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THE USE OF ASSET PROTECTION TRUSTS FOR TAX PLANNING PURPOSES

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I. Creating a Delaware Asset Protection Trust.

What follows is a summary of the relevant issues to consider when drafting a Delaware asset protection trust under the Qualified Dispositions in Trust Act, 12 Del. C. § 3570, et. seq., (the “Act”). Included are the requirements for creating a trust (a Delaware asset protection Trust) under the Act, prohibited powers which the grantor may not retain under the Act, permissible powers which the grantor may retain under the Act and who may defeat a Delaware asset protection trust.

A. Requirements To Create A Delaware Asset Protection Trust.

There are six requirements to create a Delaware asset protection trust under the Act. These requirements are as follows:

1. A disposition by a transferor by means of a trust instrument. 12 Del. C. § 3570(7).
2. The trust instrument must appoint a qualified trustee within the meaning of 12 Del. C. § 3570(8). 12 Del. C. § 3570(11).
3. The qualified trustee must maintain or arrange for custody in Delaware of at least some of the trust assets, maintain records for the trust on an exclusive or non-exclusive basis, prepare or arrange for the preparation of fiduciary income tax returns for the trust or otherwise materially participate in the administration of the trust. 12 Del. C. § 3570(8)b.
4. The trust must provide that Delaware law governs the validity, construction and administration of the trust. 12 Del. C. § 3570(11)a.
5. The trust must be irrevocable. 12 Del. C. § 3570(11)b.
6. The trust must contain a spend-thrift clause which should make reference to the Bankruptcy Code. 12 Del. C. § 3570(11)c.

B. Prohibited Grantor Powers.

There are several powers that are impermissible for the grantor to retain under the Act. These powers include:

1. The grantor may not serve as trustee of the trust. 12 Del. C. § 3570(8)a. & (8)c.
2. The grantor may not serve in an advisory position (including as a trust protector or distribution adviser) provided the grantor may serve as investment adviser for the trust. 12 Del. C. § 3570(8)d. & 12 Del. C. § 3571.

3. The grantor may not retain the power to direct distributions from the trust. 12 Del. C. § 3570(8)d. & 12 Del. C. § 3571.
4. The grantor may not demand a return of assets transferred to the trust. 12 Del. C. § 3571.

C. Permissible Powers Retained by Grantor.

The Act permits the grantor to retain a variety of powers. These powers include:

1. The grantor may serve as investment adviser for the trust and as such retain the right to consent to or direct investment decisions. 12 Del. C. § 3570(8)d.
2. The grantor may retain the power to veto distributions of income or principal from the trust. 12 Del. C. § 3570(11)b.1.
3. The grantor may appoint advisers who have authority to remove and appoint qualified trustees or trust advisers, advisers who have authority to direct, consent to or disapprove distributions from the trust and advisers described in 12 Del. C. § 3313. 12 Del. C. § 3570(8)c.
4. The grantor may retain the power to remove and replace trustees or trust advisers. 12 Del. C. § 3570(11)b.7.
5. The grantor may retain a limited power of appointment exercisable by will or other written instrument effective upon the grantor's death. 12 Del. C. § 3570(11)b.2.
6. The grantor may retain the ability to receive income or principal pursuant to broad discretion or a standard as determined by Delaware trustees, non-Delaware trustees and/or advisers. 12 Del. C. § 3570(11)b.6.
7. The grantor may retain the right to receive mandatory income distributions. 12 Del. C. § 3570(11)b.3.
8. The grantor may retain an interest in a CRT or a QPRT. 12 Del. C. § 3570(11)b.4.
9. The grantor may receive up to a 5% interest in GRAT, GRUT or total-return uni-trust. 12 Del. C. § 3570(11)b.5.
10. The grantor may retain the potential or actual use of real property held under a qualified personal residence trust or the possession and enjoyment of a qualified annuity interest within the meaning of Treasury Regulations § 25.2702-5(c)(8). 12 Del. C. § 3570(11)b.5.

