A Review of Grantor Trusts

by Walter Q. Impert – Dorsey & Witney, LLP[1]

I. Background

Subchapter J of the Internal Revenue Code ("IRC") sets forth the rules and procedures governing the taxation of the income of estates, trusts, beneficiaries, and decedents. Generally, trust income is either taxed to the trust itself, or to the beneficiaries of the trust. However, the rules in Subpart E of Subchapter J govern when the income of a trust will be taxable to the grantor, or another person deemed to be the substantial owner of the trust, for federal income tax purposes, rather than to the trust itself or to the beneficiary of the trust.

IRC § 671 provides that the grantor or substantial owner of a trust is subject to taxation on the income, deductions, and credits of the trust. IRC § 673 through § 678 set out rules to determine when the existence of the trust should be ignored for federal income tax purposes.

These rules were established at a time when it could be advantageous to shift income from the grantor of a trust to the trust itself or the trust's beneficiaries, and thereby benefit from the trust's or beneficiaries' lower tax rates. Today, because trusts quickly reach the highest marginal income tax rates, and because children under age 19 (and in some cases under 25) are taxed at their parents' tax rates, there is less reason to use trusts for income shifting. However, the grantor trust rules may be used for essentially the opposite purpose, to shift the income tax burden from a trust to the grantor, resulting in a variety of potential gift and estate tax benefits.

Under Treas. Reg. § 1.671-3(a)(1), "if a grantor or another person is treated as the owner of an entire trust, he takes into account in computing his income tax liability all items of income, deduction, and credit (including capital gains and losses) to which he would have been entitled had the trust not been in existence during the period he is treated as owner." The regulations provide specific rules for determining the items of income, deduction, and credit to be included in computing the grantor's income tax liability if the grantor is treated as the owner of less than the entire trust. *See* Treas. Reg. § 1.671-3(a)-(c).

II. Powers That Cause Grantor Trust Status

There are several powers contained in Subpart E that will cause an irrevocable trust to be treated as owned by the grantor or the substantial owner of the trust for income tax purposes within the meaning of IRC § 671. Several of these powers, however, may not be suitable for estate planning purposes because they could cause unacceptable estate and gift tax consequences. This article focuses on the powers that, if used properly, are not likely to have adverse gift or estate tax consequences.

A. Power to Add Beneficiaries

Under IRC § 674(a), a grantor will be treated as the owner of any portion of a trust if the beneficial enjoyment of the income or corpus of the trust is subject to a power of disposition exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party.

However, IRC §§ 674(b)(5)-(7), 674(c), and 674(d) each provide that if any person has a power to expand the class of potential beneficiaries of the trust to include charities, the general rule of IRC § 674(a) *will* apply and, for income tax purposes, the grantor will be treated as the owner of the portion of the trust to which the power applies.[2] A power to add non-charitable beneficiaries that extends beyond adding after-born or after-adopted children can also trigger grantor trust status under IRC § 674. Although, assuming the trust already included all of the individual beneficiaries or classes of individual beneficiaries that the grantor wishes to benefit, the grantor may not want the power holder to be allowed to add non-charitable beneficiaries.

Since this power is, in essence, a power of appointment, if the potential appointees are not limited to charitable beneficiaries, to avoid gift and estate tax concerns, the power holder should be precluded from appointing the property to the power holder, the power holder's estate, the power holder's creditors, or the creditors of the power holder's estate. In addition to estate and gift tax concerns, the power must also be limited so that the power holder qualifies as a nonadverse party as defined under IRC § 672(b).

If the power holder can add beneficiaries who are entitled to receive both income and principal from the entire trust, the mere existence of the power to add beneficiaries, even if it is never exercised, will cause the entire trust (including both income and corpus) to be treated as owned by the grantor within the meaning of IRC § 671.[3]

1. Who May Hold the Power

IRC § 674(a) provides that the grantor will be treated as the owner of a trust if the power to affect beneficial enjoyment is held by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party.[4] Thus, in order to achieve grantor trust status, the power must be held by the grantor, the grantor's spouse,[5] or any other person or entity who is not a beneficiary of the trust.

Not surprisingly, if this power is retained by the grantor, the result would be estate tax inclusion under IRC §§ 2036(a)(2) and 2038(a)(1).[6] Thus, in order to avoid estate tax inclusion, the power to add beneficiaries must be given to a nonadverse party other than the grantor.

