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Eliminate State Tax on Trust Income: A Comprehensive Update on Planning With Incomplete Gift Non-Grantor Trusts

*Kevin R. Ghassomian, Esq.**

Private letter rulings dating back to 2001 affirm various tax attributes of incomplete gift non-grantor trusts, known popularly as "DING Trusts," which have been used by taxpayers to relocate investments from high-tax states to no-tax states. In 2007, the Internal Revenue Service questioned the integrity of its rulings on the DING Trust and cast doubt on its continuing viability for tax planning purposes. After nearly six years of indecision, a flurry of favorable new rulings was released in March of 2013, restoring widespread confidence in the DING Trust as an option for taxpayers seeking relief from rising income tax rates. This article examines the DING Trust within the context of the new rulings and recent case law, suggesting structural safeguards and recommendations for most effectively employing the technique to mitigate income tax liability at state and local levels.

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INTRODUCTION

The top federal tax rate on long-term capital gains increased from 15% in 2012 to 23.8% in 2013 due to a combination of higher income tax rates[1] and a new 3.8% tax on investment income.[2] When including state and local taxes, the top marginal effective tax rate on capital gains in the United States now averages 27.9%.[3] Compared to other developed

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[1] Under the American Taxpayer Relief Act of 2012 ("ATRA"), long-term capital gains and qualified dividends will be taxed at 20% for households with taxable income exceeding $400,000 for individuals, $450,000 for married couples filing jointly, and $425,000 for heads of households. Pub. L. No. 112-240, 126 Stat. 2313 (2013). *See also* I.R.C. Reg. § 1(h).

[2] The 3.8% tax enacted under the Patient Protection and Affordable Care Act ("Affordable Care Act"), not as part of ATRA, applies to net investment income if the taxpayer's adjusted gross income exceeds $250,000 for joint filers or $200,000 for single filers. Pub. L. No. 111–148, 124 Stat. 119–1025 (2010). The 3.8% tax also applies to the undistributed net investment income of trusts in excess of $11,950 in 2013. *Id. See also* I.R.C. Reg. § 1411.

[3] A marginal effective tax rate includes federal income taxes, state income taxes, local income taxes (here approximated as weighted averages across the state), federal Medicare taxes including those in the Affordable Care Act, and the interaction between taxes for deductibility purposes. *See* Kyle E. Pomerleau, *Fiscal Fact No. 362: The High Burden of State and Federal Capital Gains Taxes*, TAX FOUNDATION, Feb. 20, 2013, http://taxfoundation.org/?sites/?taxfoundation.org/?files/?docs/?ff362.pdf (citing Gerald Prante

countries, which average 16.4%, seven of the ten highest capital gains rates are found in U.S. states.[4] In fact, California's aggregate effective rate of 33% is the second highest capital gains rate in the world, higher than those of France, Finland, and Sweden.[5] New York ranks fifth in the world with a rate of 31.4%.[6]

Yet, within the U.S., there is great variability with respect to capital gains rates among the states, with many having no income tax at all.[7] Thus, Private Letter Rulings 201310002 through 201310006 ("2013 PLRs"), issued by the Internal Revenue Service ("IRS") in March of 2013,[8] were welcomed by taxpayers, as they ended a near six-year hiatus on private letter rulings ("rulings" or "PLRs") involving incomplete gift non-grantor trusts, a tax planning technique known popularly as the "DING Trust."[9] The 2013 PLRs provide continuity with a prior line of IRS rulings that affirm the regulatory treatment of the DING Trust and effectively approve, as its key to tax savings, a means by which taxpayers can migrate investments from high tax states to low-tax or no-tax states.[10]

The success of the technique, as set forth in the PLRs, depends on the taxpayer's ability to relinquish enough control over the trust to avoid grantor trust status for income tax purposes but not enough for transfers to the trust to be deemed completed gifts for gift tax purposes.

& Austin John, *Top Marginal Effective Tax Rates by State and by Source of Income, 2012 Tax Law vs. 2013 Scheduled Tax Law (as enacted in ATRA),* Feb. 2013, *available at* http://papers.ssrn.com/?sol3/?papers.cfm?abstract_id=2176526).

4 *Id.*

5 *Id.*; *see also* Richard Morrison, *U.S. Now Has Some of the World's Highest Capital Gains Tax Rates*, The Heartland Institute, Feb. 13, 2013, http://news.heartland.org/?newspaper-article/?2013/?02/?20/?us-now-has-some-worlds-highest-capital-gains-tax-rates.

6 *See* Pomerleau, *supra* note 3.

7 *Id.* at 2, 5 (citing Table 1 which notes the states that do not tax capital gains).

8 PLR 201310002 (Nov. 7, 2012); PLR 201310003 (Nov. 7, 2012); PLR 201310004 (Nov. 7, 2012); PLR 201310005 (Nov. 7, 2012); PLR 201310006 (Nov. 7, 2012).

9 Although incomplete gift non-grantor trusts can be settled in any jurisdiction that permits irrevocable self-settled spendthrift trusts, advisors in Delaware took the early lead in marketing such trusts for state income tax planning purposes; thus, they are widely known as "Delaware Incomplete Gift Non-Grantor Trusts" or "DING Trusts."

10 In March of 2014, the IRS released ten additional DING Trust rulings, affirming its reasoning in the 2013 PLRs and approving the settlor's appointment of guardians to act on behalf of minors on the trust's distribution committee. PLR 201410001 (Oct. 21, 2013); PLR 201410002 (Oct. 21, 2013); PLR 201410003 (Oct. 21, 2013); PLR 201410004 (Oct. 21, 2013); PLR 201410005 (Oct. 21, 2013); PLR 201410006 (Oct. 21, 2013); PLR 201410007 (Oct. 21, 2013); PLR 201410008 (Oct. 21, 2013); PLR 201410009 (Oct. 21, 2013); PLR 201410010 (Oct. 21, 2013) Five more favorable DING Trust rulings were released in July of 2014, PLR 201430003 (Jul. 25, 2014); PLR 201430004 (Jul. 25, 2014); PLR 201430005 (Jul. 25, 2014); PLR 201430006 (Jul. 25, 2014); and PLR 201430007 (Jul. 25, 2014).

Threading this regulatory needle requires an overtly contrived trust structure that is best explained within the context of the 2013 PLRs. This article, therefore, begins with the facts of PLR 201310002, which are representative of the rest of the 2013 PLRs.[11] The article follows with an explanation of the DING Trust's operative requirements and concludes with a summary of its benefits and recommendations for those who may implement the strategy.

I. Facts of Private Letter Ruling 201310002

The taxpayer, a resident of New Jersey, transferred investment assets to an irrevocable spendthrift trust settled in Nevada.[12] The beneficiaries of the trust included the taxpayer and his descendants; but distributions to them by the trustee, an independent corporate fiduciary in Nevada, were subject to the authority of a committee ("Distribution Committee").[13] The members of the Distribution Committee, initially the settlor and his four sons, maintained the power to direct income and principal among themselves and other trust beneficiaries in two ways: (1) by majority agreement with the settlor's consent ("Settlor's Consent Power") or (2) by unanimous agreement without the settlor's consent ("Unanimous Member Power").[14]

In addition, the settlor retained two controls over the trust assets: (1) a non-fiduciary lifetime power to make distributions of principal for the health, education, maintenance, and support of the settlor's issue ("Settlor's Sole Power") and (2) a testamentary power to appoint the remaining balance of the trust to anyone other than the settlor's estate, his creditors, or the creditors of his estate ("Settlor's Testamentary Power").[15] Trust distributions could be made equally among the beneficiaries or to any one or more of them to the exclusion of others, and any undistributed income was to be accumulated and added to principal.[16]

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[11] The 2013 PLRs were issued to separate taxpayers within one family who were all beneficiaries of the same trust; so, the facts and rulings in each PLR are virtually identical. This article will, therefore, reference the 2013 PLRs interchangeably with PLR 201310002.

[12] William D. Lipkind & Steven J. Oshins, The Ultimate Estate Planner, Inc., Teleconference Presentation: The NING Trust: Saving Significant State Income Taxes for Your Clients in High Income Tax Jurisdictions (May 2, 2013) [hereinafter Lipkind & Oshins, Teleconference] (confirming that the state of the settlor's domicile was New Jersey and the state in which the trust was settled was Nevada).

[13] PLR 201310002 (Nov. 7, 2012).

[14] *Id.*

[15] *Id.*

[16] *Id.*

At the settlor's death, the trust's unappointed balance was to be distributed among the settlor's descendants in further trust.[17]

The Distribution Committee, which would terminate at the settlor's death, could only be comprised of trust beneficiaries and was required at all times to have at least two members serving, neither of whom could be the settlor.[18] Consequently, the Distribution Committee also was to cease when there were fewer than two eligible members serving, even if the settlor was also then serving. Though not explicit in the ruling, departing Distribution Committee members would not be replaced automatically unless a replacement was needed to maintain the two-member minimum.[19]

II. Tax Issues and Related Trust Requirements

The complexity of the DING Trust's operating structure, evident in PLR 201310002, is a result of the gauntlet of tax authority that confronts it. First, the taxpayer who settles the trust must be domiciled in a jurisdiction that will not tax the accumulated income or capital gains of an out-of-state non-grantor trust. Second, the trust must avoid grantor trust status so that its income is taxed to the trust rather than to the settlor. Third, the taxpayer's transfer of assets to the trust must be incomplete for gift tax purposes so that the conveyance settling the trust is not taxable. Finally, the members of the distribution committee must not hold controls that could be deemed general powers of appointment; otherwise, any assets subject to such controls would be includible in the estates of the committee members and taxed accordingly.

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17 *Id.*

18 "[The] Trust provides that at all times at least two 'Eligible Individuals' must be members of the Distribution Committee. An 'Eligible Individual' means a member of the class consisting of the adult issue of Grantor, the parent of a minor issue of Grantor, and the legal guardian of a minor issue of Grantor. A vacancy on the Distribution Committee must be filled by the eldest of Grantor's adult issue other than any issue already serving as a member of the Distribution Committee, or if none of Grantor's issue not already serving as a member of the Distribution Committee is an adult, then the legal guardian of the eldest minor issue shall serve, or if such minor issue does not have a legal guardian, then the parent of such minor issue. If at any time fewer than two Eligible Individuals are members of the committee, the Distribution Committee shall be deemed not to exist." *Id.*

19 This fact can be inferred from the ruling's analysis addressing a regulatory example in which the death of one member of a group enhanced the power of each remaining group member. *Id.* It was also confirmed by William Lipkind, the attorney who secured the 2013 PLRs. William D. Lipkind, *Bill Lipkind on PLR 201310002: DING Redux*, Leimberg Info. Services, Inc. Est. Plan. Newsl. #2076, Mar. 12, 2013, *available at* http://www.leimbergservices.com/?openfile.cfm??filename=D%?3A%?5Cinetpub%?5Cwwwroot%?5Call%?5Clis%?5Fnotw%?5F2076%?2Ehtml [hereinafter Lipkind, *DING Redux*].

A. Settlor's Domicile Must Not Tax Income of Out-of-State Non-Grantor Trusts

The DING Trust is a non-grantor trust, separate and apart from its settlor for income tax purposes, and therefore independently taxed on any income and gains it may realize. Thus, DING Trusts are most useful as a tax mitigation device when sitused in states that do not impose income tax on resident non-grantor trusts.[20] Consequently, the threshold issue for a taxpayer contemplating a DING Trust is whether his or her state of domicile taxes the accumulated income and capital gains of a non-grantor trust located in another state. The answer varies by jurisdiction, as each state asserts its own grounds for taxing trusts.

1. *State Bases for the Taxation of Trust Income*

Generally, there are five bases for state taxation of trusts: (1) if the trust was created by the will of a testator who lived in the state at death,[21] (2) if the settlor of an inter-vivos trust lived in the state,[22] (3) if the trust is administered in the state,[23] (4) if one or more trustees live or

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20 "Seven states—Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming—do not tax the income of trusts." Richard Nenno, *Planning to Minimize or Avoid State Income Tax on Trusts*, 34 ACTEC L.J. 131, 132 (2008).

