross estate. Lifetime taxable gifts do not remove the value of the gifted property from the decedent's estate tax base. All taxable gifts are included in the decedent's estate tax base either as adjusted taxable gifts or as gifts included in the gross estate. As a result, if the value of gifted property declines between the date of the gift and the date of death, the decedent's estate tax will be more than it would have been if the gift had not been made.

Consider the following example:

Example 1.

Donor (D) makes a gift of $11.8 million worth of the common stock of X to a trust for her children in 2020 in order to use all of her remaining exclusion amount. D has made no prior gifts. She pays no gift tax. D dies in 2024 when the X stock is worth only $4 million. She has a taxable estate of $10 million. D's estate tax base is the sum of her adjusted taxable gifts and her taxable estate or $21.8 million. Assume that the exclusion amount has not been reduced and is $13,000,000 in 2024. Her estate tax would be calculated as follows:

Taxable Estate	$10,000,000
Adjusted Taxable Gifts	$11,800,000
Estate tax base	$21,800,000
Tentative tax	$8,577,800
Applicable exclusion amount	$13,000,000
Unified credit	$5,145,800
Net federal estate tax	$3,432,000

If D had not made the gift, D's estate tax base would have been only $14,000,000 and her estate taxes, only $400,000. The gift in this example cost the estate more than $3 million additional taxes. D's gift would have saved estate taxes only if the exclusion amount had declined to $2,113,800.

3. An income tax basis step-up would be more valuable than estate tax savings.

Most property included in a decedent's gross estate receives a new income tax basis equal to fair market value at death (or at the alternate valuation date).[19] Property given during life does not unless the property is included i the n decedent's gross estate.

A lifetime gift generates estate tax savings only on the income and appreciation it generates after the gift is made. If there is no investment return, there is no estate tax savings. When a donor gives appreciated property, unless the property generates a positive investment return before death, the loss of the basis adjustment will create a net tax disadvantage to the donor's beneficiaries.

Consider the following example:

Example 2.

The income tax basis of the $11.8 million worth of X stock given by D in Example 1 was $1 million before the gift. The X stock was worth $12.8 million when D died. The gift saved D's beneficiaries estate tax of $400 thousand, 40% of the $1 million appreciation. Assume that the trust that holds the X stock is in the top federal income tax bracket. When the stock is sold, the trust will pay tax of 23.8% on the gain or $2,570,400. The gift has cost the family additional taxes of $2,170,400. If the gifted X stock had been included in D's taxable estate, the estate would have paid additional estate taxes of $400 thousand but would have saved income taxes of $2,570,400.[20]

4. The donor is domiciled in New York and dies within three years of the gift.

New York estate tax is imposed on gifts made by New York domiciliaries within three years of death.[21] Because there is no similar provision of the federal estate tax law, the additional New York estate tax seems not to be deductible for federal estate tax purposes. As a result, the combined federal and New York estate tax on the gift could be as high as 56% rather than 49.6%.

Consider the following example:

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[19] Section 1014.

[20] The following formula may be used to determine the amount of total investment return a gifted appreciated asset must generate to offset the potential income tax cost of the loss of basis step up at the death of the donor:

$$X = ((E)(V) - (I)(B)) \div (E\text{-}I)$$

In this formula, the letter E means the highest combined federal and state estate tax rate applicable in the year of the donor's death to the estates of decedents who die domiciled in the donor's state of domicile. The letter I means the highest combined federal and state income tax rate applicable to the transferee's long-term capital gains. The letter V means the value of the transferred asset as finally determined for federal gift tax purposes. The letter B means the basis of the transferred asset for federal income tax purposes.

[21] N.Y. Tax Law sec. 954(a)(3).

Example 3.

D, the Donor described in Example 1, died two years after making the gift of the X stock. When D died, the value of the X stock was $11.8 million. D was a domiciliary of New York. D's estate tax is calculated as follows:

Value of estate assets	$10,000,000
Gross estate	$10,000,000
Deduction for NY estate taxes	$1,067,600
Federal taxable estate	$8,932,400
Adjusted taxable gifts	$11,800,000
Estate tax base	$20,732,400
Tentative tax	$8,238,760
Applicable exclusion amount	$11,800,000
Unified credit	$4,577,800
Net federal estate tax	$3,660,960
New York taxable estate	$21,800,000
New York estate taxes	$2,954,800
Total estate taxes	$6,615,760

If D had not made the gift, D's federal estate tax would have been only $2,906,090. The additional federal estate tax is caused by the fact that the New York estate tax attributable to the gifts made within three years of D's death may not be deductible for federal estate tax purposes because the gifted property is not included in D's federal gross estate.[22]

5. Guarding Against the Potentially Negative Consequences of Gifts

There are at least three ways of guarding against the potentially negative consequences of gifts. First, a gift can be structured in a manner that permits a donee to disclaim it and return the property to the donor. Second, a gift can be made to a trust that could be protected from gift tax by an election by the donor under Section 2056(b) (7) (a "QTIP"). Finally, the terms of the trust to which a donor has made a gift could give a person other than the donor, the power to give the donor a testamentary power that would cause the trust property to be included in his or her gross estate.

a) Disclaimers

A donor could make a gift to the trustees of a trust the trust instrument of which contains a provision that (i) gives one of the beneficiaries the power to disclaim his or her interest in the trust and (ii) provides that if the beneficiary makes a disclaimer within nine months of the gift, the trust property would be returned to the donor. If a disclaimer is made within nine months of a gift, the disclaimer is effective under local law, the beneficiary received no benefit from the trust, and the property is returned to the donor as a result of the disclaimer, Section 2019 treats the gift for federal gift tax purposes as if it had not occurred. If during the nine month period,

[22] State estate taxes imposed on property included in the gross estate are deductible under Section 2058.

the value of the gifted property declined or it became apparent that the exclusion amount was not likely to be reduced, the beneficiary might see the tax benefit of a disclaimer and might exercise his or her right to disclaim. Of course, this approach requires that the donor rely on the person with the power to disclaim to do so.

b) Gifts to QTIPs

When a donor makes a gift to a trust that is eligible for QTIP treatment, the donor, if his or her spouse is a U.S. citizen, retains the power to decide whether the gift will be taxable or not and can exercise that power at any time between the date of the gift and the date the donor's gift tax return is due. When the gift tax return is filed, if it is timely filed, the donor can make an election under Section 2056(b) (7) to treat the gift as eligible for the marital deduction. If, for example, a gift is made in November of 2020, the donor can wait until October 15, 2021 to decide whether or not his or her gift will be a taxable gift. If, with the value of hindsight, the donor concludes that the gift should be treated as a nontaxable gift because, for example, the value of the gifted property has declined significantly, the donor can make a QTIP election and protect the gift from gift tax by the marital deduction.