If the power holder is someone who appears to be subordinate or subservient to the grantor, such as a child or employee of the grantor, an argument could be made that the grantor controls the exercise of the power, which could also cause estate tax inclusion under IRC §§ 2036(a)(2) and

continued on next page

continued from previous page

A Review of Grantor Trusts

2038(a)(1). The more conservative approach would be to grant the power to a nonadverse party who is not related or subordinate to the grantor – possibly to an independent trustee, a special trustee, or even a trust protector.

2. Turning Grantor Status Off

At some point it may be necessary to "turn off" grantor trust status because it may be too burdensome for the grantor to continue to be liable for the tax attributable to the income earned by the trust. If the trust is to cease to be treated as a grantor trust within the meaning of IRC § 671, the power(s) used to create grantor trust status must be released, terminated, or otherwise rendered inapplicable.

If the power to add beneficiaries is held by a trustee, it could be argued that the release of the power by the trustee constitutes a breach of the trustee's fiduciary duty to the beneficiaries because it harms the interests of the beneficiaries and only benefits the grantor.[7] To address this concern, the grantor could include language in the trust instrument authorizing the trustee to release the tainting power even if the release would have the effect of subjecting the trust or the beneficiaries to increased income tax liability.

Additionally, the power could be vested in a specific trustee, or a third party, such as a trust protector. If the decision was made that grantor trust status should be terminated, that trustee, or third party, could resign. It could be argued that the trustee's resignation would not require a fiduciary decision to relinquish the power, and if a non-trustee held the power, fiduciary duties may not even apply. Note, however, that if the power was held by a single individual trustee, grantor trust status could be inadvertently terminated if the trustee died or became incapacitated.[8]

3. Turning Grantor Trust Status Back On

Some grantors may want the flexibility to turn grantor trust status back on. To accomplish this, a grantor trust power once released or terminated must be brought back into existence. How this is done will depend on who holds the power and how the power is structured.

If a grantor trust power is given to an independent trustee and grantor trust status was turned off by the release of the power by the independent trustee, the trust instrument might be drafted to provide that the release of a power by a trustee shall only bind the releasing trustee. In that way, if the decision is made that grantor trust status should be turned back on, the acting independent trustee could resign and a successor independent trustee could be appointed, in whose hands the tainting power would be restored.

B. Power to Substitute Assets

The power to substitute assets is described in IRC § 675(4)(C). Under the statute, the existence of a power, exercisable in a nonfiduciary capacity without the approval or consent of any person in a fiduciary capacity, to "reacquire the trust corpus by substituting other property of an equivalent value" will cause the entire trust to be treated as owned by the grantor, even if the power is never exercised.[9] This power is essentially similar to an option to purchase the assets of the trust at their then fair market value.

1. Who May Hold the Power

The introductory language of IRC § 675(4) provides that the trust will be treated as being owned by the grantor if "any person" holds a "power of administration" over the trust. As the power holder must hold the power in a nonfiduciary capacity, it is preferable that the grantor, rather than a trustee, hold this power.[10] In addition, if someone other than the grantor holds the power, there is a risk that the power holder could predecease the grantor. If this power is the sole power used to create grantor trust status, the death of the power holder could result in a premature termination of grantor trust status.

2. Gift and Estate Tax Issues

One concern is whether the retention by the grantor of a power to substitute assets could cause estate tax inclusion under IRC §§ 2036 or 2038.

Although the substitution of property by the grantor could potentially affect the *amount* of income generated by the trust assets, the substitution power, by itself, does not amount to a power to "designate the persons who shall possess or enjoy the property or the income therefrom" or to "alter, amend, revoke, or terminate" a trust. As a result, IRC §§ 2036 and 2038 should not apply to a retained power to substitute assets.[11] Furthermore, in the context of an insurance trust, a power to substitute assets should not be considered an incident of ownership that causes estate tax inclusion.[12]

3. Turning the Power Off

If the grantor holds the power to substitute assets, the grantor could terminate the power by releasing it. Under IRC § 2035, if the grantor releases a power over a trust within three years of the grantor's death, and that power would have caused the property to be included in the grantor's gross estate under IRC §§ 2036, 2037, 2038, or 2042 if the power had been retained by the grantor on the grantor's death, the value of the property over which the power was released will be included in the grantor's gross estate.