11. The grantor may retain the right to receive income or principal from the trust to pay income taxes due on the income of the trust provided that the trust instrument expressly provides for the payment of such taxes and the potential or actual receipt of income or principal would be at the trustee's discretion, or pursuant to a mandatory direction in the trust instrument, or the discretion of an adviser. 12 Del. C. § 3570(11)b.9.
12. The grantor may retain the right to receive income or principal from the trust to pay, after the death of the grantor, all or any part of the debts of the grantor outstanding at the time of the grantor's death, the expenses of administering the grantor's estate, or any estate or inheritance tax imposed on or with respect to the grantor's estate. 12 Del. C. § 3570(11)b.10.

D. Who May Defeat An Asset Protection Trust?

There are four categories of creditors who may defeat a Delaware asset protection trust and as such reach the trust assets to satisfy a judgment. The Act requires that any action involving a Delaware asset protection trust be brought in the Delaware Court of Chancery. 12 Del. C. § 3572(a). The following four categories of creditors may defeat a Delaware asset protection trust:

1. A creditor whose claim arose before the creation of the trust provided the claim is brought within four years after the creation of the trust or, if later, within one year after the creditor discovered (or should have discovered) the trust and the claim is proven, by clear and convincing evidence, that the creation of the trust was a fraudulent transfer. 12 Del. C. § 3572(b)(1).
2. A creditor whose claim arose after the creation of the trust provided the claim is brought within four years after the creation of the trust and the creditor proves, by clear and convincing evidence, that the creation of the trust was a fraudulent transfer. 12 Del. C. § 3572(b)(2).
3. A person whose claim results on account of an agreement or court order for the payment of support or alimony for the grantor's spouse, former spouse or children, or for a division or distribution of property in favor of the grantor's spouse or former spouse. 12 Del. C. § 3573(1). Only a spouse who is married to the grantor before the trust was created may avail himself or herself of such right. 12 Del. C. § 3570(9).
4. A person who suffers death, personal injury or property damage on or before the date the trust was created for which the grantor is liable. 12 Del. C. § 3573(2).

II. Completed Gift Asset Protection Trusts.

On December 17, 2010, President Obama signed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the "2010 Tax Act"). The 2010 Tax

Act increased the federal gift tax exemption and generation-skipping transfer (GST) tax exemption to \$5 million per person for calendar years 2011 and 2012. As a result, clients are presented with a unique estate planning opportunity over the next two years to transfer significant amounts of wealth out of their estate without the imposition of transfer taxes. However, even the wealthiest clients are often concerned with giving such large amounts of money away based on the fear that they may need access to assets in the future.

One option that clients may have is to create a trust in a jurisdiction such as Delaware which allows for self-settled asset protection trusts. A client can make a transfer to a trust established in such a jurisdiction, to which the client allocates gift tax exemption, that provides that the trustee may distribute income and principal from the trust to a class of beneficiaries, that includes the client, in the sole and absolute discretion of the trustee. The client can also allocate GST exemption to the trust which would allow the trust to continue in perpetuity if established in a jurisdiction such as Delaware which has abolished the rule against perpetuities. See 25 Del. C. § 503. What follows is a summary of the relevant issues to consider when creating a completed gift asset protection trust.

A. Grantor's Retention of Control.

The first issue to address is whether the transfer of assets to the trust constitutes a completed gift for federal gift tax purposes.

1. Is the Transfer to the Trust a Completed Gift?

- (a) A transfer is incomplete for federal gift tax purposes if the grantor retains sufficient dominion and control over the property. Treas. Reg. § 25.2511-2(b).
- (b) If an individual creates a self-settled trust in a jurisdiction where his or her creditors may attach the assets, the grantor has retained sufficient dominion and control over the assets because under local law the grantor is able to relegate his or her creditors to the assets of the trust. See Rev. Rul. 76-103; Rev. Rul. 77-378; and *Paolozzi v. Commissioner*, 23, T.C. 102 (1954). As such, the trust must be established in a jurisdiction that allows for self-settled asset protection trusts thereby preventing the grantor from being able to relegate his or her creditors to the assets of the trust.
- (c) Revenue Ruling 76-103.
 - (i) In Revenue Ruling 76-103, the grantor created an irrevocable trust which provided that during the grantor's lifetime the trustee could distribute income and principal of the trust in its sole and absolute discretion to the grantor. The trust further provided that upon the death of the grantor, the remaining principal of the trust was to be distributed to the grantor's issue. The trust was determined to be a discretionary trust under the laws

of the state in which the trust was created and the entire property of the trust was subject to the claims of the grantor's creditors.