The disadvantage of this approach, from the standpoint of tax efficiency, is that trust income will be required to be paid to the beneficiary spouse for life even if the gift is treated as a taxable gift. The income will increase the value of the spouse's estate causing more estate tax than if the gift had been made without the income requirement. The disadvantage can be reduced by avoiding investments in assets that produce a high level of current income.

c) Power to grant a testamentary power of appointment

The terms of the trust agreement could give a person other than the donor or a beneficiary of the trust a power to give the donor a testamentary power of appointment over the trust principal, but not income, and to revoke that power at any time. The power holder would, by conferring the testamentary power on the donor, be able to cause the inclusion of the gift in the donor's gross estate. The power holder's power would be exercisable only at a time when he or she reasonably believed, based on current circumstance, that the inclusion of the gift in the donor's gross estate, would be likely to reduce future combined estate and income taxes. If the testamentary power were granted, the trust property would be included in the donor's gross estate under Section 2038 at its date of death value. It would no longer be included in the donor's estate tax base as an adjusted taxable gift at its date of gift value.[23] And the basis of the property would be adjusted to its date of death value. The power conferrable on the donor does not have to be a significant power. The power, for example, to merely change the time of enjoyment of trust property should be sufficient.[24]

The existence of the power to grant a testamentary power over principal to the donor should not cause inclusion in the donor's gross estate if the power is never conferred. Until the power is conferred the donor does not have a power. Section 2038 does not apply to a power the exercise of which on the date of the decedent's death is subject to a contingency beyond his or her

[23] Section 2001(b).
[24] *Lober v. United States*, 346 U.S. 335 (1953).

control.[25] Although Section 2036 does apply to powers subject to contingencies beyond the decedent's control, it does not apply to powers over property that do not affect the enjoyment of income received or earned during the decedent's life.[26] The testamentary power that can be conferred by the power holder would be limited to a power over trust principal, and would not apply to any income earned after the gift.

If, after conferring the testamentary power, circumstances changed so that gross estate inclusion was no longer desirable, the power holder could simply revoke the power. If a decedent relinquishes a Section 2038 power within three years of his or her death, the property that was subject to the power will be included in his or her gross estate to the same extent that it would have been included if the power had not been relinquished.[27] The three year rule does not apply to the decedent's powers that were terminated without any action by the decedent

C. Retaining the Possibility of Benefitting from Gifted Assets

Techniques that enable a donor to make transfers using his or her currently available exclusion amount while retaining an interest in or the possibility of reacquiring an interest in the gifted property include (i) transferring an interest in an entity such as a partnership, while retaining an interest in the entity that is treated as having a zero value under Section 2701 (an "Intentionally Defective Preferred Interest") and (ii) transferring property to trusts from which the donor or the donor's spouse may receive future distributions.

1. The Intentionally Defective Preferred Interest.

An intentionally defective preferred interest in an entity is an equity interest that entitles its holder to distribution rights that are not qualified interests within the meaning of Section 2701. If an individual acquires such an interest in an entity at the same time that his or her children or trusts for their benefit acquire junior interests in the entity, or if he or she transfers junior interests in the entity while retaining the preferred interest, the preferred interest will be treated as having a zero value. As a result, the individual will be treated under Section 2701 as having made a gift to the holders of the junior interests equal to the value of the preferred interest.

Consider the following example.

Example 4.

D creates an irrevocable trust for the benefit of her children and transfers property worth \$1.1 million to the trustees.[28] D and the trustees form a limited liability company (L) with two classes of membership interests, Class A and Class B. The holders of Class B interests hold all the voting rights. Class A members have no voting rights. The holders of the Class A interests are entitled to an annual noncumulative preferred return from L's profits of 1% of the value of their capital

[25] Reg. 20.2038-1(b).
[26] Reg. 20.2036-1(b)(3).
[27] Sections 2035(a) and 2038(a).
[28] D should not be a trustee of the Family Trust in order to avoid the possible application of the conclusion in *Powell v. Comm'r,* 148 T.C. 392 (2017) that a decedent's right to amend a limited liability agreement with the consent of all the other members was a retained interest within the meaning of Section 2036(a)(2).

> accounts[29] plus 2% of the amount of L's profits in excess of the profits needed to fund the preferred return.[30] The holder of the Class A interests have the right to require L to redeem the Class A interests for an amount equal to the capital account associated with the interest at any time.[31] L has the right to redeem the Class A interests at the death of D for an amount equal to the capital account associated with the interests. The holders of Class B partnership interests are entitled to all other partnership income and gains. The trustee of the Family Trust transfers property worth $1,100,000 to L for all of L's Class B interests. L transfers property worth $9,900,000 to L for all of L's Class A interests.

D's transfer of property worth $9,900,000 to L will be treated as a taxable gift by her even though D will retain full access to the property for the rest of her life. If D retains the Class A interests until death, they will be included in D's gross estate under Section 2033 at a value of at least $9,900,000 if the value of L itself is at least that amount.[32] The interest should receive a date of death basis under Section 1014. The amount on which C's tentative estate tax is computed under §2001(b) will be reduced by $9,900,000 the amount by which C's taxable gifts were increased by the application of Section 2701 but not in excess of the value the Class A interests included in C's gross estate.[33] As a result, D's estate tax should be no higher than it would have been if D had made an outright gift of $9,900,000.