Based on the argument, discussed above, that the retention by the grantor of a power to substitute trust assets

continued on next page

continued from previous page

A Review of Grantor Trusts

with other assets having an equal value would not cause the assets of the trust to be included in the grantor's gross estate if the grantor held the power at the grantor's death, the release of the power by the grantor within three years of death should not cause estate tax inclusion under IRC § 2035.

C. Power to Sprinkle Income and Principal Held By a Related or Subordinate Trustee

An unrestricted power held by trustees, a majority of whom are nonadverse related or subordinate parties, to sprinkle income and principal among a class of beneficiaries would cause the grantor to be treated as the owner of the entire trust under IRC § 674(a).

If the trustee who holds the sprinkling power is subordinate or subservient to the grantor, it could be argued that the grantor controls the exercise of the power, thereby giving the grantor the power to sprinkle income and principal exercisable "in conjunction with" the power holder, which could cause estate tax inclusion under IRC §§ 2036(a)(2) and 2038(a)(1).[13] Nevertheless, so long as there is no express or implied agreement that the trustee will follow the directions of the grantor, and the grantor does not have the power to remove the trustee and appoint a related or subordinate party as trustee,[14] there appears to be a strong basis to refute this argument.

To achieve grantor trust status using this power depends upon the identity of the trustees as related or subordinate parties who are not beneficiaries of the trust. If the sprinkling power is used by itself to achieve grantor trust status, there is a risk that the power could be terminated inadvertently if there is a change in the trustee.

D. Power to Lend Trust Income and/or Principal to Grantor Without Adequate Security

Under IRC § 675(2), the grantor will be treated as the owner of the entire trust if the grantor can borrow from the trust, or a nonadverse party can make loans to the grantor from the trust, without adequate interest or adequate security, or both, unless the trustee is authorized under a broad general lending power to make such loans to any person.[15]

The retained right to borrow the trust assets with adequate interest but without adequate security may not differ, in substance, from the retained power to reacquire the assets of the trust by substituting other assets of equivalent value. In other words, a power to borrow from the trust without adequate security can be seen as a power to substitute the assets of the trust for another asset of equivalent value (namely, an unsecured promissory note bearing adequate interest). Given the apparent similarity of these two powers, if the power is to be held by the grantor, the substitution power may be the preferable power.

E. Actual Borrowing of Trust Assets

IRC § 675(3) provides that the grantor will be treated as the owner of any portion of a trust if the grantor has borrowed the corpus or income of the trust and has not fully repaid the loan before the end of the tax year. The provision does not include loans made by an independent trustee that provide for adequate interest and security. Grantor trust status is limited to the amount actually borrowed. Since there are other administrative powers under IRC § 675 that will cause grantor trust status as to the entire trust, even if the powers are not actually exercised, this power may not be suitable for all purposes. That said, this power does provide a fair amount of flexibility as the power can be turned "off" and "on" simply by having the grantor borrow without adequate security.

III. Typical Grantor Trusts

A. Revocable Trusts

Revocable trusts, often used for probate avoidance, privacy, and disability planning, are by nature grantor trusts. Their defining feature, that the grantor can revoke the trust, causes grantor trust treatment under IRC § 676(a).

B. Irrevocable Grantor Trusts

Some irrevocable trusts contain features that are likely to cause grantor trust status. These include:

1. Qualified Personal Residence Trusts (QPRTs)

QPRTs are authorized under Treas. Reg. § 25.2702-5(c). These trusts generally permit the grantor to give away a future interest in a residence at a discount for gift tax purposes, while retaining the right to occupy the residence rent-free for a specified term of years ("fixed term"). If the grantor survives the fixed term of the trust, the residence passes to the remainder beneficiaries without additional gift tax consequences and is excluded from the grantor's taxable estate at death.

A QPRT is generally a grantor trust under IRC § 673(a) if the grantor's reversionary interest, (namely if the grantor dies during the term of the trust,) is greater than 5 percent of the initial value of the trust. A QPRT is also a grantor trust under IRC § 677 because the applicable regulations require that during the fixed term, any income from the trust must be paid to the grantor not less frequently than annually.