- (ii) Revenue Ruling 76-103 concluded that as long as the trustee continues to administer the trust under the laws of the state subjecting the trust assets to the claims of creditors, the grantor retained dominion and control over the trust property. As such the grantor's transfer of the property to the trust does not constitute a completed gift for federal gift tax purposes.
- (iii) Revenue Ruling 76-103 also concluded that if the grantor were to die before the gift becoming complete, the date of death value of the trust property would be includible in the grantor's gross estate for federal estate tax purposes under Section 2038 because of the grantor's retained power to, in effect, terminate the trust by relegating the grantor's creditors to the entire property of the trust.

(d) Revenue Ruling 77-378.

- (i) In Revenue Ruling 77-378, the grantor created an irrevocable trust which provided that the trustee was empowered to pay to the grantor such amounts of the trust's income and principal as the trustee determines in its sole and absolute discretion. Under the applicable state law, the trustee's decision whether to distribute trust assets to the grantor was entirely voluntary. Furthermore, the grantor was prohibited from requiring that any of the trust assets be distributed to the grantor nor could the creditors of the grantor reach any of the trust assets.
- (ii) Revenue Ruling 77-378 concluded that the grantor had parted with dominion and control over the property that the grantor transferred into the trust. Although the trustee had an unrestricted power to pay trust assets to the grantor, the grantor could not require that any of the trust assets be distributed to the grantor nor could the grantor utilize the assets by going into debt and relegating the grantor's creditors to the trust. Revenue Ruling 77-378 therefore concluded that the grantor's transfer to the trust was a completed gift for federal gift tax purposes.

2. Sections 2036(a)(2) and Section 2038.

Another concern relates to whether the trust assets will be includible in the grantor's estate under Sections 2036(a)(2) and Section 2038 of the IRC because of the grantor's retained power to terminate the trust by relegating the grantor's creditors to the entire property of the trust.

- (a) Section 2036(a)(2) of the IRC provides that a decedent's gross estate includes property transferred in trust other than for full and adequate consideration if

the decedent retained the right to designate the persons who shall possess or enjoy the property or income therefrom. IRC § 2036(a)(2).

- (b) Section 2038 of the IRC provides that a decedent's gross estate includes property transferred in trust other than for full and adequate consideration if the decedent retained the right to alter, amend or revoke the trust. IRC § 2038.
- (c) Both Sections 2038(a) and 2036(a)(2) have been used to cause a self-settled trust whose assets are subject to the claims of the grantor's creditors to be included in the grantor's estate. See Rev. Rul. 76-103; Estate of Paxton, 68 TC 785 (1986).

B. Grantor's Retained Beneficial Interest.

Another issue to address is whether the grantor's mere retention of a discretionary beneficial interest in the trust will cause the assets to be included in the grantor's gross estate under Section 2036(a)(1) of the IRC.

1. Section 2036(a)(1).

- (a) Section 2036(a)(1) of the Internal Revenue Code provides that a decedent's gross estate shall include property transferred in trust other than for full and adequate consideration if the decedent retained the right to income from the property. IRC § 2036(a)(1).
- (b) The use, possession, right to income or other enjoyment of the transferred property is considered as being retained by the decedent to the extent the use, possession, right to the income, or other enjoyment is to be applied toward the discharge of a legal obligation of the decedent. Treas. Reg. § 20.2036-1(b)(2).
- (c) The right to the income need not be express but may be implied. Treas. Reg. § 20.2036-1(1)(i).

2. Revenue Ruling 2004-64 (the "2004 Ruling").

- (a) The 2004 Ruling addressed the gift tax consequences to a grantor of a trust, with respect to which the grantor is treated as the owner of for income tax purposes, if the grantor pays the income tax attributable to the inclusion of the trust income in the grantor's taxable income.
- (b) The 2004 Ruling also addressed the estate tax consequences if, pursuant to the governing instrument or applicable local law, the grantor of the trust may or must be reimbursed by the trust for the income tax.