21 "Seventeen states—Connecticut, the District of Columbia, Illinois, Louisiana, Maine, Maryland, Michigan, Minnesota (trusts created or first administered in state after 1995), Nebraska, Ohio, Oklahoma, Pennsylvania, Utah, Vermont, Virginia, West Virginia, and Wisconsin—tax a trust created by the Will of a resident. New Jersey and New York tax on this basis in certain circumstances, and Idaho, Iowa, and Montana tax if this is one of several factors. Although Delaware, Missouri, and Rhode Island tax if the trust has at least one resident beneficiary, Arkansas and Massachusetts tax if the trust has at least one resident trustee. Alabama taxes on this basis if a trust has a resident fiduciary or current beneficiary." *Id.*

22 "Twelve states—the District of Columbia, Illinois, Maine, Maryland, Minnesota (trusts created or first administered in state after 1995), Nebraska, Oklahoma, Pennsylvania, Vermont, Virginia, West Virginia, and Wisconsin (trusts created or first administered in state after October 28, 1999)—tax an irrevocable trust created by a resident. New Jersey and New York tax on this basis in certain circumstances, and Connecticut, Delaware, Michigan, Missouri, Ohio, and Rhode Island tax if the trust has at least one resident [noncontingent] beneficiary. Massachusetts taxes if the trust has at least one resident trustee and at least one resident [noncontingent] beneficiary, but Arkansas taxes if the trust has at least one resident trustee. Idaho and Montana tax if this is one of several factors; Alabama taxes on this basis if a trust has a resident fiduciary or current beneficiary." *Id.* at 132–33.

23 "Fifteen states—Colorado, Georgia, Indiana, Kansas, Louisiana (inter-vivos trusts unless trust designates law of another state), Maryland, Minnesota (trusts created or first administered in state before 1996), Mississippi, New Mexico, North Dakota, Oregon, South Carolina, Utah (inter vivos trusts only), Virginia, and Wisconsin (inter vivos trusts created or first administered in state before October 29, 1999)—tax a trust if it is administered in the state. Idaho, Iowa, and Montana tax on this basis if it is combined with other factors. Hawaii taxes if the trust has at least one resident beneficiary. Oregon

do business in the state,[24] or (5) if one or more beneficiaries live in the state.[25] In some jurisdictions, a trust might be deemed a tax resident under more than one of these categories.[26] It is also possible for a trust to be subject to taxation in more than one state.[27] Fortunately, trust tax rules in many jurisdictions, including high-tax states like California,[28] provide safe-harbor exemptions and ample planning opportunities for those seeking to implement a DING Trust.[29]

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provides guidance on whether a corporate trustee is administering a trust in the state." *Id.* at 133.

24 "Eight states—Arizona, California, Georgia, Kentucky, New Mexico, North Dakota, Oregon, and Virginia—tax if one or more trustees reside in the state. Idaho, Iowa (inter vivos trusts only), and Montana tax on this basis when combined with other factors. Delaware, Hawaii, and New Hampshire tax on this basis only if the trust has one or more resident [noncontingent] beneficiaries. Arizona, California, and Oregon provide guidance on whether a corporate trustee is a resident. If some, but not all, of the trustees of a trust are California residents, California taxes only a portion of the income." *Id.*

25 "Five states—California, Georgia, North Carolina, North Dakota, and Tennessee—tax a trust if it has one or more resident [noncontingent] beneficiaries. If a trust is taxed on this basis, California and Tennessee tax only income attributable to resident [noncontingent] beneficiaries." *Id.*

26 This may occur, for example, when a trust created by the will of a resident is administered in the state. Richard Nenno, *Planning to Minimize or Avoid State Income Tax on Trusts,* 34 ACTEC L.J. 131, 132 (2008).

27 *Id.*

28 If a trust is administered by a California trustee or has California noncontingent beneficiaries, regardless of whether its settlor is or was a resident of California, the trust income will be subject to California income tax. However, only a proportionate share of the trust's taxable income from sources outside California will be subject to tax when there are nonresident co-trustees or nonresident beneficiaries. CAL. REV. & TAX. CODE §§ 17743–17744; 18 CAL. CODE REGS. §§ 17743–17744. Thus, California income tax can be reduced by appointing co-trustees outside of California. *See* Charles A. Redd, *State Income Tax Issues With Trusts*, NAEPC J. OF EST. & TAX PLAN., 2d Q. 2011, at 1, 7 (2011). It should be noted that, even if a Californian is receiving current income distributions from a trust that has a non-California trustee, the trustee should be able to defer or avoid California taxation of accumulated ordinary income and capital gains if distribution of such income and gains is within the trustee's discretion. *See* Cal. Franchise Tax Board Technical Advice Memorandum 2006-0002 (Feb. 17, 2006). Accordingly, a California beneficiary who is a mere discretionary beneficiary, as in the 2013 PLRs, is categorized, in California, as a contingent beneficiary. For a state-specific treatment of DING Trusts in California, see Mathew G. Brown, David L. Keligian, and Gregory E. Lambourne, *California Income Tax Issues for Non-California Trusts*, California Trusts and Estates Quarterly, Volume 19, Issue 4 (2014) and Volume 20, Issue 2 (2014).

29 States that tax trusts based on the tax residence of the trustee, tax residence of the beneficiary, or any other factor besides the tax residence of the settlor, provide much more flexibility in changing the residence of the trust for income tax purposes. *See* Philip J. Michaels & Laura M. Twomey, *How, Why, and When to Transfer the Situs of a Trust*, 31 EST. PLN. 28 (Jan. 2004); *see also* Nenno, *supra* note 20. Section 605(b)(3)(D)(i) of the New York State Tax Law provided a safe harbor for certain nonresident trusts; however, as of March 31, 2014, New York treats DING Trusts as "grantor trusts" for purposes of the New York income tax. Thus, New York settlors of such trusts will be required to

Regardless, states that impose an income tax will do so on "source income" derived directly from in-state assets or activities, without regard for the taxpayer's residence.[30] Thus, after confirming the tax bases of out-of-state non-grantor trusts, settlors of DING Trusts must also ensure that they fund the trusts with income-producing assets that are not sourceable to their states of domicile. Notably, most forms of investment income, including gains from the sale of a business[31] and ordinary portfolio income,[32] are excepted from state sourcing rules.

The settlor of the trust in PLR 201310002 resided in New Jersey, a high tax jurisdiction that taxes trust income based on the location of the trust's assets and the domicile of its fiduciaries.[33] Accordingly, the taxpayer settled the trust using non-sourceable investments and a corporate trustee in Nevada, where there is no state income tax.[34] The settlor also ensured that there were no other fiduciary ties to New Jersey, such as a resident investment advisor, which, as noted by counsel to the taxpayer

report all of the trust's income tax items on his or her individual income tax returns and will be responsible for the associated income tax liability. N.Y. TAX LAW § 612(b)(41).

30 Redd, *supra* note 28, at 5–6 ("Generally, states tax resident trusts on all their world-wide income and tax nonresident trusts only on the income generated from real property, tangible personal property or business interests within the state, *i.e.*, the 'source' income of the nonresident trust. Thus, the planning opportunities available from changing the tax residency are limited to realized capital gains and accumulated income that are not considered 'source' income.") (citations omitted).

31 States usually treat gain from the sale of a business interest under their general rules for taxing income from the sale of an intangible asset; thus, any gains are taxed by the state where the seller of the interest is domiciled unless the interest had acquired a situs in a different state. *See, e.g.*, GP Credit Co., LLC v. Orlando Residence, Ltd., 349 F.3d 976 (7th Cir. 2003); In re Lambert, 179 F.3d 281 (5th Cir. 1999); Gordon v. Holly Woods Acres, Inc., 328 F.2d 253 (6th Cir. 1964). It is important to note, however, that when a membership interest in a limited liability company is sold, the determination as to whether the interest acquired a taxable situs in a state other than that of the seller's domicile is a fact dependent inquiry that can be difficult to predict. California, for example, is notorious for taking aggressive stances in such matters. *See* Robert W. Wood, *California Sourcing and M&A*, The M&A Tax Report, Volume 21, Number 7 (Feb. 2013) (discussing California's bewildering source income rules and related authority as they pertain to sales of membership interests in limited liability companies).

32 The widely adopted Uniform Division of Income for Tax Purposes Act classifies such income as nonbusiness income, allocated to the individual's state of residence. UNIF. DIV. OF INCOME FOR TAX PURPOSES ACT §§ 6(c), 7 (Nat'l Conference of Comm'rs on Unif. State Laws 1957). *See also, e.g.*, Allied-Signal, Inc. v. Dir., Div. of Taxation, 504 U.S. 768 (1992); Hoechst Celanese Corp. v. Franchise Tax Bd., 22 P.3d 324 (Cal. 2001); Pledger v. Getty Oil Exploration Co., 831 S.W.2d 121 (Ark. 1992).

33 *See* Pennoyer v. Tax. Div. Director, 5 N.J. Tax 386 (1983); Potter v. Tax. Div. Director, 5 N.J. Tax 399 (1983) (holding that a trust cannot be taxed on its income if the trustees and assets are out of state).

34 *See* Lipkind & Oshins, Teleconference, *supra* note 12.

(and discussed below), might have established a tax nexus to the settlor's state of domicile.[35]

2. *Avoiding Fiduciary Contacts with the Settlor's State of Domicile*

Settlors of DING Trusts should be mindful of the residence of anyone participating in the trust's administration, not just the trustee. Indeed, parties with any sort of discretionary authority over the trust, whether as an investment advisor or member of a distribution committee,[36] may be deemed to hold a fiduciary power regardless of their titular designation in the trust instrument.[37] This is of paramount importance in the DING Trust context because revenue officials in states that base taxation (in whole or in part) on a trustee's domicile, New York and California in particular, have been able to maintain a tax nexus through such non-trustee participants by characterizing them as fiduciaries under state law.[38]

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35 *Id.* (noting that the trust's investment advisor did not reside in New Jersey).

36 The trust at issue in the 2013 PLRs had an independent corporate trustee, subject to the direction of a distribution committee and an investment advisor. *Id*. Though there was no trust protector named, the discussion of this Section II.A.2 applies in equal measure to any third party non-trustee participant, including trust protectors. *See infra* note 38 and its accompanying text.

37 The traditional fiduciary functions of a trustee include (1) exercising the important labor-intensive and liability-sensitive discretionary investment management and distribution responsibilities, (2) performing all ministerial administrative responsibilities necessary to implement those exercises of discretion, (3) preparing fiduciary accountings and trust tax returns, and (4) otherwise administering trusts in accordance with the governing instruments and applicable state trust law. Unlike this traditional trust model, a multi-participant or "directed trust" arrangement involves a co-trustee or a non-trustee fiduciary, typically a "protector" or "advisor," empowered to direct the trustee holding legal title to the trust assets to execute the empowered party's directions concerning the critical discretionary investment or trust distribution powers or both. The traditional trustee is thereby relegated to implementing those directions and often performing other administrative functions such as recordkeeping, maintaining principal and income accounts, and preparing and filing trust tax returns. *See* Joseph F. McDonald, III, *Emerging Directed Trust Company Model*, TR. & EST., Feb. 2012, *available at* http://wealthmanagement.com/?estate-planning/?emerging-directed-trust-company-model.

38 *See* John P.S. Duncan & Anita M. Sarafa, *Achieve the Promise—and Limit the Risk—of Multi-Participant Trusts,* 36 ACTEC L.J. 769 (Spring 2011) (citing King & Tenney v. Cal. State Bd. of Equalization, 2007 Cal. Tax LEXIS 406 (Cal. Oct. 4, 2007) (asserting that a trustee or any other person may be a California fiduciary for tax purposes if they act in any fiduciary capacity for a trust)); N.Y. State Dept't Tax'n & Fin., JPMorgan Chase Bank, Adv. Op., TSB-A-04(7)(I) (Nov. 12, 2004) *available at* http://www.tax.ny.gov/?pdf/?advisory_?opinions/?income/?a04_7i.pdf (last accessed Apr. 27, 2011) (asserting that in New York an advisor or committee that directs the trustee on investment, distribution, or other matters or that has a veto power over the trustee's actions will be treated as a co-trustee, thereby subjecting the trust to New York tax if such an advisor or

Fortunately, states with directed trust statutes,[39] including all that have adopted the standard language of the Uniform Trust Code,[40] provide that trusts, subject to a few mandatory exclusions,[41] can override state law.[42] Consequently, settlors in these states may negate the fiduciary status of non-trustee participants through express language in the trust instrument.[43] In the absence of explicit clarity, either from statute or from the trust itself, courts generally apply to all trust participants the duties and liabilities of full trustees or co-trustees, particularly when powers that are fiduciary in nature are divided or shared among them.[44]

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committee member lives in New York, even if the trustee and all trust property are outside the state).