The intentionally defective preferred interest technique permits a donor to use her available exclusion amount without relinquishing her interest in the property. There is a risk, however, that the regulations that permit a decedent's estate to use the higher of the exclusion amount available at death or the exclusion amount used during the decedent's life may not be available to the extent that the decedent's lifetime gifts are included in his or her taxable estate rather than included in his or her adjusted taxable gifts. The preamble to Reg. 20.2010-1(c), the regulation that permits the use of the higher exclusion indicates that the Internal Revenue Service and

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[29] A noncumulative return is not a qualified payment within the meaning of § 2701. If D wants the economic security of a high cumulative return, D could elect under § 2701(c)(3)(C) to treat the cumulative return as a non-qualified payment.

[30] The interest in excess profits is suggested in order to more clearly show that the Class A interests are equity interests rather than debt.

[31] The Supreme Court in *Dickman v. United States*, 465 U.S. 330 (1984) concluded that the holder of an interest free demand note who fails to demand repayment is making a continuing gift of the amount of the forgone interest. The Tax Court in *Snyder v. Comm'r*, 93 TC 529 (1989) refused to apply the *Dickman* rationale to the holder of shares of noncumulative preferred stock who declined to exercise her right to require the corporation to redeem her shares.

[32] Because of the put right exercisable at D's death, the Class A interests should be worth at least $9,900,000 at her death if the assets of L are worth at least that amount despite the fact that the preferred return is likely less than a market rate of return. It is possible that the value could be higher depending on (1) the extent to which the preferred return has actually been paid and is likely to continue to be paid, (2) the rates of return attainable on fixed income securities at the time of her death, and (3) the value of the right to 2% of the profits in excess of the preferred return.

[33] Treas. Reg. §25.2701-5. In the absence of Section 2701, the Class A interests would have been valued at $9,900,000 because the holder had the power to require L to redeem them for that value.

Treasury may consider making this change.[34] If this change occurs, the holder of the interest should be able to avoid the result by making a gift of the interest shortly before death.

2. Trusts from which the donor's spouse or the donor may receive future distributions.

a) Domestic Asset Protection Trusts (DAPTs)

The concerns of a grantor about loss of all future access to the property he or she transfers to a trust may be alleviated if the terms of the trust permit the trustee to make distributions to the grantor. The power of the trustee of a trust to make distributions from the trust to the grantor should not, by itself, cause the grantor's transfers to the trust to be incomplete for gift tax purposes.[35] In the absence of retained enjoyment pursuant to an express or implied understanding with the trustee, the trust property should not be included in her gross estate under Section 2036 even if she actually receives distributions.[36]

If, however, the grantor's creditors can compel the trustee to use trust property to pay the grantor's debts, it is likely that the grantor's gift to the trust will be incomplete[37] and that the trust assets will be included in his or her gross estate under either or both of Sections 2036(a)(1) or 2038.[38]

A trust that gives its trustee the power to make distributions to its grantor is generally referred to as a "self-settled trust." The Uniform Trust Code, which has been adopted in some form in 34 states and the District of Columbia,[39] provides that during the life of the grantor of a self-settled trust, his or her creditors can reach the maximum amount held in the trust that can be distributed to or for his or her benefit regardless of her motivation for creating the trust.[40] Other states that

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[34] RIN 1545-B072, ¶6 (2017).

[35] *Herzog v. Comm'r*, 116 F.2d 591 (2d Cir. 1941) *aff'g* 41 BTA 509 (1940); Treas. Reg. 25.2511-2(b); Rev. Rul. 77-378, 1977-2 C.B. 347.

[36] *Estate of German v. United States,* 7 Cl Ct 641 (1985); *In re Uhl's Estate,* 241 F.2d 867 (7th Cir. 1957).

[37] *Outwin v. Commissioner*, 76 TC 153 (1969); *Paolozzi v. Comm'r*, 23 T.C. 182 (1954), *acq. 1962-1 C.B. 4*; Rev. Rul. 76-103, 1976 C.B. 293.

[38] *Estate of Paxton v. Comm'r,* 86 T.C. 785 (1986).

[39] The states that have adopted the Uniform Trust Code are Alabama, Arizona, Arkansas, Colorado, Connecticut, District of Columbia, Florida, Illinois, Kansas, Kentucky, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, New Hampshire, New Jersey, New Mexico, North Carolina, North Dakota, Ohio, Oregon, Pennsylvania, South Carolina, Tennessee, Utah, Vermont ,Virginia, West Virginia, Wisconsin, and Wyoming. Uniform Laws Commission Acts, https://www.uniformlaws.org/committees/community-home?CommunityKey=193ff839-7955-4846-8f3c-ce74ac23938d

[40] Unif. Trust Code §505(a)(2), Unif. Law Comm'n (2000 with subsequent amendments). This provision of the Uniform Trust Code was based on a similar provision in the Restatement of Trusts. Restatement (Second) of Trusts §156(2).

have not adopted the Uniform Trust Code have statutes that have been construed to have the same effect.[41] Section 548(e) of the United States Bankruptcy Code pulls into the bankruptcy estate any property transferred to a self-settled trust or similar device if the transfer was made to hinder, delay or defraud a creditor and a bankruptcy proceeding is commenced within ten years of the transfer.[42]

Of the 34 states that have adopted the Uniform Trust Code, ten have statutes that, under certain circumstances, permit grantors to have beneficial interest in the trusts they have created without subjecting trust assets to the claims of the grantor's creditors. An additional nine states have created similar laws. Trusts which include their grantors as potential beneficiaries created in the states that protect their assets from the claims of their grantor's creditors are frequently referred to as domestic asset protection trusts of "DAPTs").[43]