- (c) The 2004 Ruling held that assuming there is no understanding, expressed or implied, between the grantor and the trustee regarding the trustee's exercise of its discretion to reimburse the grantor for the income tax liability, the trustee's discretion to satisfy such obligation will not alone cause inclusion of the trust assets in the grantor's gross estate for federal estate tax purposes.
- (d) However, the 2004 Ruling specifically states that the trustee's discretion to reimburse the grantor for the income tax liability combined with other factors including, but not limited to: (i) an understanding or preexisting arrangement between the grantor and the trustee regarding the trustee's exercise of its discretion; (ii) a power retained by the grantor to remove the trustee and name a successor trustee; or (iii) applicable local law subjecting the trust assets to the claims of the grantor's creditors may cause inclusion of the trust assets in the grantor's gross estate for federal estate tax purposes.
- (e) The 2004 Ruling seems to address the concern raised in the completed gift asset protection trust context regarding whether the grantor's mere retention of a discretionary beneficial interest is sufficient to cause inclusion of the trust assets in the grantor's estate under Section 2036(a)(1) of the IRC. Following the rationale contained in the 2004 Ruling, the trustee's mere ability to distribute assets to the grantor should not alone cause inclusion of the assets in the grantor's gross estate for federal estate tax purposes.

C. The Private Letter Rulings.

Two Private Letter Rulings have been issued addressing the transfer tax consequences associated with self-settled asset protection trusts. See PLR 9837007 and PLR 200944002. Both Private Letter Rulings involved the use of Alaska trusts established by Alaska residents.

1. PLR 9837007 (the "1998 PLR").

- (a) In the 1998 PLR the grantor created a trust for the benefit of herself and her descendants. The trustee could, but was not required to, distribute income and/or principal from the trust to any of the beneficiaries.
- (b) The 1998 PLR concluded that the transfer to the trust would be a completed gift for federal gift tax purposes because a creditor of the grantor would be precluded from satisfying claims out of the grantor's interest in the trust. However, it expressly did not rule on whether the assets would be included in the grantor's estate for federal estate tax purposes.

2. PLR 200944002 (the "2009 PLR").

- (a) In the 2009 PLR the grantor created a trust for the benefit of himself, his spouse and descendants. Distributions of income and principal could be made

to the beneficiaries of the trust in the sole and absolute discretion of the trustee.

- (b) The 2009 PLR again concluded that the transfer to the trust was a completed gift for federal gift tax purposes. However, the 2009 PLR also concluded that the trustee's discretionary authority to distribute income and/or principal to the grantor does not by itself cause the trust to be includable in the grantor's estate for federal estate tax purposes under Section 2036(a)(1) of the IRC.
- (c) The analysis contained in the 2009 PLR is based primarily on the 2004 Ruling. Both the 2004 Ruling and the 2009 PLR conclude that the assets will not be included in the grantor's estate under Section 2036(a)(1) under the theory that the trustee's discretionary authority to distribute assets to the grantor will not by itself result in estate tax inclusion. However, neither the 2004 Ruling nor the 2009 PLR address whether Sections 2036(a)(2) or 2038 will cause inclusion in the grantor's estate under the theory that the grantor could terminate the trust by relegating the grantor's creditors to the entire property of the trust. For the reasons discussed in Section III Paragraph A of this outline, Sections 2036(a)(2) and 2038 should not cause the assets to be included in the grantor's estate as long as the trust is created in a jurisdiction allowing for self-settled asset protection trusts as the grantor will be prohibited from relegating his or her creditors to the assets of the trust.

D. Creditor Exceptions.

1. All states that have self-settled trust legislation, other than Alaska or Nevada, allow certain creditors to access the trust. For example, the Delaware Qualified Dispositions in Trust Act allows for certain family claims, including child support and alimony, provided that with respect to an alimony claim the spouse must have been married to the grantor before the trust was created. 12 Del. C. §§ 3573(1) and 3570(9).
2. A question has arisen as to whether the mere fact that a family creditor could reach the trust assets is enough to cause the transfer to the trust from being an incomplete gift or otherwise cause the trust assets to be included in the grantor's gross estate under Sections 2036(a)(2) and 2038.
3. The reason for this concern stems from language contained in the 2004 Ruling. The 2004 Ruling expressly states that the trustee's discretion to distribute trust assets to a grantor to satisfy the grantor's income tax liability combined with other factors, such as applicable local law subjecting the trust assets to the claims of the grantor's creditors, may cause inclusion of the trust assets in the grantor's estate for federal estate tax purposes.

