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TO THE EDITOR

I welcome the publication of [“Installment Sales to Defective Grantor Trusts” by D. Silverman, Sec. Tax’n Newsl., Fall 2000 at 11], since it enables me to say in public what I have been saying in private for some time, without earning the opprobrium of those who are using this technique for blowing their cover.

Viewed from the perspective of someone who practiced in the 1970s and ‘80s, the notion that by making an installment sale to an intentionally defective grantor trust (a better term would be an intentionally grantor-taxed irrevocable trust) a taxpayer can transfer her estate to her beneficiaries while avoiding both income taxes on the sale and estate and gift taxes is simply laughable.[1]

The point of this letter is not to make the various technical arguments which can be made against the technique, which should be obvious to all competent tax practitioners, but to wonder that an attorney could fashion a spiel to convince his client, and worse, himself, that such a position might be sustainable upon examination by the Service or in Tax Court.

Return with us to the thrilling days of yesteryear, when the tax-shelter lawyer rides again! Selecting a line from the statute here, a private letter ruling there, and a revenue ruling over yonder, the Masked Man concocts an argument, prepares the documents, collects a fee, and “Heigh-ho, I’ve got the Silver, Away!”

Do we not remember the rule of 78’s depreciation, the advanced royalty payment, the investment tax credit strip, the “losses are ordinary, gains are capital” allocations, and all of the other techniques which, like the sale to the intentionally grantor-taxed irrevocable trust, were based upon inapplicable, out-of-context, or simply incorrect statements of law? Have the principles that in tax law, substance prevails over form, and that sham transactions are ignored, been overturned? Have we forgotten the hundreds of millions, perhaps billions, of dollars paid in taxes, interest, and penalties by participants in the tax shelters of the ‘90s and ‘80s? Or perhaps we hunger for those days again, when we could collect fees for putting clients into contrived tax schemes and more fees for getting them out?

I had thought that as tax lawyers, we had learned our lesson from the tax shelter debacle of the 1980s, but I see by the corporate tax shelter promotions that we have not. I had thought that those of us practicing in the estate planning area were above this sort of thing but I see from the “ghoul charitable lead trust[2]” and the sale to the intentionally grantor-taxed irrevocable trust that we are not.

Tax lawyers have a dual responsibility: to our client and to the tax system as a whole. It should not be necessary for any of us to learn this by means of the IRS imposing preparer, tax shelter promoter, and aiding and abetting penalties, but if it is, so be it.

Very truly yours,
Mitchell R. Miller
Beverly Hills, California

DAVID SILVERMAN RESPONDS

The general principles governing the tax consequences of asset sales to intentionally defective grantor trusts seem firmly grounded in the Code and the law, and their straightforward application appears to result in the tax conclusions which were outlined. Nevertheless, the IRS could challenge various parts of the transaction, which if successful, could negate some (or all) of the tax benefits sought. In particular, the IRS could attempt to assert that (i) the initial "sale" to the grantor trust is actually a taxable sale which results in immediate tax to the grantor under IRC section 1001; (ii) IRC section 2036

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1 In theory, the fair market value of the property at the time of transfer is included in the taxpayer’s estate by virtue of the installment obligation and its proceeds, but an important part of these schemes is the elimination of these assets from the taxpayer’s estate as well.

2 A charitable lead trust whose measuring life is that of a fatally—but not terminally—ill individual, usually not related to the donor of remainder beneficiaries of the trust, and frequently rounded up from a list of nursing home or AIDS patients.

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applies, with the result that the entire value of the trust is includible in the grantor's estate; (iii) that IRC section 2702 applies, the annuity is not qualified, and a taxable gift occurs at the outset; or (iv) the step transaction doctrine applies.

I disagree, however, with Mr. Miller's assertion that the tax treatment espoused is inherently sinister. Similar arguments made against minority discounts for LLCs have been rejected by the courts. According to the ABA Formal Opinion 85-352, "a lawyer who is asked to advise his client in the course of the preparation of the client's tax returns may freely urge the statement of positions most favorable to the client just as long as there is reasonable basis for this position." Failing a successful IRS challenge, the technique could substantially reduce estate taxes. Clients should be apprised of risks. However, we should not be so presumptuous as to assume that an informed client is incapable of making an intelligent choice when implementing an estate plan. Asset sales to defective grantor trusts deserve further consideration.

Very truly yours,
David L. Silverman
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