Grantors who want to retain the possibility of access to the assets in the trusts they create should consider using trustees resident in a state that has adopted a DAPT law and creating them in conformity with that state's DAPT law requirements. If the trust's creator is also a resident of that state and there's no express or implied understanding with the trustee that assets will be distributed to the grantor, the grantor's gifts to the trust should be complete, and the trust assets should not be included in his or her gross estate under Section 2036(a)(1) or 2038.[44] Grantors who are not residents of a DAPT state may not have that same protection. For example, in *In re Huber,*[45] the US Bankruptcy Court held that the assets in a trust governed by Alaska law would not be protected from the claims of the grantor's creditors. In that case virtually all connections of the trust (grantor, trustees who had almost total control, location of assets) were outside Alaska and the grantor had been receiving regular trust distributions).[46]

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[41] For example, New York law has long provided such a rule. New York EPTL 7-3.1 says "A disposition in trust for the use of the creator is void as against the existing or subsequent creditors of the creator." In some jurisdictions, the rule arose under common law. *See also De Rousse v. Williams*, 181 Iowa 379 (1917) and *Everett v. Peyton,* 167 NY 117 (1901). The extent to which New York EPTL 7-3.1 would actually permit creditors to reach the assets in a discretionary trust with multiple beneficiaries is not clear. In *Herzog v. Comm'r*, 116 F.2d 591 (2d Cir. 1941) *aff'g* 41 BTA 509 (1940), the Court of Appeals of the Second Circuit concluded that the predecessor of New York EPTL 7-3.1 would not be so construed. In a later case, V*anderbilt Credit Corp. v. Chase Manhattan Bank, NA*, 100 A.D.2d 544 (2d Dep't 1984) construed the section to apply to a trust from which the trustee could make distributions to the grantor, but, in that case, the grantor was the only current beneficiary.

[42] 11 U.S. Code § 548. This provision should not cause inclusion in the gross estate of the grantor if his or her motive for creating and funding the trust was to minimize estate taxes rather than to hinder, delay, or defraud a creditor.

[43] The trusts that have DAPT laws are Arizona, Connecticut, Delaware, Hawaii, Indiana, Michigan, Missouri, Nevada, New Hampshire, Ohio, Oklahoma, Rhode Island, South Dakota, Tennessee, Utah, Virginia, West Virginia, and Wyoming. *See,* https://www.oshins.com/state-rankings-charts, for a chart comparing the different DAPT laws.

[44] *See* P.L.R. 9837007 (June 10, 1998), holding that gifts by an Alaska resident to an Alaska DAPT were completed gifts and P.L.R. 200944002 (July 15, 2009), holding that assets given to an Alaska DAPT would not be included in the gross estate of the Alaska resident grantor.

[45] 201 BR 685 (WD WA 2013). *See* Blattmachr et al., "Avoiding the Adverse Effects of *Huber*," Trusts & Estates 20 (Jul. 2013).

[46] See, also, discussion in Blattmachr, Shenkman & Gassman, **"**Toni 1 Trust v. Wacker: Reports of the Death of DAPTs for Non-DAPT Residents Is Exaggerated**,"** LISI Asset Protection Newsletter 362 (Mar. 16, 2018).

To the extent practical and acceptable to the client, the majority of the trust's contacts should be with a DAPT state, including trustees, trust protectors, advisors, etc.[47] If the grantor is not a resident of a DAPT state, it would be difficult to avoid the contact with his or her state that the grantor's residence provides. One solution might be to give the trustee the power to distribute to another trust of which the grantor is a beneficiary rather than the power to distribute directly to the grantor.

b) Hybrid Domestic Asset Protection Trusts and Special Power of Appointment Trusts

Another approach is to avoid naming the trust's grantor as a beneficiary of the DAPT when it is created but to include a provision that permits another person to add the grantor as a beneficiary after a period of time (perhaps, after the running of the statute of limitations under the laws of the state of the grantor for fraudulent conveyances or for more than ten years, the years specified in Section 548(e) of the Bankruptcy Code, mentioned above).

It is not certain that this approach would prevent a court from determining the trust is subject to the claims of the grantor's creditors. For example, in *Iannotti v. Commissioner of New York State Department of Health*,[48] the court held, that a trust would be subject to the claims of the grantor's creditors because the "trust protector" could add the grantor as a beneficiary. It is possible the court reached this conclusion because it determined the trust protector was a fiduciary.

Greater protection might be obtained by giving a third party, not a trustee, other fiduciary, or beneficiary, a limited power of appointment that is broad enough to include the grantor, a special power of appointment trust.[49] The laws of many states permit a trustee who has the power to distribute trust property to a beneficiary to distribute the property to a trust of which he or she is beneficiary even if the trust has different terms and even if the recipient trust instrument gives the beneficiary a broad power of appointment that could be exercised in favor of the grantor.[50]

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[47] A foreign asset protection trust may also be considered. It is beyond the scope of this article to discuss the use or foreign trusts in detail, but their use raises certain issues that are not raised with a domestic trust, including the possibility of the treatment of the grantor's death as an income tax recognition event. See, Section 684; *cf. In re Lawrence*, 251 B.R. 630 (S.D. Fla. 2000) (incarceration for failure to return assets in a foreign trust to the United States; impossibility defense rejected). This possibility may not be a concern for a donor who is seeking to protect a trust from inclusion in his or her gross estate and is not seeking to avoid creditor claims.

[48] 725 NYS 2d 866 (2001). Note that the decision does not recite all of the relevant facts. They can be gleaned only by reviewing all of documents submitted in connection with the proceedings.

[49] *See* O'Connor, Gans and Blattmachr, "SPATs: A Flexible Asset Protection Alternative to DAPTs," 46 Estate Planning 3 (Feb. 2019 for a more detailed discussion of SPATs.