If the residence transferred to the trust is encumbered by a mortgage, one benefit of grantor trust treatment is that the mortgage interest deduction continues to apply. Another benefit is that the $250,000 per individual ($500,000 per married couple) exclusion against capital gains on the sale of a residence would apply if the residence is sold.

continued on next page

continued from previous page

A Review of Grantor Trusts

2. Grantor Retained Annuity Trusts (GRATs)

GRATs are qualified annuity interests authorized under Treas. Reg. § 25.2702-3(b). A GRAT is a trust that pays a predetermined annuity amount to the grantor each year for a specified term of years. If the grantor survives the term of the trust, then any remaining assets pass to the remainder beneficiaries and are excluded from the grantor's taxable estate.

Like a QPRT, a GRAT is generally a grantor trust under IRC §§ 673(a) and 677. IRC § 677 would apply if the income of the trust is less than the annuity amount, so that all of the income is distributed to the grantor each year. That said, it is generally advisable to include an additional grantor trust feature to ensure grantor trust treatment, such as the power to substitute assets.

As the goal of a GRAT is to pass as much of the trust assets to the remainder beneficiaries as possible, grantor trust status allows the trust assets to appreciate free of the burden of income tax payments since the grantor is obligated to pay the trust's income tax liability. Another benefit is that the trustee may sell low basis assets before the trust terminates, thereby allowing the beneficiaries to receive cash or other assets with a tax basis equal to its value, and reducing the grantor's taxable estate by the amount of the income tax payment. If the grantor has a power to substitute assets, the grantor can exchange high-basis assets for low-basis assets before the grantor's death (or before trust terminates, if earlier than the grantor's death), thereby achieving the same result without incurring capital gains tax.

3. Life Insurance Trusts

Life insurance trusts are generally treated as grantor trusts under IRC § 677(a)(3). There is little debate that if trust income is actually used to pay insurance premiums for insurance on the life of the grantor, then that income will be taxable to the grantor.

However, there appears to be conflicting guidance on whether merely having the power to apply trust income to the payment of life insurance on the life of the grantor causes grantor trust treatment.[16] In addition, there may be questions about grantor trust status if the income is greater than the premium payment or if non-income sources, such as the principal or loan proceeds, are used to pay insurance premiums. Therefore, it is recommended that one of the other mechanisms discussed under Section II above be incorporated into the trust agreement to ensure grantor trust treatment, if that is desired.

One important benefit of grantor trust status for life insurance trusts is that the transfer for value rules in IRC § 102(a)(2) would not apply if one grantor trust purchased a life insurance policy from a second grantor trust having the same grantor. Likewise, the transfer for value rules would not apply if a grantor trust purchased life insurance of which the grantor is the insured from a non-grantor trust.[17] However, the transfer for value exception does not apply to a transfer of life insurance to the insured, to a partner of the insured, to a partnership in which the insured is a partner, or to a corporation in which the insured is a shareholder or officer.

4. Asset Protection Trusts

An asset protection trust for the benefit of the grantor will generally be treated as a grantor trust under IRC § 674(a) if the beneficial enjoyment of the trust corpus or income is subject to a power of disposition, exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party as defined in IRC § 672(a).[18]

A foreign asset protection trust, having a U.S. grantor as its beneficiary, will generally be treated as a grantor trust under IRC § 679(a). In fact any foreign trust established by a U.S. grantor with a U.S. beneficiary (whether or not the grantor is a beneficiary) is treated as a grantor trust under IRC § 679(a).

5. Crummey Trusts

The IRS has taken the position that the beneficiary of a trust who has a right of withdrawal over the trust assets is treated as the owner of a portion of the trust for federal income tax purposes.[19] This position may cause problems if the planner's goal is for the grantor of the trust to be treated as the owner of the trust income and principal for federal income tax purposes, such as in cases where the trust has purchased assets from the grantor on an installment basis.[20] However, under IRC § 678(b), powers retained by a grantor causing grantor trust status with respect to the grantor will supersede grantor trust status over trust income with respect to the beneficiary.

C. Intentionally Defective Irrevocable Trusts.

Many irrevocable trusts are not grantor trusts unless the trust includes a feature that causes grantor trust status. The individual powers discussed in Section II are some of the typical ways that an irrevocable trust is made "intentionally defective," and as a result, ignored for federal income tax purposes.