39 For a complete list of states with directed trust statutes, *see* Richard W. Nenno, *Directed Trusts: Making Them Work*, TAX MGMT. EST., GIFTS AND TR. J. (2013), at Appendix A, *available at* https://www.wilmingtontrust.com/?repositories/?wtc_?sitecontent/?PDF/?Directed_?Trusts_?Article_?03_?13.pdf.

40 UNIF. TRUST CODE §§ 105 (2005). The full text of the Uniform Trust Code is available at http://www.uniformlaws.org/?shared/?docs/?trust_?code/?utc_?final_?rev 2010.pdf. (last visited Sept. 4, 2013). To determine which states have enacted the Uniform Trust Code, go to http://www.uniformlaws.org/?Act.aspx??title=Trust%20Code (last visited Sept. 4, 2013).

41 In states adopting the standard Uniform Trust Code language, the statute does not allow the trust instrument to override the duty of a trustee to act in good faith, the power of the court to modify compensation of a trustee, limits on exculpatory provisions, and the rights of the person other than a trustee or beneficiary. UNIF. TRUST CODE §§ 105(a)(2), (7), (10), (11).

42 Some trust law scholars maintain that fiduciary duties simply are default rules and that the settlor and trustee can agree by contract to waive them. *See, e.g.,* John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 YALE L.J. 625, 629 (1995) (arguing that trustees' fiduciary duties find their origin in contract law); *see also* Melanie B. Leslie, *Trusting Trustees: Fiduciary Duties and the Limits of Default Rules*, 94 GEO. L.J. 67, 69 (2005) (pointing out that "the default rule paradigm has increasingly influenced doctrine and permeates the recently promulgated Uniform Trust Code . . . .") (footnote omitted). Under a contractarian view of trusts, a settlor and trustee could privately agree to modify or waive application of some fiduciary rules. Others, however, argue against the ability to waive or significantly modify essential trustee duties. *Id.* at 69-70.

43 Trust counsel must determine (a) the exact duties of each trust participant, (b) the standards that should apply to them, (c) their liability for losses to the trust or its beneficiaries arising from any failure to fulfill an assigned duty, and (d) how the participants should work together. A recent review of the common law and statutory law on the subject concluded that the only way to make these determinations with an adequate degree of confidence about the outcome is to specify exactly what is desired in the trust instrument and make sure those provisions will be governed by the laws of a state that lets the instrument override contrary state law. *See* Duncan & Sarafa, *supra* note 38, at 774.

44 *See* Duncan & Sarafa, *supra* note 38, at 785, 801 (citing McLean v. Davis, 283 S.W.3d 786, 794–95 (Mo. Ct. App. 2009) (holding that a trust protector was a fiduciary due in part to the presence of certain fiduciary "earmarks," including a reference to "fi-

Accordingly, the settlor in PLR 201310002 was careful to ensure that the powers of the Distribution Committee were exercisable in a discriminatory manner for the express benefit of the committee members themselves, and *not* as a fiduciary for anyone else.[45] As such, it would be difficult, if not altogether impossible, for New Jersey to assert a fiduciary nexus through the committee members. Indeed, as beneficiaries with *non-fiduciary* powers of appointment, a more apt characterization of their authority, members of the Distribution Committee were freed from accountability in exercising their power and, as a result, had no fiduciary connection with the state regardless of their domicile for tax purposes.

This was not the case with respect to the trust's investment advisor, whose power differed from that of the Distribution Committee because it was exercisable for the express benefit of others, in this case, the trust beneficiaries.[46] Though the trustee was explicitly relieved of liability for following the investment advisor's direction,[47] the investment advisor remained accountable for its decisions and, as a consequence, would be considered a fiduciary under state law.[48] Thus, the settlor in PLR 201310002, as noted above, made sure to designate an out-of-state in-

duciary capacity" in the trust instrument and a formal relationship with the beneficiaries requiring the protector to act with beneficiaries' interest in mind)).

45 The trust at issue in the 2013 PLRs was a discretionary trust with no distribution standards that could be enforced by the beneficiaries. *See infra* note 98 and its accompanying text.

46 Though not explicit in the 2013 PLRs, counsel to the taxpayer confirmed that there was an out-of-state investment advisor who was authorized to direct the trustee with regard to the management of the trust assets. *See* Lipkind & Oshins, Teleconference, *supra* note 12.

47 In a directed trust, such as the one at issue in the 2013 PLRs, the discretionary authority to invest trust assets need not be held by the trustee. *See* NEV. REV. STAT. ANN. § 163.5549. Thus, with a directed trust, the trustee functions more as an administrator or custodian, and can be relieved of liability for following the investment advisor's direction with respect to investment-related decisions within the advisor's scope of authority. *Id.* Note, however, exculpatory language in a directed trust is not absolute and generally seems to provide a lower level of protection to the trustee receiving investment direction. See *Duemler v. Wilmington Trust Co.*, C.A. No. 20033 N.C. (Del. Ch. 2004), *Rollins v. Branch Banking and Trust Company of Virginia*, 56 Va. Cir. 147 (Va. Cir. Ct. 2002).) (subjecting the trustee to a reasonableness standard in relying on the advisor, rather than being liable only if the trustee were guilty of willful misconduct or gross negligence in relying on the advisor); *see also* Nenno, *supra* note 39.

48 Under typical circumstances, an ordinary negligence standard—the investment adviser must act reasonably—is recommended. In situations in which the investment advisor must deal with difficult assets, such as a minority interest in a business, or litigious beneficiaries, consideration should be given to protecting the investment adviser from liability for investment decisions except in cases of willful misconduct or gross negligence.

vestment advisor so as to avoid any resident fiduciary contacts (and potential tax nexus) with New Jersey.[49]

B. Settlor Must Not Retain Controls that Trigger Grantor Trust Status

When a trust is deemed a grantor trust, the trust's income is taxed to its settlor and thereby subject to taxation in the settlor's state of domicile regardless of the trust's residence for state income tax purposes.[50] Taxpayers seeking the benefit of the DING Trust's advantageous tax situs must therefore ensure that the trust avoids grantor trust status or else any potential state tax savings will be lost.[51] Accordingly, the settlor of a DING Trust must not possess any of the controls prohibited by the grantor trust rules of sections 671 through 679 of the Internal Revenue Code of 1986, as amended ("I.R.C." or "Code").

Among the restrictions contained in the grantor trust rules, five consistently arise in the DING Trust context. First, the settlor cannot retain a material reversionary interest in the trust.[52] Second, the settlor cannot have the power to control beneficial enjoyment of the trust's assets without approval of an "adverse party."[53] Third, the settlor cannot have the power to revoke the trust or revest its assets in himself.[54] Fourth, subject to certain exceptions, neither the settlor nor the settlor's spouse can receive prohibited distributions of current or accumulated income from the trust.[55] Finally, the trust assets must not be subject to claims by the settlor's creditors.[56] Each of these prohibitions was addressed by the 2013 PLRs.[57]

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[49] *See* Lipkind & Oshins, Teleconference, *supra* note 12.

[50] A trust is deemed a grantor trust when a settlor or another person is treated as the owner of the trust income or principal or both for federal income tax purposes. This means that the settlor (or such other person) must include in the computation of taxable income all items of "income, deductions, and credits against tax of the trust" attributable to the portion of the trust that he or she is deemed to own. I.R.C. § 671. In other words, the settlor or such other person treated as the owner of the trust is taxed as if he or she had received the assets directly. *Id.*; Treas. Reg. § 1.671-2(d) (2000).

[51] From the language of the statute, it is not clear that a grantor trust is treated as being one and the same as the settlor, but that is the longstanding position of the IRS, as set forth in Rev. Rul. 85-13, 1985-1 C.B. 184.

[52] I.R.C. § 673(a).

[53] I.R.C. § 674(a).

[54] I.R.C. § 676(a).

[55] I.R.C. § 677(a).

[56] Treas. Reg. § 1.677(a)-1(d) (1971).

[57] Though not included among the five common grantor trust triggers, I.R.C. § 675 must always be a consideration for settlors of DING Trusts. It leads to grantor trust status when administrative control of the trust is exercised primarily for the benefit of the settlor. This is a question of fact, dependent on the actual management of the trust, not its operational mechanics. Thus, grantor trust status under I.R.C. § 675 is not addressed

1. *Retained Reversions Under Code § 673*

Code § 673 provides for grantor trust treatment if the settlor of a trust holds a reversionary interest in income or principal worth more than 5% of the trust's value at its inception.[58] In prior DING Trust rulings, a settlor's eligibility to receive discretionary distributions from the trust did not qualify as a reversionary interest.[59] The IRS ruled consistently in the 2013 PLRs, concluding in accordance with the past rulings, yet without explanation, that the settlor did not possess a reversionary interest that could trigger grantor trust status.[60]

Notably, a reversionary interest is not defined by the grantor trust rules, and because the IRS stance in the PLRs is not elaborated upon, the precise rationale for determining whether a reversionary interest exists in the DING Trust context is somewhat speculative. However, it is likely based upon the term's traditional definition, which identifies a reversion as the interest remaining with the owner of a vested estate upon transferring a lesser-vested estate to another person.[61]

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by the PLRs but rather by an examining agent upon filing of the applicable federal income tax returns. Trustees must therefore ensure that they follow their fiduciary responsibilities in strict adherence to the language of their trusts. In so doing, grantor trust status under I.R.C. § 675 should be avoided.

58 I.R.C. § 673(a) provides that the settlor shall be treated as the owner of any portion of a trust in which the settlor has a reversion in either principal or income if, at the creation of the trust, the value of the reversion exceeds 5% of the value of such portion. A trust will be considered a grantor trust if the value of a retained interest, whether an interest in the income or principal, exceeds 5% of the value of the trust property. However, a grantor can be treated as the owner of only a portion of a trust. The value of the retained interest is determined at the time of the transfer to the trust. The interest rate prescribed by I.R.C. § 7520 is used to value a retained interest.

59 *See, e.g.,* PLR 200612002 (Nov. 23, 2005); PLR 200502014 (Sept. 17, 2004); PLR 200247013 (Aug. 14, 2002); PLR 200148028 (Aug. 27, 2001).

60 Although the settlor's spouse may be a discretionary distributee during the lifetime of the settlor, a DING Trust should not provide the surviving spouse with a qualified terminable interest property ("QTIP") trust or any other beneficial interest at the settlor's death. Under I.R.C. § 672(e), the settlor is treated as holding any power or interests held by the settlor's spouse. Thus, a QTIP trust would likely cause the settlor to be deemed to possess a reversionary interest that would cause the DING Trust to be a grantor trust under I.R.C. § 673. All is not lost for the settlor's spouse, however, because the settlor may retain and exercise a testamentary limited power of appointment in favor of the spouse either outright or in some type of trust in which the spouse holds an interest, such as a QTIP trust.

61 *E.g.* 1 John A. Barron, Jr. & Lewis Mallalieu Simes, The Law of Future Interests § 82 (3d ed. 2004); 2 Herbert T. Tiffany & Basil Jones, Tiffany on Real Property § 311(a) (2010).

Under this definition, the settlor of a properly drafted DING Trust[62] could not hold a reversion because the settlor presumably would have transferred his *entire* legal interest, not a lesser interest, to a third party trustee. After such a transfer, the settlor becomes a trust beneficiary subject to the trustee's discretion,[63] having an interest in property that does not amount to legal ownership.[64] Support for the argument that section 673 uses the term in this manner—and thus does not cover a settlor's beneficial interest in a DING Trust—can be found in IRS guidance, case law, and legislative history.[65]

2. *Power to Control Beneficial Enjoyment Under Code § 674*

Code § 674 generally triggers grantor trust status when trust property is subject to a power of disposition exercisable by a settlor without "adverse party" approval.[66] An adverse party, for these purposes, is "any person having a substantial beneficial interest in the trust which would be adversely affected by the exercise or non-exercise of the power."[67] Under this definition, beneficiaries of the same trust are adverse to each other with respect to any power over the disposition of trust property, as their respective beneficial interests are diminished upon an exercise of a dispositive power in favor of anyone other than

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62 In a property drafted DING Trust, there are no ascertainable standards for making distributions to the settlor; thus, his or her access to income and principal from the trust depends upon the non-fiduciary direction of a distribution committee.