[50] *See*, e.g., S.D. Codified Laws §55-2-15.

c) *Spousal Lifetime Access Trusts*

Some donors have sufficient confidence in their spouses to feel comfortable transferring assets to trusts of which their spouses are beneficiaries. As long as the motive for the transfer is the reduction of estate taxes rather than a motive to hinder, delay, or defraud creditors, the trust should be free from the claims of creditors. If creditors cannot reach the trust assets, the grantor's transfer should be complete for gift tax purposes and excludable from the grantor's gross estate unless the trust terms mandate the use of the trust property to discharge the obligation of the grantor to support his or her spouse.[51]

By creating a trust for a spouse, a donor is likely to be able to continue to benefit from the property through the spouse without concern of estate tax inclusion.[52] In fact, if the beneficiary spouse has a power of appointment (or is later granted one by a decanting or otherwise[53]), the beneficiary spouse could exercise it in favor of a trust for the donor spouse. Unless the Internal Revenue Service (or a creditor) could show an understanding that the beneficiary spouse would exercise it in this manner, there should be no inclusion in the gross estate of the grantor even if the power is actually exercised in favor of a trust for the grantor's benefit.[54] For additional protection, any trust the beneficiary spouse creates for the donor spouse should probably have a trustee resident in a state that has DAPT legislation.[55]

The matter is more complicated if each spouse creates a trust for the other. Dual trusts raise the risk of application of the "reciprocal trust" doctrine under which a person (A) is treated as the grantor of a trust for A's benefit that was actually created by another person (B) if A, in consideration of B's creation of the trust for A, created a trust for B. The application of this doctrine , potentially increases the risk of exposure to estate tax.[56] The parameters of how different the trusts for the spouses must be to avoid the doctrine have not been determined. Although one case[57] held the doctrine did not apply when one spouse gave a lifetime special power of appointment to the other spouse and no power of appointment was granted to the other, greater protection would be obtained if the trusts are created at different times, with different trustees, with different assets and under the laws of different jurisdictions.[58] One spouse might create a trust for the other spouse and delay advising the beneficiary spouse of the creation of the

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[51] *See* discussion in Gans & Blattmachr, "Another Look at Spousal Lifetime Access Trusts," Leimberg Estate Planning Newsletter 1387 (December 18, 2008); but *cf.* Merrick & Goodwin, "The Good, Bad and Ugly of Spousal Access Trusts," Leimberg Estate Planning Newsletter 1334 (Aug. 20, 2008).

[52] *See Gutchess* v. *Comm'r*, 46 T.C. 554 (1966), *acq*. 1967-1 CB 2.

[53] Zeydel & Blattmachr, "Tax Effects of Decanting-Obtaining and Preserving the Benefits," 111 Journal of Taxation 288. (Nov. 2009).

[54] *Cf.* Rev. Rul. 2004-64, 2004-64, 2004-2 C.B.

[55] *See* Rothchild et al., "IRS Rules Self-Settled Alaska Trust Will Not Be Grantor's Estate," 37 Estate Planning 3 (Jan. 2010).

[56] *United States v. Estate of Grace,* 395 U.S. 316 (1969). *See also*, Slade, "The Evolution of the Reciprocal Trust Doctrine Since Grace and Its Application in Current Estate Planning," Tax Mgt Estates, Gifts & Trusts. (May 1992); Steiner & Shenkman, "Beware of the Reciprocal Trust Doctrine," Trusts & Estates 14 (2012).

[57] *Estate of Levy v. Commissioner*, T.C. Memo 1983-453.

[58] *See* suggestions in Blattmachr, Gans & Zeydel, "Supercharged Credit Shelter Trust[sm]," 21 Probate & Property 52 (Jul./Aug. 2007).

trust to reduce the risk of any claim of an implied understanding.[59] Extra protection could be obtained if the trust is created in a DAPT jurisdiction because if the decedent is a mere discretionary beneficiary with no power to control the beneficial enjoyment of the property, there should be no estate tax inclusion if the creditors of the beneficiary cannot attach the trust assets).[60]

3. Making Gifts without Parting with Assets.

a) Gifts Made With Borrowed Funds

If an individual has no assets that he or she is willing to part with or has only highly appreciated assets but wants to make gifts now before a possible change in the tax law, consideration should be given to borrowing the funds to use to make the gifts. Individuals with significant assets are generally able to negotiate loans from financial institutions at favorable interest rates. In some cases, individuals who are beneficiaries of trusts will be able to borrow funds from the trusts at favorable interest rates, the assets that he or she wishes to retain.

b) Gifts of Promises to Make Gifts

An enforceable promise to make a gift in the future made without full and adequate consideration in money or money's worth is treated as a taxable gift despite the fact that the promisor has not parted with any assets.[61] The enforceability of a promise to make a gift is determined under applicable state law. To be enforceable, the promise should generally be supported by consideration, but that consideration need not be financial. A promise to pay a sum of money in the future to a child's trust in exchange, for example, for that child's promise to read at least one good book a month should be sufficient. There is an exception to the required consideration rule in Pennsylvania. Under Pennsylvania law, a written promise is enforceable despite the absence of consideration if the writing states that the promisor intends to be legally bound.[62]

A promised gift will not remove any assets from the promisor's gross estate if the promisor does not make the promised payment on a date before death. No deduction will be available for the debt because the promise was not based on full and adequate consideration in money or money's

[59] The reciprocal trust doctrine was developed under common law and later applied to the tax law. See *De Rousse v. Williams*, 181 Iowa 379 (1917), and *Everett v. Peyton*, 167 NY 117 (1901). *Lehman v. Comm'r*, 109 F2d 99 (2d Cir. 1940), cert. denied, 310 U.S. 637 (1940).

[60] *See* PLR 2009-44-002 (not precedent) discussed in Rothchild, note 39, *supra*.

[61] *Comm'r v. Copley's Estate*, 194 F.2d 364 (7th Cir. 1952), aff'g 15 T.C. 17 (1950), *acq*., 1965-2 C.B. 4; *Harris v. Comm'r*, 178 F.2d 861 (2d Cir. 1949), *rev'd on other grounds*, 340 U.S. 106 (1950); Rev. Rul. 84-25, 1984-1 C.B. 191.

[62] "A written release or promise, hereafter made and signed by the person releasing or promising, shall not be invalid or unenforceable for lack of consideration, if the writing also contains an additional express statement, in any form of language, that the signer intends to be legally bound." 33 P.S. §6.

worth.[63] Revenue Ruling 84-25,[64] however, will permit the removal of the amount of the promised gift from the promisor's adjusted taxable gifts. Unless Reg. 20.2010-1(c) is amended to reach a different result, the removal of the gift from the promisor's adjusted taxable gifts should not prevent a claim on the promisor's estate tax return that the estate is entitled to use the higher exclusion amount available on the date the gift was promised.