4. Proponents of Alaska and Nevada law have argued that the mere existence of the family claim exception contained in statutes of other jurisdictions, such as Delaware, would be enough to cause the assets to be includible in the grantor's estate under Sections 2036(a)(2) and 2038 and therefore a grantor should only establish a trust in Alaska or Nevada if the grantor desires for the trust assets to be excluded from his or her estate.
5. However, what is overlooked in this argument is the theory of acts of independent significance, which is discussed in the next section of this outline.

E. Acts of Independent Significance.

1. The theory of acts of independent significance is applied when determining whether the grantor retained a power which rises to the level of a power which will cause inclusion in the grantor's gross estate under Sections 2036(a)(2) or 2038 of the IRC or otherwise result in an incomplete gift. If the retained power allows the grantor the ability to act in such a way so as to affect the beneficial interest of the trust, but the possibility of such action occurring is so diminimus and speculative, the power will be found to be an act of independent significance. See *Estate of Tully*, 528 F.2d 1401 (1976); *Ellis v. Commissioner*, 51 T.C. 182 (1968), judgment aff'd, 437 F.2d 442; Rev. Rul. 80-25; and PLR 9141027.
2. Courts have ruled that the possibility of divorce is an act of independent significance. See *Estate of Tully*, 528 F.2d 1401; PLR 9141027.

(a) Estate of Tully.

- (i) In the Estate of Tully case the Court addressed whether death benefits paid directly to the decedent's widow by his employer should be included in the decedent's estate under Section 2038.
- (ii) The decedent and his business partner entered into an agreement which provided that upon the decedent's death the company would pay the decedent's widow a death benefit equal in amount to twice the annual salary which the company had paid to the decedent for the year immediately preceding the date of his death.
- (iii) One of the arguments made by the Internal Revenue Service was that the decedent retained a Section 2038 power to revoke or terminate the transfer of the death benefits to his wife by virtue of the possibility that he could have divorced his wife prior to his death.

- (iv) The Court held that the possibility of divorce is so diminimus and so speculative rather than demonstrative, real, apparent and evident that it cannot rise to the level of a Section 2038 power.
3. Courts have also determined that acts of independent significance include failure to support a spouse as well as the ability to have or adopt children. *Ellis v. Commissioner*, 51 T.C. 182 (1968), judgment aff'd, 437 F.2d 442; and Rev. Rul. 80-255.
- (a) Revenue Ruling 80-255.
 - (i) In Revenue Ruling 80-255, the decedent created an irrevocable trust which provided that the income was to be paid in equal shares to the decedent's children and principal was to be distributed twenty-one (21) years after the creation of the trust in equal shares to the decedent's children, per stirpes. The trust instrument also provided that the decedent's children, born or adopted after the creation of the trust, were to be additional beneficiaries.
 - (ii) The issue addressed in Revenue Ruling 80-255 was whether the decedent retained a power to change the beneficial interest of the trust for purposes of Sections 2036(a)(2) and 2038 of the IRC because the trust provided that children born or adopted after the creation of the trust were to become beneficiaries and the decedent had the ability to bear or adopt additional children.
 - (iii) Revenue Ruling 80-255 determined that the act of bearing or adopting children is an act of independent significance. Revenue Ruling 80-255 held that although the decedent's act of bearing or adopting children will automatically result in adding the child as a beneficiary to the trust, such result is merely a collateral consequence of bearing or adopting children and is not equivalent to the decedent's retention of a power to designate or change beneficial interest within the meaning of Sections 2036(a)(2) and 2038 of the IRC.

F. Conclusion.

1. Completed gift asset protection trusts present a unique planning opportunity for clients who want to utilize the increase in gift tax and GST exemption to transfer assets out of their estate but are concerned with the possibility of needing access to the funds in the future.
2. It is extremely important that in establishing a completed gift asset protection trust there is no implied understanding between the grantor and the trustee regarding distribution from the trust to the grantor.