Three important benefits of grantor trust status include:

1. Tax-Free Gift when Grantor Assumes the Trust's Income Tax Liability

A common use of irrevocable trusts for high net worth individuals is as a vehicle to shift assets to lower generations in a manner that minimizes transfer taxes. Once assets have been transferred by means of lifetime gifts by the grantor to a properly drafted irrevocable trust, then the assets of the

continued on next page

continued from previous page

trust and any appreciation in the value of the trust assets are not included in the grantor's taxable estate at death.

Many grantors welcome the opportunity to pay the trust's income tax liability each year in order for the trust assets to grow without reduction for income tax liability each year. The effect of the grantor's income tax payment is no different than if the grantor had made an additional gift to the trust each year in the amount of the trust's income tax liability. Accordingly, the grantor receives a benefit that is equivalent to making a gift to the trust without using the grantor's annual exclusion or lifetime exclusion, paying gift tax, or having to file a federal gift tax return.[21]

2. Opportunity to Sell Assets to the Trust on an Installment Basis

A grantor may sell assets to a grantor trust with no gift tax and no income tax consequences. In addition, the sale can be on an installment basis, so that the income of the trust is used to pay down the trust's obligation to the grantor. The result is similar to a freeze in the value of the grantor's estate, because the grantor receives a promissory note with a fixed value, while the grantor trust receives assets that may appreciate in value.

The structure of an installment sale to a grantor trust is straightforward. First, the grantor creates and funds the trust, preferably with cash. Though the sale has no gift tax consequences, the funding of the trust would be a taxable gift and the grantor would generally use some or all of the grantor's lifetime gift tax exclusion. After some reasonable period of time, the grantor sells assets to the trust in exchange for a cash down payment and a promissory note representing the balance of the purchase price. To avoid an additional gift, the purchase price must be the fair market value of the assets sold to the trust, and the promissory note must carry interest at the applicable federal rate (AFR) prescribed by the Internal Revenue Service.

Transactions between the grantor and the grantor trust have no income tax consequences, so no gain is recognized on the sale of the grantor's assets to the trust. Additionally, the grantor is not taxed on interest payments received from the trust. Nevertheless, since the trust is ignored for federal income tax purposes, the grantor is taxed on all income generated by the trust assets. Federal estate tax savings result from the assets sold appreciating in value at a rate that is greater than the note's interest rate, as well as on any valuation discounts that might apply to the assets sold to the trust.

3. S Corporation Stock Ownership

Trusts are not generally permissible shareholders of S corporations without making a qualified subchapter S trust (QSST) election or an electing small business trust (ESBT) election. Each election has its drawbacks and must be made with caution. However, under IRC § 1361(c)(2)(A)(i), a grantor trust is a permissible shareholder of S corporation stock, without the need for any special elections, if the grantor is a permitted S corporation shareholder.

IV. Discretionary Power to Pay Grantor's Tax Liability Attributable to Trust

Revenue Ruling 2004-64 states: "If, pursuant to the trust's governing instrument or applicable local law, the grantor must be reimbursed by the trust for the income tax payable by the grantor that is attributable to the trust's income, the full value of the trust's assets is includible in the grantor's gross estate under IRC § 2036(a)(1). If, however, the trust's governing instrument or applicable local law gives the trustee the discretion to reimburse the grantor for that portion of the grantor's income tax liability, the existence of that discretion, by itself (whether or not exercised) will not cause the value of the trust's assets to be includible in the grantor's gross estate."[22]

Nevertheless, caution should be exercised before even a discretionary tax reimbursement clause is included in the trust agreement. The Revenue Ruling explains that other facts may result in estate tax inclusion. Those facts include "an understanding or pre-existing arrangement between [the grantor] and the trustee regarding the trustee's exercise of this discretion; a power retained by [the grantor] to remove the trustee and name [the grantor] as successor trustee; or applicable local law subjecting the trust assets to the claims of [the grantor's] creditors." [23]

In Washington state, assuming no implied agreement with the trustee, or other bad facts, estate tax inclusion may turn on whether or not the discretionary tax reimbursement provision would cause the trust assets to be subject to the grantor's creditors. To the extent that a creditor can reach the assets of a grantor trust with a tax reimbursement clause, then that tax reimbursement clause may cause the trust assets to be included in the grantor's gross estate under IRC § 2036(a)(1).[24]