Promised gifts should not be split with a spouse under Section 2513. Splitting will result in an adjusted taxable gift for the splitting spouse. The adjustment to the promisor's adjusted taxable gifts provided by Revenue Ruling 84-25, is limited to the promisor and does not extend to the splitting spouse. If a promised gift is split, there should be a definite plan to pay the obligation before the promisor's death.[65]

V. Use Techniques That Permit Shifting Future Investment Returns Without Making Taxable Gifts

A. Grantor Retained Annuity Trusts

1. In General

Under Section 2702, a donor is treated, for gift tax purposes, as transferring the entire value of property the donor has transferred to a trust (or trust equivalent) for the benefit of members of his or her family, undiminished by the value of the interest in the trust he or she retained unless, subject to a few small exceptions or special rules, the property is a personal residence or the interest retained is a unitrust or annuity interest. Reg. 25.2702-3 sets forth detailed requirements that must be satisfied to qualify a retained annuity for "qualified" annuity" treatment. A trust that satisfies these requirements is commonly called a "grantor retained annuity trust" or a "GRAT."

Most estate planners believe that the value of the annuity can be designed to approach or possibly equal the value of the entire property transferred to the trust. If this approach is used, the value of the gift caused by the creation and funding of the GRAT will be extremely small.[66] The value of the gifted remainder in the GRAT is determined by subtracting from the value of the transferred assets the discounted value of the stream of required annuity payments. Because the discount rate established under Section 7520 is only .4% in September 2020, the amount of the annuity payments required to produce a remainder interest worth only .1% of the transferred property is quite low. For example, if $10 million worth of assets is transferred in September

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[63] Section 2053(c)(1)(A).
[64] 1984-1 C.B. 191.
[65] For a more detailed discussion of this technique, *see* Bramwell, "Donative Promise Can Lock in 2012 Gift Tax Exemption," 30 Est. Planning (August 2012).
[66] On account of the uncertainty of any requirement for the value of the annuity stream retained, it has been suggested that a word formula be used to describe the annuity and the term for which it is retained. *See* discussion in Blattmachr & Zeydel, The Forty-First Annual Philip E. Heckerling Institute on Estate Planning, Chapter 2, at ¶202.3.

2020 to a five-year GRAT, the annual payments, if a constant amount, need be only $2,082,694 to produce a remainder interest worth $10,000.

2. Successful GRATs: Growth Above the Section 7520 Rate.

Because the value of the taxable remainder can be quite small, GRATs provide a significant opportunity to shift future investment return out of the gross estate of the grantor. However, in order to be successful, the growth and income of the assets once contributed to the trust must exceed the interest rate applicable to value the retained annuity in the GRAT. The greater the growth and income, the better the estate tax result.[67]

3. Amount Included in Gross Estate if Grantor's Death Occurs During Term.

If the grantor dies during the retained annuity term, all or a portion of the assets in the GRAT will be included in his or her estate for federal estate tax purposes.[68] The amount included is the lesser of the entire value of the trust or an amount equal to the amount of the annuity divided by the Section 7520 rate in effect at the grantor's death.

4. Short-Term GRATs.

Some have suggested that GRATs should be structured as short term GRATs and that the grantor transfer the annuity payments as received into new GRATs of similar duration. Although the regulations do not specifically authorize short-term GRATs, there is no reported instance in which the Internal Revenue Service has successfully challenged a GRAT based on its short duration.[69] Not only does a short term GRAT reduce the mortality risk, it also reduces the possibility that a poor investment performance during one year will adversely affect good performances in prior years. For example, suppose a GRAT is funded with $1 million and is to pay the grantor $330,000 a year for three years. The value of the assets doubles in value in the first year to $2 million. After the trustee pays the first year annuity of $330,000, the trust will be worth $1,670,000. There is no further appreciation in the second year. At the end of the second year the trustee again pays the $330,000 annuity leaving the trust with $1,340,000 at the beginning of the third year. It appears that the GRAT will be tremendously successful. But if the trust declines by 80% in the third year, it will have only $268,000 at the end of that year, not enough to pay the annuity. Nothing will be available to transfer to the remainder beneficiaries. If the GRAT had been a two-year GRAT (paying, for example, $500,000 each year as an annuity) and experienced the same assumed 100% growth in the first year and no growth in the second, $1 million would pass to the successor beneficiaries. For this reason short term GRATs, with the grantor-annuitant rolling the annuity payments received into other short term GRATs, likely should be preferred

There are legislative proposals, which, if enacted, would impose gift tax on short term GRATs. If it seems likely that such legislation is about to be enacted, the grantors of existing GRATs may want to purchase assets from their GRATs and use these assets to create long-term GRATs that

[67] *See* discussion in Bloomberg Tax Management Portfolio 836-2d.

[68] Reg. 20.2036-1(c)(2).

[69] The GRATs that were the subject of the successful taxpayer challenge to the validity of one of the examples that originally appeared in the 20.2702-3 regulations were two year GRATs. *Walton v. Comm'r*, 115 T.C. 589 (2000).

may not be affected by the legislation if created and funded before the effective date of the legislation.

5. Asset Splitting GRATs.

Another useful strategy is the creation of separate GRATs for different assets. For example, funding a GRAT with two different securities will prevent negative returns in one security from diminishing the benefit of positive returns in the other.

Although there is a possibility that the Internal Revenue Service might attempt to require that two or more GRATs funded at the same time with the same terms and the same beneficiaries be combined, there is no reported instance in which the Service has taken this position. The Service's attempt in 1983 to enforce a regulation for which there was no statutory authority that treated separate trusts as a single trust for income tax purposes failed.[70] Section 643(f) now permits this treatment for income tax purposes. In the absence of specific authority under the transfer tax law, such an attempt should not be successful. In order to diminish the risk of a successful argument that the multiple trusts are treated as one,[71] consider funding the GRATs at different times and providing different durations and payouts and successor different beneficiaries.