3. Notwithstanding the fact that all states, other than Alaska and Nevada, allow for certain creditors to access the trust, the theory of acts of independent significance should allow a grantor to establish a completed gift asset protection trust in any jurisdiction allowing for self-settled asset protection trusts and have the assets excluded from his or her estate.
4. It should also be possible to leverage the gift made to the trust by having the trustee purchase a life insurance policy on the life of the grantor with the proceeds gifted to the trust. This will essentially allow the grantor to still benefit from the cash value contained in the policy (at the discretion of the trustee) and have the death benefit excluded from the grantor's estate upon his or her death.

III. Incomplete Gift Non-Grantor Trusts.

It is possible for a grantor to establish a trust in a jurisdiction that allows for the creation of self-settled asset protection trusts, retain a beneficial interest in the trust and have the trust treated as a non-grantor trust for income tax purposes. Typically the grantor will also want the trust to be an incomplete gift for transfer tax purposes. In Delaware we refer to these trusts as DING trusts. The acronym stands for Delaware Incomplete Gift Non-Grantor trust.

A. Tax Structure of Trust.

1. Section 677(a)(3) of the IRC provides that the grantor shall be treated as the owner of a trust for income tax purposes if trust income, without the approval or consent of any adverse party, may be distributed to the grantor or the grantor's spouse. IRC § 677(a)(3). Therefore, in order for the trust to be a non-grantor trust for income tax purposes, the consent of an adverse party must be obtained prior to distributing assets to the grantor or the grantor's spouse.
2. The trust also must be created in a jurisdiction which allows for self-settled asset protection trusts because if creditors of the grantor can reach the trust assets the trust will be a grantor trust. Treas. Reg. § 1.677(a)-1(d).
3. The trust is structured as an incomplete gift for federal gift tax purposes through the grantor's retention of a testamentary limited power of appointment over the trust. Treas. Reg. § 25.2511-2(b).

B. The Private Letter Ruling.

1. Several Private Letter Rulings (the "PLRs") confirm that under Delaware law a grantor can create a non-grantor trust, fund the trust with contributions that are not considered taxable gifts for federal gift tax purposes and still retain the right to receive discretionary distributions of trust income and principal from the trust. See

PLR 200715005; PLR 200647001; PLR 200637025; PLR 200612002; and PLR 200502014.

2. In the PLRs, the grantor created a discretionary trust for the benefit of the grantor and others (the “permissible beneficiaries”). A Delaware corporate trustee is appointed as sole trustee of the trust.
3. A committee (the “Distribution Committee”) consisting of two of the permissible beneficiaries of the trust, has the power, by unanimous consent, to direct the trustee to distribute trust assets to or among the permissible beneficiaries. In addition, the grantor and one member of the Distribution Committee may by agreement direct the trustee to make distributions. If a member of the Distribution Committee resigns or otherwise ceases to serve, a permissible beneficiary other than the grantor or the grantor’s spouse is appointed as a successor Distribution Committee member.
4. The grantor retains a limited testamentary power of appointment over the trust assets to appoint the remaining trust assets to any person or organization other than the grantor, the grantor’s estate, the grantor’s creditors or the creditors of the grantor’s estate.
5. The PLRs conclude that the grantor has not made a completed gift upon establishment of the trust due to the retention of the grantor’s limited testamentary power of appointment over the trust assets. However, the grantor will be treated as making a taxable gift when a trust distribution is made to someone other than the grantor.
6. The PLRs also conclude that the Distribution Committee members have a substantial adverse interest to each other for purposes of Section 2514 of the IRC and therefore do not possess general powers of appointment over the trust. See IRC § 2514(c)(3)(B).

C. IR-2007-127 (the “2007 Notice”).

1. In 2007 the IRS issued a notice calling into question the gift tax consequences to the members of the Distribution Committee. See IR-2007-127.
2. The 2007 Notice stated that the conclusions reached in the PLRs with respect to the gift tax consequences of the Distribution Committee members may not be consistent with Revenue Ruling 76-503 and Revenue Ruling 77-158 (the “Revenue Rulings”). See Rev. Rul. 76-503 and Rev. Rul. 77-158.