63 I.R.C. § 673(c) provides that discretionary powers should be assumed to be exercised to maximize the value in favor of the grantor "*in determining whether a reversionary interest has a value in excess of five percent.*" I.R.C. § 673(c) (emphasis added). However, this should not be interpreted to suggest that a discretionary exercise in favor of the grantor can be assumed to determine whether a reversion actually exists. "Rather, the assumption is only made in calculating the value of a traditional reversion, relative to the size of the trust, in applying the five percent exception." Thomas R. Pulsifer, *Taking Advantage of the "Delaware Advantage": Why and How to Settle Trusts in Delaware and Move Trusts to Delaware*, MORRIS, NICHOLS, ARSHT & TUNNELL LLP, Apr. 13 2010, http://www.mnat.com/?assets/?attachments/?208.pdf (concluding that I.R.C. § 673(c) does not operate to create a reversion where none exists under the traditional definition contemplated by Congress).

64 Black's Law Dictionary defines beneficial interest as "[p]rofit, benefit, or advantage resulting from a contract, or the ownership of an estate as *distinct from the legal ownership or control*." BLACK'S LAW DICTIONARY 142 (5th ed. 1979) (emphasis added).

65 For a comprehensive treatment of reversionary interests under I.R.C. § 673, see Pulsifer, *supra* note 63 (concluding that a settlor's retained beneficial interest in a DING Trust does not amount to a reversionary interest).

66 I.R.C. § 674(a) provides, in general, that the settlor shall be treated as the owner of any portion of a trust for which the beneficial enjoyment of the principal or the income is subject to a power of disposition exercisable by the settlor or a non-adverse party or both without the approval or consent of any adverse party.

67 I.R.C. § 672(a).

themselves.[68] The settlor in PLR 201310002 retained three controls that implicate I.R.C. § 674 prohibitions, namely the Settlor's Consent Power, the Settlor's Sole Power, and the Settlor's Testamentary Power.

The Settlor's Consent Power, which allowed the settlor to approve or disapprove trust distributions directed by the Distribution Committee, avoided triggering grantor trust treatment because the committee members, each a beneficiary of the trust, were deemed to be adverse to the settlor under the aforementioned definition.[69] The Settlor's Sole Power, exercisable by the settlor for the health, education, maintenance, and support of his descendants, was dismissed as a grantor trust trigger under an exception to I.R.C. § 674 for powers limited by an ascertainable standard.[70] As for the Settlor's Testamentary Power, it too avoided I.R.C. § 674 under an exception for powers exercisable by will.[71] Thus, in each instance, the settlor's retained powers over the trust escaped grantor trust treatment under I.R.C. § 674.

3. *Power to Revoke the Trust and Revest Trust Property Under Code § 676*

Code § 676(a) provides that a settlor of a trust is treated as the owner, and the trust a grantor trust, if the settlor has the power to revoke it.[72] Code § 676(a) also applies if the settlor's spouse[73] or a non-adverse party, or both, have the power to revest title to trust property in the settlor.[74] In PLR 201310002, the trust was irrevocable;[75] moreover, title to the trust property could only be revested in the settlor in conjunction with the Distribution Committee, which, as already noted, was

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68 An interest in the trust is substantial if "its value in relation to the total value of the property subject to the power is not insignificant." Treas. Reg. § 1.672(a)-1(a) (1960). Generally an interest of a remainderman is only adverse to the exercise of a power over principal. Treas. Reg. § 1.672(a)-1(d) (1960). The interest of an ordinary income beneficiary, however, may be adverse to just a power over income but could also be adverse to a power over principal. Treas. Reg. § 1.672(a)-1(c) (1960). A "non-adverse party" is anyone who is not an adverse party. Treas. Reg. § 1.672(b)-1 (1960).

69 Each possessed "a substantial beneficial interest in the trust which would be adversely affected by the exercise or non-exercise" of the Settlor's Consent Power. I.R.C. § 672(a).

70 PLR 201310002 (Nov. 7, 2012); I.R.C. § 674(b)(5)(A).

71 I.R.C. § 674(b)(3).

72 *See* I.R.C. § 676(a).

73 A consequence of I.R.C. § 672(e).

74 I.R.C. § 676(a).

75 The revocability of a trust is a matter of state law. The Uniform Trust Code section 602 creates a presumption that a trust is revocable unless it expressly provides otherwise. *See* UNIF. TRUST CODE § 602 (2005). 7C U.L.A. 546 (2006). This presumption reverses the common law rule that trusts are presumed irrevocable unless a power to revoke was reserved at the time of creation. *See, e.g.,* 76 AM. JUR. 2D TRUSTS § 71 (2005).

comprised of trust beneficiaries who were adverse to the settlor for income tax purposes. As a result, grantor trust status under I.R.C. § 676(a) was effectively skirted.

4. *Income for the Benefit of the Settlor or Settlor's Spouse Under Code § 677*

Code § 677 triggers grantor trust status when the income of a trust may, without adverse party approval, be distributed to the settlor or the settlor's spouse or be accumulated for future distribution to the settlor or the settlor's spouse. In PLR 201310002, none of these actions could have occurred without the participation of the Distribution Committee, which, as explained above, was deemed to be adverse to the settlor for income tax purposes. Thus, grantor trust status was also avoided under I.R.C. § 677.

5. *Creditor Claims Under Treas. Reg. § 1.677(a)-1(d)*

Under Treas. Reg. § 1.677(a)-1(d), a trust is a grantor trust if its income is applied, or may be applied at the discretion of the settlor or a non-adverse party or both, to discharge the debts of the settlor or the settlor's spouse.[76] Traditional common law principles, followed by a majority of the states, allow a settlor's creditors to reach assets in trust to the maximum extent that the trustee of the trust maintains discretion to make distributions back to the settlor.[77] Thus, a self-settled trust, that is a trust created for the settlor's own benefit, will be deemed a grantor trust in most states because the settlor's beneficial interest could be attached to satisfy the settlor's debts under the common law rule.[78]

There are, however, several states with legislation that abrogates the common law, allowing settlors to establish self-settled asset protection trusts, sometimes referred to as "DAPTs,"[79] with spendthrift provi-

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76 Treas. Reg. § 1.677(a)-1(d).

77 *See, e.g.*, RESTATEMENT (THIRD) OF TR., § 58, § 60 cmt. f.

78 Another way of looking at the situation is that the settlor has indirectly retained the economic access to the trust assets through incurring debts. In the jargon used by the IRS, the settlor can thereby "relegate" his creditors to the trust assets. Rev. Rul. 76-103, 1976-1 CB 293; Rev. Rul. 77-378, 1977-2 CB 347.

79 Asset protection planning using trusts by settlors in the United States were initially only possible under the laws of offshore or foreign jurisdictions; thus, asset protection trusts settled in the United States are known as Domestic Asset Protection Trusts, or "DAPTs."

sions[80] that protect trust assets from settlors' creditors.[81] Accordingly, in such states, absent a fraudulent transfer[82] or defect in implementation,[83] assets in DAPTs are not subject to attachment by creditors.[84] Though not explicit in any ruling, the DING Trusts involved in many of the decisions issued prior to the 2013 PLRs, were, in fact, settled as DAPTs;[85] thus, the taxpayers' beneficial interests were afforded spendthrift protection and a concomitant shield from grantor trust treatment under the regulations.[86]

Following the release of the 2013 PLRs, however, creditor protection afforded by DAPTs settled by nonresidents of DAPT states has been subject to increased speculation. *In re Huber*, a decision of the Bankruptcy Court for the Western District of Washington, relied on Sec-

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80 Black's Law Dictionary defines a spendthrift provision as "[a] condition in trusts barring one or more beneficiaries from pledging or spending benefits before they are received." BLACK'S LAW DICTIONARY 1101 (2d ed. 1910).

81 Current DAPT jurisdictions are Nevada, South Dakota, Ohio, Alaska, Delaware, Tennessee, Rhode Island, New Hampshire, Hawaii, Wyoming, Missouri, Utah, Virginia, Oklahoma, and Colorado. Among them, only Alaska, Delaware, Nevada, South Dakota, and Wyoming impose no income tax on trusts. *See* Nenno, *supra* note 20.

82 A fraudulent transfer occurs when a debtor intends to hinder, delay, or defraud a creditor or transfers property to another person without receiving reasonably equivalent value in return. *See* UNIF. FRAUDULENT TRANSFER ACT §§ 4(a), 5(a).

83 The facts may support an argument that the settlor has, through an implied agreement or other defect in implementation, retained control over the DAPT in a manner that will allow the court to conclude that the requirements of the DAPT statute have not been met. Attacks under this category include the following claims: (1) there were implied agreements between the settlor and the fiduciary, (2) the trust was implemented so that it is merely the "alter-ego" of the settlor, or (3) the trust is a "sham" because of the manner in which it was implemented. David G. Shaftel & David H. Bundy, *Domestic Asset Protection Trusts Created by Nonresidents Settlors*, Estate Planning, (Apr. 2005) *available at* http://shaftellaw.com/?docs/?article_?23.pdf (noting three "general avenues of attack" that a creditor may pursue to reach assets that a settlor has transferred to a DAPT, including (1) choice of law, (2) fraudulent transfer, and (3) improper implementation).

84 It is important to note, however, that most DAPT statutes create a class of exception creditors who may be able to attach the settlor's beneficial interest in the DAPT. Nevada is currently the only state without any exception creditors. *See* Gideon Rothschild, *Asset Protection Planning—Keeping It All in the Family,* 2011 ABATAX-CLE 1022139 (Oct. 22, 2011) (noting that "Nevada is [the] only state which has no exception creditors"). The exception creditor provisions found in every other state generally take the form of carveouts for property settlements of divorcing spouses, alimony, child support, and preexisting tort creditors. *Id.*

85 William D. Lipkind & Steven J. Oshins, *New Private Letter Ruling Approves NING Trust*, THE ULTIMATE ESTATE PLANNER, INC., June 21, 2013, http://ultimateestate planner.com/?lawyer/?New_?Private_?Letter_?Ruling_?Approves_?NING_?Trust_?cp 7987.htm.

86 Treas. Reg. § 1.677(a)-1(d).

tion 270 of the Restatement (Second) of Conflict of Laws[87] to invalidate an Alaska DAPT settled by a Washington resident.[88] The decision of the *Huber* court is considered flawed[89] by many commentators because it ignores Section 541(c)(2) of the Bankruptcy Code, which excludes a debtor's interest in a spendthrift trust from the bankruptcy estate if the trust's spendthrift provisions are enforceable under applicable state law.[90]

To determine which state's spendthrift law applies—that of the settlor's home state or that of the DAPT state—Section 273 of the Restatement (Second) of Conflict of Laws respects the choice expressed by the settlor in the trust instrument.[91] Rather than addressing the enforceability of the trust's spendthrift provision, however, the *Huber* court instead focused on the validity of the trust itself, a broader, less definite, and, arguably contraindicated inquiry,[92] requiring the trust to conform with the public policy of the state with the closest ties.[93] The *Huber* court found that the trust had its most significant relationship with Washington, partially based on the debtor's residence, and concluded,

[87] An inter vivos trust of interests in movables is valid if valid under the law of the state designated by the settlor to govern the validity of the trust, provided that the application of its law does not violate a "strong public policy" of the state with which the trust has its most significant relationship under the principles stated in § 6 of the Restatement. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 270 (1971).

[88] In re Huber, 493 B.R. 798 (Bankr. W.D. Wash. 2013).

[89] *See* Jonathan D. Blattmachr et al., *Avoiding the Adverse Effects of Huber*, TR. & EST., July 2013; *see also*, Gideon Rothschild & Daniel Rubin, *Alaska Asset Protection Trust Deemed Invalid Under Washington Law*, (May 29, 2013) *available at* http://wealth management.com/?asset-protection/?alaska-asset-protection-trust-deemed-invalid-under-washington-law.

[90] "A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title." 11 U.S.C. § 541(a)(1).

[91] "Whether the interest of a beneficiary of an [inter vivos] trust of movables is assignable by him and can be reached by his creditors is determined . . . by the local law of the state, if any, in which the settlor has manifested an intention that the trust is to be administered, and otherwise by the local law of the state to which the administration of the trust is most substantially related." RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 273 (1971).