6. Declining Annuity Payment GRATs.

Another structure that might be considered to increase the chances of successful GRATs is the use of steeply declining annuity payments. Initially, many estate planners thought it would be best to start with low annuity payments and increase them to enable more assets to remain in the GRAT so that more future growth would inure to the benefit of the remainder beneficiaries. The Treasury apparently became aware of this possibility and issued regulations that limit the benefit of increasing annuity payments to 20% annually.[72] There is, however, no limitation on declining annuity payments.[73] Declining annuity payments can produce the greatest opportunity for the growth above the Section 7520 rate to be removed from the grantor's gross estate. Consider, for example, a GRAT funded with $1 million which provides for an annuity equal to $990,000 at the end of the first year and $15,000 at the end of the second year. If the investment performance at the end of the first year is poor the GRAT will essentially fail; at the end of the first year, all or substantially all of the trust assets will be returned to the grantor. The grantor can then contribute the returned property to a new short-term GRAT. If the trust has good investment performance (e.g., the trust is worth $1,300,000 at the end of the first year), the $990,000 annuity will be paid to the grantor at the end of the first year, who can contribute that payment to a new GRAT and $295,000 will be transferred to the successor beneficiaries (that is, the $310,000 remaining in the GRAT after the $990,000 annuity paid at the end of the first year reduced by the remaining $15,000 annuity due for the second year), assuming no further change in value in the GRAT assets.

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[70] *Stephenson Trust v. Comm'r,* 81 T.C. 283 (1983).

[71] Under Section 643(f) two trusts may be treated as one for income tax purposes if, among other conditions, the trusts had a primary purpose to reduce income taxes. There is no comparable rule for gift tax purposes.

[72] Reg. 25.2702-3(b)(1)(ii).

[73] *See* Example 3 in Reg. 25.2702-3(e).

7. The 99 Year GRAT.[74]

All or a substantial portion of the assets in the GRAT will be included in the gross estate of the grantor if death occurs while he or she is still entitled to annuity payments from the trust. However the amount included is limited to the value of the trust assets at the grantor's death (or on the alternate valuation date under Section 2032 if applicable) of an amount equal to the annuity payable at death divided by the Section 7520 in effect at the grantor's death. If the Section 7520 rate is higher at death than when the GRAT was created or if the value of the assets in the trust increases significantly, the value of assets included in the gross estate could be less, perhaps significantly less, than the initial value of the contribution to the trust. The possibility of excluding a portion of the GRAT assets is increased with long-term GRATs.

For example, suppose a GRAT was funded in August 2020 with $1 million when the Section 7520 rate was .4% and provided an annuity of $12,250 a year for 99 years. The value of the gift of the remainder would be about $200. If the grantor dies when the Section 7520 rate is 3%, the amount included in the gross estate would be $12,250/.03 or only $408,333; if rate were 5% the includible amount would be only $245,000. If the rate were 5% and the trust were still worth $1 million, $755,000 would be transferred estate tax free. In fact, if the Section 7520 rate is greater than 1.25% at the grantor's death, less than $1 million would be included in the grantor's gross estate (but never more than the value on the grantor's date of death or alternate valuation date).

If interest rates rise significant before death, the grantor could sell his or her entitlement to the remaining annuity payments for a price equal to the annuity divided by the then Section 7520 rate. If the sale were made to a trust that is treated as owned by the grantor , no income would be caused by the sale.[75] If the grantor lives for at least three years after the sale, no portion of the GRAT should be included in his or her gross estate.

B. <u>Split-Purchase Annuity Trusts</u>

1. In general

Section 2702, which causes the value of interests retained in certain trusts to be subject to gift tax applies to so-called split purchases, such as the acquisition by a parent of a life estate in an asset when a member of his or her family (such as a child) acquires the remainder. This application is referred to as the "joint purchase rule."[76] If, for example, a parent acquires a life interest in an asset as part of the same transaction in which the parent's child acquires a remainder interest, the parent will be treated as having acquired both interests and having transferred the remainder interest to the child in exchange for the price the child paid for the remainder interest. The zero value rule of Section 2702(a) will apply to treat the parent as having made a gift to the child of the value of the life interest. But if the interest acquired by the parent is in the form of a qualified annuity interest, the rule that assigns a zero value to the parent's interest will not apply. A joint purchase should be done within a trust structure to facilitate compliance with the GRAT regulations. Two taxpayers (perhaps a parent and child or a parent and a grantor trust held for

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[74] This idea was first developed by Turney P. Berry of Wyatt, Tarrant & Combs, LLP, Louisville, KY.

[75] *See* Rev. Rul. 85-13, 1985-1 C.B. 184; Example 5, Reg. 1.1001-2(c).

[76] Section 2702(c)(2).

the child) would each contribute funds to a trust. Their contributions would be in proportion to the relative values of the interests of each in the trust. Such a trust arrangement is often referred to as a split purchase annuity trust.

2. Advantages of the Split Purchases Annuity Trust

The Split Purchase Annuity Trust offers significant advantages over a conventional GRAT. First, although a GRAT might be successful even if the grantor dies soon after the GRAT is created, except in the case of a long-term GRAT, it is not likely to achieve success. As a result, many estate planners do not suggest GRATs to clients with diminished life expectancies even if death is not imminent because of the mortality risk. If, however, the remainder beneficiary of a GRAT paid full value for the remainder interest, section 2036 should not apply to the GRAT if the term holder dies before the term expires.[77]

Second, if section 2036 does not apply to a split purchase annuity trust, it should be possible for the senior family member to acquire an annuity payable for life without concern over gross estate inclusion of anything other than the present value of the right to receive the remaining annuity payments.[78] The acquisition of an annuity payable for life, may be important to individuals who want to achieve estate tax planning goals but who are reluctant to surrender interests in assets.