D. The Revenue Rulings.

1. The Revenue Rulings have facts that are identical. In the Revenue Rulings, three siblings, A, B and C owning equal one-third interests in their family business

- contribute their respective interests in the business to an irrevocable trust for the benefit of their descendants. The trust permits the trustees to distribute trust property to whomever they select, including themselves, in such proportions and at such times as they see fit. Each trustee has the ability to designate one of the trustee's relatives to serve as successor trustee upon the trustee's death or resignation. In the event a trustee fails to designate a successor, the oldest adult living descendant of a deceased or resigned trustee is to occupy the vacant trustee position.
2. The decedent, D, was selected by A to be one of three original trustees and D served in that position until D's death.
 3. The Revenue Rulings address whether any of the trust assets are includible in D's gross estate under Section 2041 of the IRC under the view that D had a general power of appointment over the trust assets held jointly with the other two co-trustees. The Revenue Rulings conclude that one-third (1/3) of the value of the trust as of the date of D's death is includible in D's gross estate under Section 2041 of the IRC as property subject to a general power of appointment. In reaching the conclusion the Revenue Rulings focused on the language of Section 2041 of the IRC. Section 2041(b) of the IRC sets forth the definition for a general power of appointment. Section 2041(b)(1)(C)(ii) of the IRC provides that a power that is not exercisable by the decedent except in conjunction with a person having a substantial adverse interest in the property subject to the power is not a general power of appointment. IRC § 2041(b)(1)(C)(2).
 4. The Revenue Rulings determined that the Section 2041(b)(1)(C)(ii) safe harbor did not apply to D because the remaining co-trustees did not have a substantial adverse interest to D. The terms of the trust provide that upon D's death a successor trustee is to be appointed in D's place. The remaining co-trustees do not receive the entire power of appointment upon D's death. Instead, the surviving co-trustees must continue to share the power with D's replacement. The Revenue Rulings determined that this does not put the surviving co-trustees in a better economic position after D's death and as such their interest is not substantially adverse to D.
 5. In reaching this conclusion, the Revenue Rulings also focus on the regulations under Section 2041 of the IRC. See Treas. Reg. § 20.2041-3(c)(2) and (3). The Revenue Rulings state that had the trust been drafted so that upon D's death the power of appointment would vest solely in the remaining co-trustees, the co-trustees' interests would be substantially adverse to that of D and D would not have a general power of appointment resulting in the inclusion of one-third (1/3) of the trust assets in D's estate under Section 2041 of the IRC.

E. Comparing the PLRs to the Revenue Rulings.

1. The PLRs are similar to the Revenue Rulings in that upon the resignation of any Distribution Committee member, a permissible beneficiary is to be appointed as a

- successor Distribution Committee member in place of the resigning Distribution Committee member. Therefore, the distribution power does not vest in the remaining Distribution Committee members but instead must be shared with a successor Distribution Committee member. This does not put the remaining Distribution Committee members in a better economic position after the resignation of a Distribution Committee member.
2. However, there is an important fact which distinguishes the PLRs from the Revenue Rulings. The PLRs conclude that the transfer to the trust by the grantor is an incomplete gift and that a distribution from the trust to any person other than the grantor would be a completed gift. In the Revenue Rulings, A, B and C irrevocably transferred their interests in the family business to the trust upon its creation at which time they made a taxable gift to the trust. Distributions from the trust to the beneficiaries would not be considered taxable gifts by A, B or C.
 3. If the rationale of the Revenue Rulings were applied to the PLRs, distributions from the trust would constitute completed gifts by the Distribution Committee members. This would produce unprecedented gift tax results. For instance, a distribution from the trust to the grantor would constitute a taxable gift to the grantor of property which the grantor is already treated for federal transfer tax purposes as owning. Furthermore, a distribution to any other person besides the grantor would constitute a taxable gift of the same property to the same person at the same time by both the grantor and the Distribution Committee members.

F. Conclusion.

1. Incomplete gift non-grantor trusts present a unique opportunity for individuals residing in states such as California, New York New Jersey, Kentucky, Massachusetts, Michigan and Missouri to minimize or avoid state income tax.
2. The IRS has not resolved the gift tax issue raised by the 2007 Notice. However, it is my understanding that the IRS is now willing to consider Private Letter Rulings on DING trusts.
3. There are several structures that could be used to ensure that the Distribution Committee members have substantial adverse interests. For instance, the trust could be structured with a shrinking Distribution Committee. Another option could be to allow the remaining Distribution Committee members by unanimous vote to decide whether to appoint a successor Distribution Committee member upon the death, resignation or incapacity of a Distribution Committee member.