[92] "[S]ection 270 is specific to the validity of a trust rather than the efficacy of a purported restraint on alienation of beneficial trust interests. With regard to the conflict of laws issue on this latter matter, section 273 of the Restatement (Second) of Conflict of Laws is the applicable authority." Gideon Rothschild et al., *Self-Settled Spendthrift Trusts: Should a Few Bad Apples Spoil the Bunch?,* 9 J. Bankr. L. & Prac. 59 (Nov./Dec. 1999).

[93] *Huber*, 493 B.R. 798.

with little if any substantive analysis,[94] that Washington had a "strong public policy against self-settled asset protection trusts."[95]

Despite the ruling in *Huber*, and even without spendthrift protection, the trust at issue in PLR 201310002 still avoids the prohibitions of Treas. Reg. § 1.677(a)-1(d).[96] As noted above, a trust is self-settled and therefore subject to attachment under the common law rule to the extent that the trustee *must or may* make distributions back to the settlor.[97] The trust in PLR 201310002 restricted the trustee from making any distributions to the settlor unless directed by the Distribution Committee, which, as discussed above, was comprised of non-trustee participants who had no fiduciary obligation to make a distribution to the settlor or otherwise.[98] Consequently, the trust at issue in the PLR was not self-settled and, as such, evades grantor trust status under I.R.C. § 677 regardless of whether the trust's spendthrift protections were enforceable.[99]

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94 In examining Washington's public policy on "self-settled asset protection trusts," the court's analysis was seemingly incomplete, failing to acknowledge or consider that Washington safeguards individual retirement accounts from creditors, an effectively equivalent form of self-settled spendthrift protection. The *Huber* court's public policy analysis also disregarded other forms of "self-settled asset protection," such as life insurance, annuities, homesteads, tenancies by the entirety, and section 529 plans. *See* Robert T. Danforth, *Rethinking the Law of Creditors' Rights*, 53 Hastings L.J. 287, 325, 333–343 (2002) (noting various forms of self-settled spendthrift protection).

95 *See Huber*, 493 B.R. 798 (citing Wash. Rev. Code § 19.36.020 which voids transfers to self-settled trusts with regard to the settlor's existing or future creditors).

96 Though the trust in the 2013 PLRs had a spendthrift clause and was valid under Nevada law, it was not settled as a DAPT.

97 *See supra* text accompanying notes 78-80.

98 "[A] discretionary beneficiary has no contractual or enforceable right to any income or principal from the trust, and therefore the beneficiary cannot force any action by the trustee. *In re Marriage of Jones*, 812 P.2d 1152 (Colo. 1991); G. Bogert, *Trusts and Trustees*, Section 228 (2nd ed. 1979). This is because a court may only review a discretionary trust for abuse and bad faith. There is no reasonableness standard of review by a court with respect to a discretionary trust. Further, the discretionary interest is not assignable. *Id.* In this respect, a discretionary beneficiary's interest is generally not classified as a property interest. Rather, it is nothing more than a mere expectancy. U.S. v. O'Shaughnessy, 517 N.W. 2d 574 (Minn. 1994); *In re Marriage of Jones*, 812 P.2d 1152 (Colo. 1991). If a beneficiary has no right to force a distribution from a trust, then the same rule applies to the beneficiary's creditor. The creditor may not force a distribution. In this respect, whether the assets of a discretionary trust are protected does not depend on spendthrift provisions with respect to the current beneficial interest. . . . [T]he asset protection features of a discretionary trust are much stronger than those of a support trust or a mandatory distribution trust that must rely on spendthrift protection." Mark Merric and Steve J. Oshins, *Effect of the UTC on Asset Protection of Spendthrift Trusts*, Estate Planning Magazine, Volume 31, No. 8, (Aug., Sept., & Oct. 2004).

99 Under Treas. Reg. § 1.677(a)-1(d), a trust is a grantor trust if its income is applied, or may be applied at the discretion of *the settlor or a non-adverse party or both*, to discharge a legal obligation of the settlor or the settlor's spouse. Income (and principal)

C. Settlor's Transfer of Assets Must Be Wholly Incomplete for Gift Tax Purposes

Current federal gift tax rates far exceed the highest state income tax rates. Thus, any potential DING Trust income tax savings would be nullified if a gift tax were assessed upon the trust's funding. A DING Trust is, therefore, only effective for tax planning purposes if the settlor's transfer of assets to the trust escapes gift tax.

Generally, a gratuitous conveyance of property is subject to gift tax when there is an irrevocable transfer of an entire interest in the property such that the transferor has no dominion or control over it.[100] Under the gift tax regulations, this occurs when a transferor can no longer change the disposition of the property.[101] Conversely, if the transferor retains the power to alter the disposition of the property (and never relinquishes that power), then the gift is incomplete.[102] Accordingly, a settlor's ongoing control over a gift in trust can render it incomplete for gift tax purposes.[103]

A series of PLRs from 2001 to 2007 affirmed this result in the DING Trust context, concluding repeatedly that a gift in trust was incomplete due to the settlor's retention of a testamentary limited power of appointment, which enabled the settlor to control the disposition of the trust assets at his or her death.[104] To the chagrin of many tax advisors, the IRS revised its stance on the issue with the 2012 release of

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from the trust at issue in the ruling was only distributable to the settlor upon the direction of the Distribution Committee, which was comprised of adverse parties. Accordingly, there was no way the settlor's legal obligations could be satisfied without the participation of an adverse party.

100 Sanford's Estate v. Comm'r of Internal Revenue, 308 U.S. 39 (1939); *see also* Burnet v. Guggenheim, 288 U.S. 280 (1933).

101 Treas. Reg. § 25.2511-2(c) (1999) ("A gift is also incomplete if and to the extent that a reserved power gives the donor the power to name new beneficiaries or to change the interests of the beneficiaries as between themselves unless the power is a fiduciary power limited by a fixed or ascertainable standard."). Section 25.2511-2(b) provides the general rule as to what is a complete or incomplete gift: "As to any property, or part thereof or interest therein, of which the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit or for the benefit of another, the gift is complete. But if upon a transfer of property (whether in trust or otherwise) the donor reserves any power over its disposition, the gift may be wholly incomplete, or may be partially complete and partially incomplete, depending upon all the facts in the particular case." Treas. Reg. § 25.2511-2(b) (1999).

102 *See* Id.

103 *See Sanford*, 308 U.S. 39 (holding that the retention of control over the disposition of trust property, whether for the benefit of the donor or others, renders the gift incomplete until the power is relinquished).

104 *See, e.g.*, PLR 200647001 (Aug. 7, 2006) (citing Treas. Reg. § 25.2511-2(b) (1999) (stating that if the donor is the discretionary income beneficiary, a retained testamentary power of appointment causes the transfer to the trust to be an incomplete gift)); PLR

Chief Counsel Advice Memorandum 2012-08-026 ("CCA").[105] The IRS therein advanced a more nuanced position, asserting that a gift in trust subject to a retained testamentary power in the settlor was actually a transfer in two parts: (1) a current interest that is complete for gift tax purposes and (2) a remainder interest that is incomplete for gift tax purposes.[106]

Citing extensive authority, the IRS explained that the underlying justification for the refinement in its thinking was that a testamentary power of appointment can only be exercised if the trust property is not distributed before the settlor's death.[107] Consequently, for a gift in trust to be wholly incomplete, as to both its current and remainder interests, the settlor needs to retain controls over the *lifetime and testamentary*

200612002 (Nov. 23, 2005); PLR 200637025 (June 5, 2005); PLR 200502014 (Sept. 17, 2004); PLR 200247013 (Aug. 14, 2002); PLR 200148028 (Aug. 27, 2001).

105 I.R.S. Chief Couns. Adv. Mem. 2012-08-026 (Sept. 28, 2011).

106 It is important to note that a Chief Counsel Advice Memorandum such as this is not "the law" and simply reflects the opinion of the IRS attorney that prepared it. Nevertheless, such memoranda often show how the IRS may consider a particular tax issue in the event of a taxpayer examination.

107 The CCA concluded that retained testamentary powers of appointment over a trust under which the grantors were not beneficiaries cause the *remainder interest* to be an incomplete gift, but concluded that the testamentary powers of appointment relate only to the remainder interest. During the grantors' lifetimes, they had no ability to keep the trustee from making distributions among the potential trust beneficiaries—which might potentially include all of the trust assets. Therefore, the CCA reasoned that the gift was complete as to the "beneficial term interest" that existed before the grantors' deaths—but was an incomplete gift as to the remainder interest. (Treas. Reg. § 25.2511-2(b) states that if the donor is the discretionary income beneficiary, a retained testamentary power of appointment causes the transfer to the trust to be an incomplete gift.) The task then became to determine the relative values of the term interest (a completed gift) and the remainder interest (an incomplete gift). The CCA reasoned that § 2702 applied, and because the retained interest (i.e., the interest passing to "applicable family members") was not a qualified interest, it had to be valued at zero under § 2702. Therefore, the completed gift of the term interest was the full value transferred to the trust. The CCA raised concerns that merely reserving a testamentary limited power of appointment in the grantor may be insufficient by itself to cause the transfer to a DING trust to be an incomplete gift by the grantor.

disposition of the trust estate.[108] As detailed below, the taxpayer in PLR 201310002 did just that.[109]

1. *Testamentary Power of Appointment*

As with the prior PLRs involving DING Trusts,[110] the settlor in PLR 201310002 retained a testamentary limited power of appointment. Contrary to those prior PLRs, however, the IRS applied its reasoning from the CCA and concluded that the Settlor's Testamentary Power amounted to "a retention of dominion and control over the remainder" and was therefore an incomplete gift with respect to the remainder only.[111] Accordingly, the full gift tax effect of the settlor's transfer would depend on the nature and extent of the settlor's other retained controls, specifically those over the disposition of the trust estate during the settlor's lifetime.

2. *Lifetime Powers of Appointment*

Perhaps mindful of the limitations on retained testamentary powers articulated in the CCA, the settlor in PLR 201310002 also reserved two lifetime powers of appointment over the trust, namely, the Settlor's Consent Power and the Settlor's Sole Power.[112] As to each power, the IRS determined that its retention was enough to render the settlor's gift "wholly incomplete" as to both the trust's current and remainder interests.

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108 *Sanford*, 308 U.S. at 43–44 ("[R]etention of control over the disposition of the trust property, whether for the benefit of the donor or others, renders the gift incomplete until the power is relinquished whether in life or at death."); *see also* Diana S.C. Zeydel, *When is a Gift to a Trust Complete—Did CCA 201208026 Get It Right?*, 117 J. TAX. 142 (2012); Steve Akers, *Favorable "DING Trust" Letter Rulings; Confirmation of IRS's Position that Settlor's Retention of Testamentary Power of Appointment Does Not Necessarily Cause Full Transfer to Trust to Be Incomplete Gift*, AM. C. OF TR. & EST. COUNS., June 24, 2013, http://www.actec.org/?public/?Akers_?Favorable_?DING_?Trust_?PLRs_?Musings.asp.

109 PLR 201310002 and its companion rulings affirm the reasoning of the CCA, supporting its conclusion that the retention of a testamentary power causes the transfer of property to the trust to be incomplete "with respect to the remainder" for federal gift tax purposes and, accordingly, complete as to the term interest prior to the termination of the trust without a retained lifetime power over it. PLR 201310002 (Nov. 7, 2012); PLR 201310003 (Nov. 7, 2012); PLR 201310004 (Nov. 7, 2012); PLR 201310005 (Nov. 7, 2012); PLR 201310006 (Nov. 7, 2012).

110 *See, e.g.*, PLR 200928013 (Mar. 12, 2009); PLR 200744020 (June 8, 2007); PLR 200712008 (Oct. 26, 2006); PLR 200449006 (Aug. 11, 2004); PLR 199936004 (May 7, 1999).

111 PLR 201310002 (Nov. 7, 2012).

112 *Id.*

a. *Settlor's Consent Power*

The Settlor's Consent Power, which authorized distributions of income and principal from the trust, could only be exercised by a majority of the Distribution Committee with the consent of the settlor. The IRS concluded that the interests of the Distribution Committee members with respect to the exercise of the power were *not* substantially adverse to the settlor's interest in the exercise of the power.[113] Consequently, the trust's income and principal, which comprised the entire trust estate, remained under the settlor's dominion and control for gift tax purposes.[114]

The irony, of course, is that the IRS had already determined in the same ruling that the interests of the Distribution Committee members, each a beneficiary of the trust, were adverse to those of the settlor, albeit for income tax purposes.[115] The apparent inconsistency in treatment on this point arises from differences in the way adversity is determined for income and gift tax purposes.[116] The IRS posits and summarily dismisses two ostensibly applicable definitions in the gift tax context, both of which are found in Treas. Reg. § 25.2514-3(b)(2).