VI. Summary and Conclusions

Tremendous opportunities for estate tax planning are available to individuals who wish to reduce the wealth transfer tax burden their families may otherwise face. Motivating individuals to consider this planning may be difficult to accomplish. But estate planners should advise their clients of the opportunities appropriate for them to consider. Not only may significant taxes be saved but structures may be implemented that may allow the client to continue to benefit from the assets transferred.

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[77] *Cf. Kimbell v. United States,* 371 F.3d 257 (5th Cir. 2004); *Magnin v. Comm'r,* 184 F.3d 1074 (9th Cir. 1999); *United States v. Wheeler,* 116 F.3d 749 (5th Cir. 1997); *Estate of D'Ambrosio,* 101 F.3d 309 (3rd Cir. 1996), rejecting earlier conclusions reached by the Courts of Appeals for the Federal Circuit and the Tenth Circuit (*Gradow v. United States*, 897 F. 2d 516 (Fed. Cir. 1990) *United States v. Allen,* 293 F.2d 916 (10th Cir. 1961)) that Section 2036 will apply to an individual's transfer of property with a retained term interest unless the consideration she receives for the transfer augments her estate by an equivalent amount. *See also,* P.L.R. 9515039 (January 17, 1995).

[78] Normal actuarial principles under Section 7520 may not be used if death is imminent but, even if it is not imminent, planners may forego using a GRAT for life or even for a term because the GRAT assets will not have had sufficient time to outperform the Section 7520 rate which must be paid, along with the original value of the trust corpus, to the grantor. Reg. 20.7520-3(b)(3).

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In the early 1950s, Dallas was on the verge of dynamic growth. The economy was based on diversity; the area was attracting talent from around the world; and the local leadership was committed to education, culture and progress. In 1955 Bishop Thomas K. Gorman and a group of visionary lay leaders recognized that along with this growth would come responsibility to those in need. To satisfy this situation, they determined that a foundation should be established to provide the Catholic Diocese with various means of financial and professional support and its purpose was firmly established and remains steadfast.

The Catholic Foundation was created and continues to develop a perpetual endowment to provide financial assistance to charitable, religious and educational organizations within the Diocese of Dallas. The Foundation is administered by a staff of professionals and is governed by a Board of Trustees comprised of Catholic business and civic leaders who give freely of their time, energy and varied expertise.

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The Catholic Foundation continues to foster charitable giving by making it easy for donors to provide financial support to the institutions, agencies, and organizations that most effectively address the educational, religious, cultural, and social service needs in their local communities or across the country, whether it be Catholic or non-Catholic. As an enduring public charity, The Catholic Foundation helps donors shape a lasting legacy which will help meet the needs of our community in the years to come.

THE CATHOLIC FOUNDATION

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Before joining The Catholic Foundation, Matt led **Kramer Global Advisory, LLC** and **Leopard International Company**. He gained 29 years of international business and leadership experience at Dallas-based **Commercial Metals Company** (CMC), most recently at **CMC Americas** as Executive Vice President. Matt leads with integrity and remains a constant leader despite the ever-changing nature of economic cycles. In addition to his professional career, he has been active in local parishes and Catholic organizations for more than 35 years. He is a member of **St. Rita Catholic Community**, **Serra Club of Metropolitan Dallas**, **Legatus Dallas** along with the **Dallas Estate Planning Council** and the **Estate Planning Council of North Texas**. Matt is the board chair, and chair of the strategy and compensation committee, at **Central States Manufacturing Inc.** of Lowell, Arkansas**.**

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Prior to coming to The Catholic Foundation, Cheryl served as Vice President of External Affairs at **Communities Foundation of Texas**, which she joined in 1993. At The Catholic Foundation, she is responsible for overall development and marketing strategies. Cheryl, a Dallas native, has been involved in community and church service for over 35 years. A participant in **Leadership Dallas**, 1999, Cheryl is a member of **St. Thomas Aquinas Catholic Church**, **The Ursuline Academy Alumni Association**, **Charter 100**, **Dallas Vocation Guild** and **The Serra Club of Dallas** and **Chancellor, Norwegian Consulate of North Texas**. She holds membership on the **Dallas Estate Planning Council**, the **Estate Planning Council of North Texas**, the **Association of Fundraising Professionals,** the **Partnership for Philanthropic Planning** and the **National Association of Charitable Gift Planners**.

The Catholic Foundation would be honored to partner with you as you guide your clients in their estate and wealth planning. Below please find contact information for representatives of The Catholic Foundation ready to serve you.

Carol handles all financial activities of The Catholic Foundation including accounting, grant and trust administration, capital campaigns, payroll, benefits, insurance and tax filings. Carol served as Director of Financial Controls for **SEI Benefit Services**, a division of **SEI Investment Services Corporation**, for eight years. She began her career with **Price Waterhouse** and was an audit senior upon her departure from the firm after six years. Carol serves as Treasurer for the Board of Directors of **The Vitamin Bridge,** an organization that supports expectant mothers.

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Michael has held various management positions throughout his career. Prior to coming to The Catholic Foundation, he served as the director of the annual **Catholic Community Appeal for the Diocese of Dallas**. He is part of the **National Association of Charitable Gift Planners**, **Association of Fundraising Professionals**, **The Estate Planning Council of North Texas** and he currently serves on the Board of **The Dallas Estate Planning Council**. In the community, Michael is a member of **The Serra Club of Dallas**, **Knights of Columbus** and active at **St. Rita Catholic Community** as a member and Past Chairman of the Stewardship Council.

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Elizabeth has worked with a variety of different clients and firms throughout her career. For her most recent role, Elizabeth served as the Assistant Vice President for University Advancement at the **University of Dallas** and the Director of Major and Planned Gifts at **The Senior Source.** Before that, she worked as a senior trader for **Highside Capital Management**; as Vice President Institutional Equity Sales at **Fidelity Capital Markers** and **Citi Group**. In addition, Elizabeth is a local council Board Member of the **National Association of Charitable Gift Planners** and she serves on **The Dallas Estate Planning Council** and **The Estate Planning Council of North Texas**. She is a member of **St. Thomas Aquinas Catholic Church** and volunteers with **Equest** and **The Pegasus Project.**

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