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Report 2

Tuesday, January 6

Reporter: Gene Zuspann Esq.
9:45 - 10:30 a.m.
But I Just Wanted a Few Strings Over the Trust Assets for Me and My Family

Steve R. Akers

Steve has a lengthy outline - 105 pages. He discussed 20 points in the outline.

He suggests that the attorney first talk with the client about the non-tax reasons for selecting a trustee. His outline sets out a number of non-tax factors - capacity, personal attributes of the trustee, impartiality investment sophistication, permanence, fees and others. He touched on several of these topics.

Steve then discussed tax issues in the selection of a trustee. This part of the presentation and outline are broken down into donor tax issues and beneficiary tax issues.

He discussed gift tax issues and retained rights and the problems caused by incorrect selection. The donor should not have a retained beneficial interest unless the donor is in a jurisdiction authorizing a self-settled trust.

He analyzed a situation where the donor transfers assets to a spouse with the potential of having the spouse appoint the assets back to the grantor. There is a timing issue - this should not occur quickly but should work if there is no arrangement.

The nature of the relationship with a 3rd party trustee to the donor can cause problems. There are also dispositive powers that can trigger negative tax effects under 2036 and 2038. If the distribution powers do not contain ascertainable standards, have an absolute prohibition of the donor becoming a trustee, even thought the event that could cause the donor to become a trustee is remote or impossible. The string causes inclusion, not the ability or intent to pull the string.

Certain administrative powers can cause inclusion in the estate. Generally, if the powers are subject to review by the court then there will not be a problem. Steve discussed and there is a large section of the outline analyzing the Byrum and Strange cases and the fiduciary duty exception under Byrum. See Rev Rul 81-15.

Two prohibited administrative powers are the power to vote stock and incidents of ownership over life insurance. Note that 2036(b)(2) has a different 3 year rule if at any time during the 3 years the donor had the right to vote the stock.

Trustee removal and appointment powers - some of these can cause inclusion. The power in the donor to appoint him or herself as trustee. The power to appoint additional trustees not including self should not cause inclusion. He briefly touched upon Rev Rul 79-353 and the Vak and the Wall cases regarding the power to remove and replace trustees.

Foreign trusts can have significant problems. These include reporting for foreign trust and selection of a trustee.

The outline includes a large section in Grantor trust status but Steve only commented on these rules for a moment.

The next section covered Beneficiary Tax issues.

These include discretionary beneficial interests and gifts by a beneficiary if the beneficiary fails to exercise rights. He emphasized that once a beneficiary becomes trustee and acquires a power that constitutes a general power of appointment there is a permanent taint that is difficult to shed. This can be overridden by inclusion of ascertainable standards. Some states also have laws that protect a trustee/beneficiary if the instrument does not include ascertainable standards.

The Upjohn case - the power of a trustee to satisfy the trustee's support obligations - can cause problems. Upjohn is a 2503 case, it is not a 2041 case.

Again, if the beneficiary can appoint him/herself as trustee and if there are no ascertainable standards then such a power will cause inclusion in the estate of the beneficiary.

Having the beneficiary as the sole trustee may cause application of the grantor trust rules under 678. It appears from the cases that an ascertainable standard exception exists but this law is case law and not in the statutes or regulations.

The attorney should determine if the appointment of a trustee in another state would cause income tax inclusion/exclusion in the other state. He also discussed resident vs nonresident trusts as determining which state will tax the trust. He listed four rules determining taxation - residency of the grantor, administration in the state, residency of the trustee and residency of the beneficiary.

The next section in the outline covered savings clauses. Steve said: "Use a savings clauses." He indicate that many attorneys do not use savings clauses. His response is why not use one. There is no downside.

Finally, he spent a couple of minutes on Creditor issues in trustee selection. He pointed out that despite "black-letter law," there is little authority that a spendthrift clause will protect a beneficiary acting as a trustee.

10:45 - 11:30 a.m.
Cottage Savings is a Loss to Trust Beneficiaries
Lloyd Leva Plaine

The issues addressed are the effect of Cottage Savings and Section 1001 on various actions effecting trusts.

Lloyd believes that a division or consolidation should not be a gain realization event. However, the IRS rulings sometimes do not reach this conclusion. The determination is whether there is a "material difference" for the purposes of §1001(a).

The IRS position has varied depending on whether the power to divide, consolidate or even a distribution exists in the trust. The Service has held that §1001 applies if the trust does not have such a provision even if the action is court approved.

Lloyd (and her materials) discuss a number of PLR's. The IRS's initial position was that a reformation or division would be subject to §1001 if the beneficiary's interest is materially different from the interest in the new trust.

The IRS now appears to recognize that a trust event authorized in the instrument will not constitute an exchange [under §1001]. There are a number of rulings in the last 3 years following this position. Now there are several rulings that also hold that a statutorily authorized action will not be an exchange. Also, most bona fide settlements conforming to the intent of the grantor have been held not to be exchanges.

She next discussed the grandfathered GST trusts. Lloyd does not believe that this should apply to such trusts. Cottage Savings should not apply to situations absent a sale or exchange of an interest in a trust. However, the Service seems to believe that there will be cases where no sale of exchange was involved that it does apply.

She discussed several situations and the effects of each. These include discretionary distributions of trust principal from an exempt trust to a new trust, court settlement of a bonafide dispute, judicial construction and some other actions.

Adoption of a unitrust approach or an adjustment under UPIA section 104 should not cause a problem. Her presentation and materials was based upon the proposed 643 regulations. The final regs do somewhat expand the GST effective date safe harbor. The final regs set out what state laws will be respected and give some examples. The final regs support the conclusion that an adjustment or conversion will not be a problem if the action is authorized by state statute. Lloyd emphasized that the regs say 'state statute,' not 'state law.'

There are two examples in the regs that authorize a conversion to a unitrust or an adjustment under state statute and conclude that there will not be a problem under GST. (Examples 11 and 12). If the client's state does not authorize one of these alternatives, then either the trust situs must be moved or such an action could cause problems with a grandfathered GST trust.

There are a number of rulings discussing a greater of a unitrust or an income approach but they do not discuss gain realization. Lloyd discussed good and bad rulings and the varying fact situations. One (PLR 200231011) of these concluded that gain recognition would occur. Lloyd believes that this ruling is fact driven and the result should not apply in most cases.

She does not believe that the adoption of a unitrust approach, an adjustment approach, or the greater of the two should be treated as a realization event. She analyzed different situations and discussed the reasons what there should not be gain recognition.

Where are we? If you have a state statute, you should be OK. If the instrument authorizes the actions, then you should be OK. If you go to court to authorize an action in a reformation of the trust to comply with the settlor's intent, you should be OK. Outside of these parameters, the law is not settled and you should probably be cautious.

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