The first provides that a "taker in default of appointment under a power has an interest that is adverse to an exercise of the power."[117] The trust at issue in PLR 201310002 was distributable among the settlor's descendants upon the settlor's death; thus, the settlor's sons, as descendants and presumed trust remaindermen, would seem to qualify as takers in default. The IRS disagreed, without explanation, leading one prominent commentator to speculate that the status of the sons as takers in default of the Settlor's Consent Power was not assured.[118]

Indeed, by refusing to consent to proposed distributions, the settlor could force accumulations in the trust that would ultimately be subject

113 Treasury Regulations provide that a donor is considered as himself having a power if it is exercisable by him in conjunction with any person not having a substantial adverse interest in the disposition of the transferred property or the income therefrom. Treas. Reg. § 25.2511-2(e) (1999).

114 PLR 201310002 (Nov. 7, 2012) (stating that the settlor is "considered as possessing the power to distribute income and principal to any beneficiary himself because he retained the Grantor's Consent Power").

115 *See* Zeydel, *supra* note 108 (citing numerous regulatory discrepancies between income, gift, and estate tax treatments of powers of appointment).

116 Section 25.2511-2(e) does not define "substantial adverse interest." Treas. Reg. § 25.2511-2(e) (1999).

117 Treas. Reg. § 25.2514-3(b)(2) (1997).

118 Akers, *supra* note 108 ("The ruling gives no explanation as to why the four sons are not deemed to be 'takers in default' if a distribution is not made. Perhaps it is because of Grantor's retained testamentary limited power of appointment, so that none of the four sons could be assured of receiving any undistributed trust assets.").

to the Settlor's Testamentary Power, a control he held exclusively and could exercise to divert the entire trust estate away from the sons or any trust remaindermen. Accordingly, the sons would more aptly be characterized as "takers in default" of the Settlor's Testamentary Power rather than of the Settlor's Consent Power, as their interest in the trust property upon the non-exercise of the Settlor's Consent Power was completely uncertain.

There was no IRS elaboration on this point, and the ruling hastily jettisons its analysis to a second definition of adversity, premised upon the status of the Distribution Committee members as "coholders" with the settlor of the Settlor's Consent Power.[119] In this capacity, the sons would be deemed adverse to the settlor if they were to succeed to the settlor's authority to exercise the power.[120] In other words, the sons needed to inherit the settlor's power to consent to distributions in order to be adverse to him for gift tax purposes.

This was not a possibility under the terms of the trust as the Distribution Committee was set to terminate at the settlor's death.[121] Thus, the ruling concludes that the sons, as committee members, were not adverse to the settlor with respect to the exercise of the Settlor's Consent Power because they would be unable to exercise any committee power, let alone a power held jointly with the settlor, if the settlor were to die.[122] As such, they failed to meet the adversity required of "coholders" under the applicable regulations.

b. *Settlor's Sole Power*

The Settlor's Sole Power gave the settlor exclusive authority to make trust distributions for the health, education, maintenance, and support of his descendants.[123] Though the power was exercisable in a non-fiduciary manner, it precluded the settlor from making distributions for his own benefit and limited distributions to trust principal only, not income.[124] Despite such constraints on its exercise, the IRS determined that the settlor's retention of the Settlor's Sole Power was also enough

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119 PLR 201310002 (Nov. 7, 2012).

120 "A co-holder of the power has no adverse interest merely because of his joint possession of the power nor merely because he is a permissible appointee under a power. However, a co-holder of a power is considered as having an adverse interest where he may possess the power after the possessor's death and may exercise it at that time in favor of himself, his estate, his creditors, or the creditors of his estate." Treas. Reg. § 25.2514-3(b)(2) (1997).

121 PLR 201310002 (Nov. 7, 2012).

122 *Id.*

123 *Id.*

124 *Id.*

to make his transfer of property to the trust "wholly incomplete" for gift tax purposes.[125]

As with the ruling's other determinations, the IRS provides scant analysis to support its position, citing Treas. Reg. § 25.2511-2(c) for the proposition that a gift is incomplete "if and to the extent that a reserved power gives the donor the power to name new beneficiaries or to change the interests of the beneficiaries."[126] A review of the full text of the regulation reveals more language to parse, including a subsequent exception for "fiduciary power[s] limited by a fixed or ascertainable standard."[127] The Settlor's Sole Power, as noted above, is subject to an ascertainable standard,[128] but it is also exercisable in a non-fiduciary manner;[129] thus, it presumably avoids the exception and the gift remains incomplete. The IRS determination is therefore sound on this point despite the ruling's failure to emphasize, or even mention, the importance of the non-fiduciary nature of the retained power.

Also absent from the ruling is an explanation of why the Settlor's Sole Power, which only applies to trust principal, was enough to render both current and remainder interests incomplete. Though such a power could certainly make the transfer incomplete as to trust principal, since it applies to principal, it is unclear how the power is applicable to trust income.[130] It is also uncertain whether the inclusion of the Settlor's Sole

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125 *Id.*

126 *Id.*

127 "A gift is . . . incomplete if and to the extent that a reserved power gives the donor the power to . . . change the interests of the beneficiaries as between themselves unless the power is a fiduciary power limited by a fixed or ascertainable standard." Treas. Reg. § 25.2511-2(c) (1999).

128 That means a "clearly measurable standard under which the holder of a power is legally accountable." Treas. Reg. § 25.2511-1(g)(2) (1997). Examples of fixed or ascertainable standards include "for the education, support, maintenance, or health of the beneficiary; for his reasonable support and comfort; to enable him to maintain his accustomed standard of living; or to meet an emergency." *Id.* Non-fixed or non-ascertainable standards include "pleasure, desire, or happiness of a beneficiary." *Id.* If a power is limited by a reasonably fixed or ascertainable standard, the powerholder can be compelled to exercise his or her discretion in accordance with that standard.

129 "Interestingly, the IRS treats whether a grantor holds a substitution power in a non-fiduciary capacity for purposes of section 675(4)(C) as a question of fact to be determined in each year for income tax purposes. The IRS gave no analysis of whether the Grantor actually held the power in a non-fiduciary capacity as a factual matter." Akers, *supra* note 108.

130 Perhaps the IRS reasoned that if the settlor exercised the Settlor's Sole Power to exhaust the trust of principal, there would be little if any income remaining, an impact that would be felt by the trust's current and remainder beneficiaries. Additionally, under the terms of the trust, any undistributed income was to be accumulated and added to principal. Thus, trust income could in fact be converted to principal and, thereby, ultimately subject to the Settlor's Sole Power. PLR 201310002 (Nov. 7, 2012).

Power is even necessary, as it seems reasonable to conclude that the Settlor's Consent Power alone, as discussed above, would suffice to cause the transfers to the trust to be wholly incomplete for gift tax purposes.[131]

Based on his discussions with the IRS, the attorney who secured PLR 201310002 asserts that the taxpayer at issue would not have received the ruling without the Settlor's Sole Power.[132] Counsel therefore cautions any taxpayer seeking similar results to include the same settlor controls. To heed this admonishment, DING Trusts must be established in DAPT jurisdictions that permit settlors to retain lifetime powers of appointment. Alaska,[133] Delaware,[134] Nevada,[135] Ohio,[136] South Dakota,[137] and Wyoming[138] appear to be the only jurisdictions in which this is possible,[139] and, among them, only Alaska, Nevada, South Dakota, and Wyoming have no income tax on resident trusts.

D. Distribution Committee Members Must Not Hold General Powers of Appointment

A general power of appointment includes any power exercisable in favor of its holder, the holder's estate, the holder's creditors, or the creditors of the holder's estate.[140] Property subject to such a power can be included in the holder's taxable estate at death;[141] and a lifetime release or exercise of the power would itself be considered a taxable trans-

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131 *See* Morris, Nichols, Arsht & Tunnell Tr., Est. and Tax Group, *PLR 201310002 and Its Implications For DING Trusts*, MORRIS, NICHOLS, ARSHT & TUNNELL LLP, Mar. 30, 2013, http://www.mnat.com/?assets/?htmldocuments/?MorrisNichols_?TrustEstates TaxGroup_?AlertPLR_?March%202013.pdf.

132 Lipkind & Oshins, Teleconference, *supra* note 12 (spoken by William D. Lipkind, concerning the utility of including both the Settlor's Consent Power and the Settlor's Sole Power).

133 ALASKA STAT. § 34.40.110(b)(2).

134 DEL. CODE ANN. tit. 12, § 3570(11)b.

135 NEV. REV. STAT. ANN. § 166.040.

136 OHIO REV. CODE ANN. § 5816.05.

137 S.D. CODIFIED LAWS § 55-16-2(2)(b).

138 WYO. STAT. ANN. § 4-10-510(a)(iv)(B).

139 *But see* Robert L. Moshman, *Return of the DING Trusts: With William D. Lipkind, Steven J. Oshins, and Jonathan G. Blattmachr*, THE ESTATE ANALYST, 3, Apr. 2013, http://lawprofessors.typepad.com/?files/?return-of-ding-trusts.pdf (stating that common law applicable to all states could allow the same retained power without exposing trust assets to creditors); *see also* Delaware Qualified Dispositions in Trust Act, DEL. CODE ANN. tit. 12, §§ 3570(11)b.2, 3571 (2011) (prohibiting a settlor's retention of a lifetime power of appointment in order for a self-settled trust to be protected from claims of the settlor's creditors).

140 A general power of appointment is defined in the same way for gift tax purposes under I.R.C. § 2514 and for estate tax purpose under I.R.C. § 2041(a)(2).

141 I.R.C. § 2041(a)(2).

fer.[142] Accordingly, DING Trusts must not contain committee controls that could be characterized as general powers of appointment; otherwise, any assets subject to such controls would be included in the estates of the committee members at their respective deaths[143] and taxed as gifts if distributed during their lifetimes.[144]

A 2007 IRS News Release ("IRS Release") questioned whether DING Trust committee members, by virtue of their ability to direct trust income and principal among themselves, possessed general powers of appointment.[145] Though the IRS Release was refuted by many prominent members of the estate planning bar,[146] it nonetheless caused DING Trusts to fall out of favor among those who feared unintended estate and gift tax liabilities attendant with their use.[147] The 2013 PLRs laid these concerns to rest, citing two statutory exceptions to the definition of a general power of appointment under which the Distribution Committee powers were effectively vindicated.

1. *Statutory Exceptions Under Code §§ 2514(c)(3)(A) and (B)*

The first exception, under I.R.C. § 2514(c)(3)(A), applies to powers that the holder can only exercise in conjunction with the person who

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142 I.R.C. § 2514(b).

143 I.R.C. § 2041(a)(2).

144 *Id*.

145 I.R.S. News Release IR-2007-127 (July 9, 2007) (questioning whether their DING Trust rulings were consistent with Rev. Rul. 76-503, 1976-2 C.B. 275 and Rev. Rul. 77-158, 1977-1 C.B. 285 which indicate that "because the committee members are replaced if they resign or die, they would be treated as possessing general powers of appointment").

146 The ABA Real Property, Trust and Estate Law Section submitted written comments to the IRS in 2007. Letter from the Am. Bar Ass'n Real Prop., Tr. & Est. L. Sec. to the IRS, *Incomplete Gift Response* (Sept. 26, 2007), *available at* http://www.americanbar.org/?content/?dam/?aba/?publications/?rpte_ereport/?2007/?october/?comments_?on_?private_?letter_?rulings.authcheckdam.pdf. The authors of the comments conclude that the applicable PLRs are not inconsistent with Revenue Rulings 76-503 and 77-158, citing various distinctions and asserting that the joint power-holders in the DING rulings have more adversity to each other than do the joint power-holders in the revenue rulings. They also point out that the regulation at issue does not necessarily require succession to a power on the power-holder's death to create adversity; it merely gives that as an additional way that a joint power-holder can be deemed to be adverse if his only interest in the trust is as a co-holder of a power. In addition, they reason that no one can have a general power of appointment over property the transfer of which is incomplete, addressing a revenue ruling, a case, and several PLRs that are arguably inconsistent with that proposition.