V. Termination of Grantor Trust Status

If grantor trust status terminates during the grantor's lifetime, then the grantor is deemed to have transferred the assets to the trust at that time for federal income tax purposes. If the trust has non-recourse liabilities to a third party that are secured by the assets of the trust, then the grantor will recognize gain, because the grantor will be deemed to have transferred the secured assets to the trust in exchange for a release of liability.[25] The grantor may also recognize capital gain where the debt is owed by the trust to the grantor, because the trust may be deemed to have received the secured asset from the grantor in exchange

continued on next page

continued from previous page

A Review of Grantor Trusts

for the promissory note to the grantor as of the date that the grantor trust status terminated.[26] Though there is no direct authority, it appears that there is no deemed sale, and accordingly no gain is recognized by the trust or the grantor's estate at the death of the grantor.[27] Unfortunately, there seems to be no clear answer as to the tax basis of the property in the grantor trust.[28] Options include a carryover basis under IRC § 1015, basis acquired by purchase under IRC § 1012 (with respect to assets purchased from the grantor), or a stepped-up basis at death under IRC § 1014.[29]

---

1 Walter Q. Impert is a partner in the Tax, Trusts and Estates group at Dorsey & Whitney LLP. He received his B.A. from Occidental College in 1996 and his J.D. from the UCLA School of Law in 2002.

2 *See* Treas. Reg. § 1.674(d)-2(b).

3 *See, e.g.*, Madorin v. Commissioner, 84 TC 667 (1978).

4 IRC § 672(a) defines the term "adverse party" as "any person having a substantial beneficial interest in the trust which would be adversely affected by the exercise or nonexercise of the power which he possesses respecting the trust. A person having a general power of appointment over the trust property shall be deemed to have a beneficial interest in the trust." IRC § 672(b) defines the term "nonadverse party" as any person who is not an adverse party.

5 I.R.C. § 672(e).

6 *See* Estate of Craft v. Commissioner, 68 T.C. 249 (1977).

7 *Restatement (Second) of Trusts* § 170(1), requires the trustee to administer the trust "solely in the interest of the beneficiary." Comment q to § 170 states: "*Action in the interest of a third person*. The trustee is under a duty to the beneficiary in administering the trust not to be guided by the interest of any third person. Thus, it is improper for the trustee to sell trust property to a third person for the purpose of benefiting the third person rather than the trust estate." In a different context, at least one court has held that the release of a power by a trustee could constitute a breach of fiduciary duty. *See* Sherry v. Little, 167 N.E.2d 872 (Mass. 1960).

8 In P.L.R. 8636053, the grantor utilized a slightly different approach to turning off grantor trust status. The grantor created two irrevocable trusts for the benefit of his three children. Under the terms of the trust agreement, an independent trustee was given the power to add charitable beneficiaries with the consent of the grantor's spouse, if living, or, if not, the grantor's brother. A majority of the grantor's adult lineal descendants were given the power at any time to terminate the trustee's authority to designate additional beneficiaries. The Service ruled that the trust would be treated as a wholly grantor trust by virtue of the independent trustee's power to add beneficiaries (even though the consent of the grantor's spouse or brother was required). The ruling did not address the estate and gift tax consequences of the termination power – for example, whether or not termination of the power by a committee of the grantor's adult descendants constituted some sort of a gift because assets could no longer be diverted to charity.

9 *See* Treas. Reg. § 1.671-3(b)(3).

10 Treas. Reg. § 1.675-1(b)(4) states "If a power is exercisable by a person as trustee, it is presumed that the power is exercisable in a fiduciary capacity primarily in the interests of the beneficiaries. This presumption may be rebutted only by clear and convincing proof that the power is not exercisable primarily in the interests of the beneficiaries. If a power is not exercisable by a person in a fiduciary capacity, the determination whether the power is exercisable in a fiduciary or a nonfiduciary capacity depends on all the terms of the trust and the circumstances surrounding its creation and administration."

11 *See* Estate of Anders Jordahl, 65 T.C. 92 (1975); Revenue Ruling 2008-22.

12 *See* Revenue Ruling 2011-28.

