IRS NOTICE 2010-19
GUIDANCE FOR PERSONS MAKING TRANSFERS IN TRUST AFTER DECEMBER 31, 2009
or
"What Rath Has Estate Tax Repeal Raught!"

By William S. Forsberg

On February 2, 2010, the Internal Revenue Service (IRS) issued Notice 2010-19, Guidance for Persons Making Transfers in Trust after December 31, 2009. After it become clear that estate tax repeal would be with us in 2010 everyone starting taking a hard look at the Internal Revenue Code (IRC) and the estate tax repeal provisions. In particular, there was a focus on IRC Section 2511(c), which was enacted as part of the Economic Growth and Tax Relief Reconciliation Act of 2001 (Pub.L. 107-16, 115 Stat. 38, June 7, 2001), (EGTRRA) and reads as follows:

> **Treatment of certain transfers in trust.**
>
> Notwithstanding any other provision of this section and except as provided in regulations, a transfer in trust shall be treated as a transfer of property by gift, **unless the trust is treated as wholly owned by the donor or the donor's spouse under subpart E of part I of subchapter J of chapter 1 *(emphasis added)*** .

The first sentence was not controversial—gifts to trusts in 2010, even non-wholly owned grantor trusts, would always be completed gifts for federal gift tax purposes, unless the IRS regulations said otherwise. The last sentence of IRC Section 2511(c), however, was very alarming and concerning to the government and to trust and estate practitioners. IRC Section 2511(c) is a federal gift tax provision. Read literally, the last sentence could reasonably be interpreted to mean that **<u>any</u>** transfer in 2010 to a wholly owned grantor trust was not a gift for federal gift tax purposes, which alarmed the government. The issue that alarmed some trust and estate practitioners was whether the government might promulgate regulations to the effect that the passing of assets outside the wholly owned grantor trust (or turning off the grantor trust powers) would be a gift at that later event. If so, any transfer in 2010 to a grantor retained annuity trust (GRAT), an intentionally defective grantor trust (IGIT), or other wholly owned grantor trust would, arguably, not be counted for gift tax purposes until that later event. This would effectively eliminate the estate and transfer tax planning benefits of these types of trusts and transactions.

The legislative history of IRC Section 2511(c) suggests that this was not the intended result or meaning. Rather, the intent was to address perceived income and income tax shifting abuses that might occur because of federal estate tax repeal in 2010. With no federal estate tax after 2009, Congress felt that there might be heightened interest in avoiding federal gift tax, and more importantly, federal income tax through the use of certain income tax "shifting" techniques. If one could create a trust whereby all transfers to it were incomplete for federal gift tax purposes but complete for federal income tax purposes, one could, it was thought, manipulate the federal and state income and transfer tax systems[i]. By "threading the trust needle" in this way there would be no federal gift tax (because the transfer was incomplete for federal gift tax purposes), no federal estate tax (because of federal estate tax repeal after 2009) and, in some cases, no state income tax (because the trust or the trust beneficiaries were located in a state with no state income tax system (e.g. Florida). The overall effect would be that all federal gift and estate tax (and in some cases all state income taxes) would be avoided, and federal income tax would be minimized by shifting the income tax burden to a trust or trust beneficiary in a lower federal and state income tax bracket than that of the trust grantor.

IRC Section 2511(c) was, many thought, simply poorly drafted. However, its intended meaning and purpose could not easily be deciphered from a quick read of the statute. Many thought it simply could not mean what it apparently said, and chose to ignore it and create GRATs and IGITs and other wholly owned grantor trusts in 2010 as they had done in 2009. Many others, however, felt uncomfortable taking such a big risk, and temporarily suspended planning in these areas. To resolve this dilemma, the IRS issued Notice 2010-19, which reads as follows.

> <u>Notice 2010-19</u> applies to taxpayers making gifts in trust during 2010. Under section 2511(c), a transfer of property to a non-wholly-owned grantor trust is a transfer by gift of the entire interest in the property. **<u>To determine whether a transfer to a wholly-owned grantor trust constitutes a gift, the gift tax provisions in effect prior to 2010 apply.</u>**

Notice 2010-19 makes it clear that the gift tax consequences of a transfer to a wholly-owned grantor trust in 2010 are determined under the old rules in place before 2010. Therefore, transfers to GRATs and IGITs in 2010 should be fine and are not *per se* incomplete by reason of IRC Section 2511(c).

Finally, Code Section 2511(c) may also have an unintended and negative impact on certain inter vivos charitable trusts. The Charitable Planning Group of the ABA Real Property Trusts & Estate (RPTE) Section is currently in the process of drafting comments to the IRS on the charitable planning concerns surrounding Code Section 2511(c).

Below is a link to IRS Notice 2010-19. Also, below is a link to a memorandum submitted to the IRS by attorney Steve Gorin, Thompson Coburn LLP, St. Louis, MO, on December 20, 2009 addressing this issue.

1. Link to IRS Notice 2010-19. http://www.irs.gov/pub/irs-drop/n-10-19.pdf

2. Link to Steve Gorin memorandum on IRC Section 2511(c)

Special thanks to Steve Gorin of Thompson Coburn LLP who allowed me to submit his memorandum on IRC Section 2511(c) with this eReport.

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[i] **See**: PLR 200502014 (Jan. 14, 2005); Settlor created a non-grantor trust that shifted taxable income to trust distributees, without removing assets from settlor's gross estate and without a taxable gift.