147 Many intrepid taxpayers continued to establish DING Trusts, incorporating modifications suggested by comments to the IRS Release. Morris, Nichols, Arsht & Tunnell Tr., Est. and Tax Group, *supra* note 131.

created the power.[148] As already noted, members of the Distribution Committee in PLR 201310002 could direct trust distributions among themselves in two ways: (1) by exercising the Settlor's Consent Power, which required the settlor's approval, or (2) by exercising the Unanimous Member Power, which did not. The IRS concluded that the Settlor's Consent Power fit within I.R.C. § 2514(c)(3)(A), as it could only be exercised in conjunction with the settlor, the power's creator. Accordingly, the Settlor's Consent Power could not be deemed a general power of appointment.

Exercise of the Unanimous Member Power, on the other hand, did not require the settlor; thus, it did not fit within the first exception. It was therefore evaluated pursuant to the second exception, found in I.R.C. § 2514(c)(3)(B), which exempts from the definition of a general power of appointment any jointly-held powers subject to an adverse interest upon exercise.[149] Adversity, for these purposes, arises under the applicable regulations when joint holders succeed to each other's interest in the power and can continue to exercise it in their own favor after the death of a fellow power-holder.[150]

Stated differently, and within the context of the 2013 PLRs, an adverse interest under I.R.C. § 2514(c)(3)(B) is present with respect to the Unanimous Member Power when a member of the Distribution Committee dies and leaves his ability to exercise the power to the remaining members. The surviving members are adverse to the deceased committee member because they inherit the deceased's power to direct a distribution of trust property, a right that enhances their own interest because it provides them with a greater say over how and when a distribution is made. The IRS attempted to illustrate the conceptual benefits of this survival right in PLR 201310002 by citing the following example from the regulations:

> [I]f X, Y, and Z held a power jointly to appoint among a group of persons which includes themselves and if on the death of X the power will pass to Y and Z jointly, then Y and Z are considered to have interests adverse to the exercise of the power in favor of X. Similarly, if on Y's death the power will pass to

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148 I.R.C. § 2514(c)(3)(A) provides that a power is not deemed a general power of appointment for gift tax purposes if the possessor of the power can only exercise it in conjunction with the person who created it.

149 "A co-holder of the power has no adverse interest merely because of his joint possession of the power nor merely because he is a permissible appointee under a power. However, a co-holder of a power is considered as having an adverse interest where he may possess the power after the possessor's death and may exercise it at that time in favor of himself, his estate, his creditors, or the creditors of his estate." Treas. Reg. § 25.2514-3(b)(2).

150 *Id.*

> Z, Z is considered to have an interest adverse to the exercise of the power in favor of Y.[151]

In this illustration, Y and Z are adverse to X because on X's death, Y and Z have the opportunity to benefit economically. Adversity thereby arises when committee members, as joint holders of a power, can financially gain at the expense of each other by increasing their ability to influence the exercise of that power in their own favor.[152] Conversely, joint holders of a power are not adverse to each other when a holder's share of the power is passed to a third party upon that holder's death. In other words, there is no adversity for the remaining committee members when a third party succeeds to a deceased committee member's position because the remaining committee members retain the same proportion of power to distribute the trust assets to themselves that they had before their fellow committee member's death.

Though confirmed by counsel to the taxpayer in the ruling, the fact that the sons were not automatically replaced on the committee at death was not explicit in the PLR;[153] however, it was this fact that fit the ruling within the exception illustrated by the example.[154] Thus, without the possibility of increasing power posed by the right of survival, there would have been no adversity among the initial members of the Distribution Committee, and their interests in the exercise or non-exercise of the Unanimous Member Power presumably would have been deemed general powers of appointment.[155] Stated differently, the Distribution Committee members were adverse to each other with respect to the Unanimous Member Power because they were able to inherit each other's ability to exercise the power.[156]

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151 PLR 201310002 (Nov. 7, 2012) (citing an example set forth in Treas. Reg. § 25.2514-3(b)(2)).

152 *See* Treas. Reg. § 25.2514-3(b)(2).

153 Lipkind, *DING Redux*, *supra* note 19 (confirming that members of the Distribution Committee were not replaced at death unless and until the committee was reduced to two members).

154 *See* PLR 201310002 (Nov. 7, 2012) (citing an example set forth in Treas. Reg. § 25.2514-3(b)(2)).

155 The taxpayers in the 2013 PLRs did not request a determination as to whether the Distribution Committee, when reduced to two members and subject to automatic replacement, would be deemed to hold general powers of appointment; thus, the 2013 PLRs are silent with regard to the issue. Presumably, however, if outgoing members of a DING Trust committee of any size were automatically replaced, under the logic of the IRS Release, and the authority cited therein, they would be deemed to possess general powers of appointment. *See generally*, Lipkind, *DING Redux*, *supra* note 19.

156 Vacancies on the Distribution Committee were not filled until the committee dwindled to two members. The 2013 PLRs did not address the tax treatment of the Unanimous Member Power in this situation.

Accordingly, neither the Settlor's Consent Power nor the Unanimous Member Power could be a taxable general power of appointment as both were specifically excepted from its statutory definition. As a result, any trust property contributed by the settlor to a DING Trust presumably remains within the settlor's taxable estate, as opposed to becoming a part of the estates of the committee members, since the trust property was initially subject to an incomplete transfer by the settlor for gift tax purposes.[157] Though logic seemingly dictates this outcome, there is no authority for it other than the 2013 PLRs, which went on to conclude that any subsequent distribution to a trust beneficiary would complete the settlor's original transfer to the trust unless the distribution were made back to the settlor, in which case it would be considered a non-taxable return of property which had never left the settlor's dominion and control.[158]

2. *The Shrinking Committee Dilemma*

Under the reasoning of the 2013 PLRs, as explained above, so long as outgoing members of the Distribution Committee were not automatically replaced and the committee was allowed to decrease in size, holders of the Unanimous Member Power would be deemed adverse with respect to an exercise of the power.[159] This "shrinking committee" structure, which follows the example set forth in I.R.C. § 2514(c)(3)(B), prevents the Unanimous Member Power from meeting the definition of a general power of appointment. Under the facts of the 2013 PLRs, however, if the Distribution Committee were to dwindle to two members, not counting the settlor, the trust required an automatic replacement of outgoing committee members in order to maintain a two-member minimum.

In such circumstances, the Distribution Committee would no longer meet the "shrinking committee" requirement and the Unanimous Member Power presumably would be deemed a general power of appointment. DING Trust committees that fall to two members under such facts, thereby face a transfer tax dilemma, as any subsequent actions with a bearing upon the power, including the expansion or termination of the committee itself, could be considered an exercise or release sub-

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157 A "fundamental precept of gift and estate taxation" is that "no one may be deemed to have a general power until the transfer that creates the power is complete for gift and estate tax purposes." *See* Letter from the Am. Bar Ass'n Real Prop. Tr. & Est. L. Sec. to the IRS, supra note 146 (distinguishing Rev. Rul. 67-370, 1967-1 C.B. 324; Johnstone v. Comm'r, 76 F.2d 55 (9th Cir. 1935); PLR 200101012 (Sept. 30, 2000); PLR 200210051 (Dec. 10, 2001); PLR 200403094 (Sept. 24, 2003); and PLR 200604028 (Sept. 30, 2005)).

158 *See supra* note 103.

159 *See* Treas. Reg. § 25.2514-3(b)(2).

ject to taxation.[160] Though there is no authority on point, as the 2013 PLRs left this scenario unaddressed, there are essentially two alternatives that can prevent or alleviate the potential tax triggered by the Unanimous Member Power.

The first option requires the settlor to vest committee members with the authority to appoint successor members. Assuming there are additional trust beneficiaries who are eligible to serve, the committee's self-perpetuation through such a power could be accomplished by the agreement of the remaining committee members, with or without the settlor's consent, to prevent the committee from reaching its two-member minimum, thereby preempting the conversion of the Unanimous Member Power into a general power of appointment. Accordingly, the power to fill vacancies should be exercised while the committee has three or more members serving, or else the Service could argue that the appointment of a new member constitutes a taxable release.[161]

The second option, which would apply if there were no additional trust beneficiaries eligible to serve on the committee, requires the trust to be collapsed by having its assets distributed back to the settlor.[162] Under the 2013 PLRs, there would be no gift tax consequences with this option because, as noted above, the IRS determined that a distribution to the settlor would be considered a return of property that had never left the settlor's dominion and control.[163] Other than the 2013 PLRs, however, there is no binding precedent for this stance;[164] thus, a settlor seeking to rely on it must secure a similar determination from the IRS.

Even without a ruling, it is unlikely that the IRS would litigate the gift tax consequences of a return distribution of trust property to a settlor who, for gift and estate tax purposes, never parted with ownership of it.[165] Indeed, such an argument in the DING Trust context would

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160 Under I.R.C. § 2514(b), the release of a general power of appointment is a taxable transfer. Thus, if Distribution Committee members are deemed to hold a general power of appointment, any subsequent action that relieves them of the power could be deemed a release that would be subject to gift tax.

161 IRC § 2514(b) ("The *exercise or release* of a general power of appointment created after October 21, 1942, shall be deemed a transfer of property by the individual possessing such power.") (emphasis added).

162 The settlor could use the returned assets to settle a new DING Trust with an expanded class of beneficiaries who would be eligible to serve on a new committee.

163 *See supra* note 103.

164 I.R.C. § 6110(j)(3).

165 "We think the conclusion reached in the PLRs that no member of the Distribution Committee holds a general power of appoint also is correct because we think that no one may be deemed to have a general power until the transfer of the property subject to the power is complete for gift or estate tax purposes. We think this is a fundamental precept of gift and estate taxation." Letter from the Am. Bar Ass'n Real Prop. Tr. & Est. L. Sec. to the IRS, *supra* note 146.

also require the IRS to maintain that distributions to beneficiaries, other than the settlor, simultaneously constitute a taxable gift of the *same property* to the *same person* at the *same time* by both the settlor and the members of the Distribution Committee.[166] This seems untenable and arguably contravenes the logical dictates of gift and estate taxation[167] and related IRS authority.[168]

III. Summary

The 2013 PLRs affirm the viability of DING Trusts as an option for those seeking to manage income tax liability at state and local levels. Though PLRs cannot be cited as precedent,[169] when the facts of a PLR are substantially similar to one's own circumstances, it is reasonable from a practical perspective to rely upon the ruling as a means of assessing IRS sentiment on the issues presented. Thus, based upon applicable PLRs, which include those dating back to 2001, taxpayers seeking the benefits of a DING Trust must be mindful of the following factual bases for success:

1. Threshold Jurisdictional Considerations:

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166 Todd Flubacher & Scott D. Goodwin, *Dinged, But Not Dented*, Tr. & Est., July 2013 (noting the "anomalous and unprecedented results" of such an argument as summarized by the Delaware Bankers Association and the Delaware State Bar Association in response to the 2007 IRS Release (citation omitted)).

167 *See supra* note 165.

168 "We think that an exercise in favor of the grantor by either or both members of the Distribution Committee should not be treated as a gift by either of them. We believe this conclusion is supported by Treas. Reg. § 25.2511-2(f) which specifies that no completed gift occurs with respect to property subject to the taxpayer's power of amendment unless it is distributed to a person "other than the donor." We do not believe Rev. Rul. 67-370, discussed below, forecloses such a construction of Treas. Reg. § 25.2511-2(f) because in that revenue ruling, and unlike the situations in the PLRs, the grantor was not a permissible recipient of the property involved, a circumstance required by the regulation to avoid a completed gift. We recognize that [Treas. Reg. § 25.2511-2(f)] may be read as determining only whether the grantor would be deemed to make a gift if the property were distributed to the grantor. But, in our view, it suggests that no one would be deemed to have made a gift by the distribution to the grantor of property with respect to which the grantor's gift was incomplete. We also believe that the regulation implies that, because the grantor/donor would be treated as making a competed gift upon the distribution of trust property to someone other than the grantor, no one else could be treated as making a completed gift by virtue of such a distribution. Nevertheless, we acknowledge that one item of published guidance (Rev. Rul. 67-370), one case (Johnstone) and four private letters rulings (PLRs 200101012, 200210051, 200403094, 200604028) might be viewed as inconsistent with our view. But correctly analyzed, they are not, in our judgment, inconsistent." Letter from the Am. Bar Ass'n Real Prop. Tr. & Est. L. Sec. to the IRS, *supra* note 146.