13 *See e.g.*, Bongard v. Comm'r, 124 T.C. 95, 112 (U.S. Tax Ct. 2005) (The court found "an implied agreement existing that allowed decedent to retain the enjoyment of the property" held by a limited partnership.")

14 Rev. Rul. 95-58, 1995-2 C.B. 191 (Stating that "even if the decedent had possessed the power to remove the trustee and appoint an individual or corporate successor trustee that was not related or subordinate to the decedent (within the meaning of section 672(c)), the decedent would not have retained a trustee's discretionary control over trust income.")

15 *See also* P.L.R. 9446008 in which the Service confirmed that the mere existence of the power, even if it is never exercised, is sufficient to cause grantor trust status as to the entire trust.

16 Corning v. Commissioner, 104 F.2d 329 (6th Cir. 1939) (grantor not taxed on trust income where the trust granted the trustee the power to purchase life insurance and pay premiums, but the trust did not actually own life insurance); Rev. Rul. 66-313, 1966-2 CB 245 ("grantor will be considered the owner under Section 677(a) of the [Code] of the amount of the trust income which is used to pay the premiums on these policies of insurance on [grantor's] life); Priv. Ltr. Rul. 8839008 (Sept. 30, 1988), Priv. Ltr. Rul. 8014078 (Jan. 10, 1980); Priv. Ltr. Rul. 8007080 (Nov. 26, 1979) (each ruling that trustee's power to apply trust income or principal to pay life insurance premiums resulted in grantor trust status).

17 Rev. Rul. 2007-13, 26 CFR 1.101-1.

18 *See*, e.g. P.L.R. 201310002 (Where distributions to the grantor require the approval of distribution committee, including the grantor and other beneficiaries, the ruling concluded that "an examination of Trust reveals none of the circumstances that would cause Grantor to be treated as the owner of any portion of Trust under IRC §§ 673, 674, 676, or 677.")

19 Rev. Rul. 81-6, 1981-1 C.B. 620.

20 Samuel A. Donaldson, *Burning Questions (and Even Hotter Answers) About Grantor Trusts* (2010).

21 Rev. Rul. 2004-64, 2004-2 C.B. 7. (When the grantor of a trust, who is treated as the owner of the trust under subpart E, pays the income tax attributable to the inclusion of the trust's income in the grantor's taxable income, the grantor is not treated as making a gift of the amount of the tax to the trust beneficiaries.")

22 I.R.B. 2004-27; *see also* P.L.R. 9709001, P.L.R. 9710006, and P.L.R. 200120021 ("Accordingly, we conclude that the Trustee's and Trust Protector's discretionary power … to satisfy Settlor's income tax liability attributable to the income of the trust will not cause the Trust property to be includible in the Settlor's gross estate.")

23 Rev. Rul. 2004-64 I.R.B. 2004-27.

24 *See* Estate of Paxton, 86 T.C. 785 (1975). *See also* In re Uhl's Estate, 241 F.2d 867 (7th Cir. 1957), in which the decedent created an irrevocable trust with a corporate trustee and retained the right to receive $100 per month from the income of the trust. The trust instrument also gave the corporate trustee the power, in its uncontrolled discretion, to distribute "a greater sum than $100 a month if it shall deem advisable." The Tax Court concluded that the assets of the entire trust were includible in the decedent's gross estate because the decedent's creditors could have attached the assets of the self-settled trust for the payment of the decedent's debts. On appeal, the Seventh Circuit overturned the decision of the Tax Court, concluding, under applicable Indiana law, the decedent's creditors could not have reached the assets of the trust absent proof of actual fraud, and there was no evidence of fraud in the record.

25 In Madorin v. Commissioner, 84 TC 667 (1985), the court referenced Section 1001 of the Code and Treas. Reg. § 1.1001-2(c), Example 5, in concluding that because the grantor's share of the partnership's liabilities exceeded his adjusted basis in the partnership upon the deemed disposition, the grantor was required to recognize gain to the extent of the discharge of the grantor's liability.

26 See F. Ladson Boyle & Jonathan G. Blattmachr, *Blattmachr on Income Taxation of Estates and Trusts* § 4:8 (15th ed., rev. 2008).

27 *Id*.

28 *Id*. *See also* Donaldson, Note 21 , *supra*.

29 *See* Boyle & Blattmacher, Note 27, *supra*.