169 I.R.C. § 6110(j)(3).

a. The settlor must not reside in a jurisdiction that taxes the accumulated income and capital gains of an out-of-state non-grantor trust;[170] and

b. The trust must be settled in a no-tax state using low-basis assets, or a portfolio of investments, that would not be considered source income by the settlor's state of domicile.[171]

2. *To Prevent Grantor Trust Status*:

a. The trust must be irrevocable[172] and its income must be protected from the debts and legal obligations of the settlor and the settlor's spouse;[173] and

b. A committee of beneficiaries,[174] excluding the settlor and the settlor's spouse, must be empowered to direct the trustee to make distributions of income and principal among themselves, the settlor, and, if desired, the settlor's spouse.[175]

3. *To Avoid Gift Tax Upon Funding*:

a. The settlor must retain a lifetime power to consent to distributions of income and principal among beneficiaries, including the settlor and settlor's spouse, as directed by the committee;[176]

b. The settlor must retain a lifetime power to appoint principal among beneficiaries other than the settlor, but only if it is exercisable in a non-fiduciary manner and subject to an ascertainable standard;[177] and

c. Though not required, the settlor may also retain a limited testamentary power of appointment in order to control the disposition of the trust assets at death.[178]

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170 *See supra* Section II.

171 *See supra* Section II.A.1.

172 *See supra* Section II.B.

173 *See supra* Section II.B.

174 If a minor is appointed to the distribution committee, then a guardian may be appointed to act on the minor's behalf. This was established in March of 2014, when the IRS released ten PLRs approving a particular incomplete gift non-grantor trust that involved the appointment of guardians to act on behalf of minors seated on the trust's distribution committee. PLR 201410001 (Oct. 21, 2013); PLR 201410002 (Oct. 21, 2013); PLR 201410003 (Oct. 21, 2013); PLR 201410004 (Oct. 21, 2013); PLR 201410005 (Oct. 21, 2013); PLR 201410006 (Oct. 21, 2013); PLR 201410007 (Oct. 21, 2013); PLR 201410008 (Oct. 21, 2013); PLR 201410009 (Oct. 21, 2013); PLR 201410010 (Oct. 21, 2013).

175 *See supra* Sections II.B.

176 *See supra* Section II.C.2.a.

177 *See supra* Section II.C.2.b.

178 *See supra* Section II.C.1.

4. To Prevent Committee Members From Holding General Powers of Appointment:

a. There should be at least three beneficiaries on the committee in addition to the settlor who may also serve but is not required;[179]

b. The committee should terminate at the settlor's death or if there are ever fewer than two members, neither of whom may be the settlor or the settlor's spouse;[180]

c. The committee members should be able to name additional trust beneficiaries to the committee by unanimous agreement, with or without the consent of the settlor;[181] and

d. Committee members who die, resign, or otherwise cease to serve should not be automatically replaced; however, remaining members must promptly fill committee vacancies to prevent the committee from reaching its two-member minimum.[182]

If these structural safeguards are kept and a DING Trust is effectively implemented, its benefits can be significant. As an irrevocable spendthrift trust subject to a purely discretionary standard, the DING Trust can be used to protect assets from potential future creditor claims, including those arising from divorce, alimony, child support, and torts.[183] These protections are enhanced, if not altogether eclipsed, by the trust's prospective state and local tax savings.

Example:

> A New Jersey taxpayer, already in the top tax brackets, anticipates $20 million in long-term gains from the sale of his stock in a family-owned business. He has other assets that maintain his current lifestyle; thus, he would only need access to the sales proceeds in an emergency. He is divorced with

179 Theoretically, the committee could consist of a single member if that member met adversity requirements for income tax purposes; however, a committee of one would effectively hold a general power of appointment for gift and estate tax purposes. Consequently, a single member could abscond with the entire trust estate. Moreover, the creditors of a single member would have potential access to the assets of the trust. Due to these concerns, a multi-member committee is preferred. In the example set forth by the IRS in the 2013 PLRs, there were three members, a committee that fit squarely within the proscriptions of Treas. Reg. § 25.2514-3(b)(2). Accordingly, a multi-member committee of at least three trust beneficiaries would appear to be ideal. *See also supra* Section II.D.1.

180 *See supra* note 60.

181 *See supra* Section II.D.2.

182 *See* Id.

183 *See supra* Section II.B. 5.

three adult children, all liability-prone professionals with modest incomes. Having been sued before, the taxpayer is fearful of future lawsuits, as well as of another divorce if he were to remarry.

Under these circumstances, the DING Trust would be an appropriate solution. The taxpayer and his children can receive discretionary distributions from the trust, subject to the direction of a committee on which they could each be seated. While in trust, the assets will be protected from each beneficiary's subsequent creditors, including divorcing spouses and tort claimants.[184]

As for the tax consequences, the following table summarizes the results of an outright sale by the taxpayer versus a sale by a DING Trust settled in Nevada.[185]

	Without DING Trust	With DING Trust
Gain from Sale	$20,000,000	$20,000,000
20% Federal Capital Gains Tax[186]	($4,000,000)	($4,000,000)
3.8% Medicare Surtax[187]	($760,000)	($760,000)
8.97% New Jersey State Income Tax[188]	($1,794,000)	$0
After-Tax Proceeds[189]	$13,446,000	$15,240,000
Tax Savings	$0	$1,794,000

[184] The purported protections of a DAPT for assets contributed to it are effective after the requisite statute of limitations has been met. In Nevada, DAPT assets are protected from future creditors after the greater of two years from the date of transfer to the trust or six months from the date the creditor discovered or should have discovered the transfer to the trust with respect to preexisting creditors. *See* Nev. Rev. Stat. §§ 166.010-166.170.

[185] The after-tax totals in the table are simple calculations based on the referenced rates of taxation. The table is for illustrative purposes only and does not account for the interaction between such taxes for purposes of deduction on federal, state, and local tax returns.

[186] *See supra* note 1.

[187] *See supra* note 2.

[188] New Jersey treats capital gains as ordinary income, so the top tax rate on capital gains is 8.97%. N.J. Stat. Ann. § 54A:2-1(b)(5).

[189] This is before accounting for any local tax. Such tax would represent additional tax savings attained through using a DING trust.

> Federal tax on the gains would be about the same in the trust as it would be if the taxpayer owned the assets outright;[190] however, the trust, as a Nevada tax resident, will escape New Jersey state and local taxes, creating a savings of at least $1,794,000 upon the sale.[191] If those after-tax proceeds were then invested (and New Jersey source income were avoided), the effective rate of tax on the trust's subsequent investment income would be 23.8%, in contrast to 30.4% in the hands of the taxpayer.[192] Thus, not only would the trust yield more in the year of the sale, it could serve as a tax-advantaged investment vehicle throughout its duration, providing the taxpayer and his family with asset protection and significantly more value by the end of its term.

IV. Conclusion

The DING Trust has obvious appeal to taxpayers facing state level taxation on sizeable income-producing securities portfolios and those who anticipate a sale of highly appreciated low basis assets, such as an interest in a closely held business. Thanks to the 2013 PLRs, advisors may now recommend the DING Trust with greater confidence in its tax consequences; however, for added certainty, taxpayers who implement a DING Trust should be encouraged to request their own private letter

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190 Pursuant to I.R.C. § 1015(b), a trust's basis in any property transferred to it by its settlor is the same as the settlor's basis in that property, increased in the amount of gain or decreased in the amount of loss recognized by the settlor upon the transfer. With a DING Trust, no gain or loss is recognized upon funding because the trust is settled gratuitously, albeit incomplete for gift tax purposes; thus, carryover basis applies. Under I.R.C. § 1223(2), the holding period of each capital asset transferred includes the holding period of the asset as held by the settlor immediately before the transfer. Accordingly, the settlor's basis, under I.R.C. § 1015(b), and holding period, under I.R.C. § 1223(2), in any capital assets should carryover to the DING Trust.

191 For 2013, the 20% long-term capital gains rate applies when trust taxable income exceeds $11,950. I.R.C. § 1(h)(1)(D); ATRA, Pub. L. No. 112-240, 126 Stat. 2313 (2013); Rev. Rul. 2013-15, I.R.B 2013-5, 444. Compare this with the tax situation of an individual, in which the same income tax bracket kicks in at $400,000 of taxable income ($450,000 for married couples filing jointly). Thus, when planning with a DING Trust, advisors must weigh the balance of the state tax savings against the federal tax resulting from the income being taxed to the trust as opposed to an individual, especially given compressed trust rate brackets and the 3.8% Medicare Surtax. This can be remedied, in part, by drafting the trust with flexibility to enable the trustee to make distributions to beneficiaries in lower income tax brackets to minimize both federal and state income taxation.

192 *See* Pomerleau, *supra* note 3 (citing the "marginal effective tax rate" for residents of New Jersey which accounts for the combination of federal, state, and local taxes, as well as deductions at each level).

rulings. By securing a PLR, the taxpayer is assured that any ruled-upon positions taken on a tax return will be upheld.

An IRS ruling will also reduce the chance that a transaction involving a DING Trust will be challenged in future IRS audits. Even though PLRs are not binding at the state level, the DING Trust's state tax benefits effectively ride on its federal tax status;[193] and because the IRS has no revenue stake in the underlying state tax consequences, a favorable advance ruling on the issues presented by a DING Trust is more likely with federal tax authorities than with state level counterparts. Thus, in the DING Trust context, PLRs are the preferred means of protecting a taxpayer's interests.[194]

Of course, there is no protection for overly aggressive taxpayers who may seek to abuse the DING Trust. Accordingly, settlors should be cautioned to avoid funding such trusts with assets required for daily living[195] or those that are likely to be sold shortly after the trust is settled, especially if negotiations for the sale are completed before the trust is set up. A distribution of all, or a significant portion, of the trust assets back to the settlor after such a sale is equally suspect and should also be discouraged.[196]

In addition to creating a risk of challenge as a sham or step transaction for tax purposes, evidence suggesting that the settlor prearranged a return distribution of trust property could jeopardize the trust's creditor protections, which, as already noted, would trigger grantor trust status

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[193] With respect to grantor trusts, states' income tax laws generally conform to the federal definitions of income. Redd, *supra* note 29, at 1; Virginia F. Coleman, *Update on Planning with Grantor Trusts*, 55 TUL. L. SCH. ANN. INST. ON FED. TAX'N 9-1, 9-9 (2007); William Forsberg, *State Income Tax of Trusts Holding Business Interests*, AM. BAR ASS'N, 5, Oct. 21, 2011, http://www.americanbar.org/?content/?dam/?aba/?events/?taxation/?tax iq-fall11-steinert-trusts-paper.?authcheckdam.pdf. States similarly follow the federal classification of entities in most cases. As a result, trust income that is taxable to the grantor for federal purposes will generally be taxed to the grantor for state purposes as well. This is effectively the rule in all states that tax trusts with the exceptions of Pennsylvania and Tennessee, which do not follow the federal grantor trust rules at all, and the District of Columbia and Louisiana, which tax the grantor only in limited circumstances. *See* Nenno, *supra* note 20.

[194] A backup to the PLR is a formal tax opinion letter. Though the taxpayer will still be responsible for any taxes owed, an opinion letter may help the taxpayer avoid possible fraud or underpayment charges as well as the burden of any related penalties and fees.

[195] When a gratuitous transfer of assets is made, whether outright or in trust, and the transferor does not retain enough to pay existing and foreseeable creditors, a fraudulent transfer has occurred and it may be undone. Thus, candidacy for a DING Trust requires an existing and foreseeable surplus of assets over liabilities. Anyone who has—or is about to incur—a large obligation and wants to hide assets to avoid paying it, should be disqualified from consideration and appropriately admonished.

[196] Advisors should generally recommend that the trust be created with the intent to continue it for the lifetime of the settlor.

and subject the trust's income to taxation in the settlor's state of domicile.[197] As a consequence, the settlor would be deprived of the DING Trust's most desired benefits and could be subject to penalties and additional fees to boot. Thus, as with any tax or creditor protection strategy, DING Trusts must be implemented under the supervision of knowledgeable counsel.

As detailed throughout this article, there are varying state laws and nuanced technical requirements impacting the DING Trust. Accordingly, each of its provisions needs careful analysis to ensure not only that the trust complies with the applicable legal authority but also that it comports with the client's overall intent, taking into account the practical considerations involved in the drafting of any estate planning document. Assuming the settlor implements the DING Trust under circumstances that withstand due diligence, the DING Trust can be a powerful technique for reducing or eliminating state and local income tax exposure.

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197 *See supra* Section II.B.5.