Trust & Estates

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Intentionally Defective Grantor Trusts

In simplest terms an Intentionally Defective Grantor Trust is one in which the grantor will be treated as owner for purposes of income tax rules but which remains a completed transfer for estate tax purposes. This can be done because in general the income tax rules under code sections 673 to 679 are broader than the rules under sections 2035 to 2041, governing incomplete transfers to be included in the decedent's estate.

The main goal therefore is for the grantor to remain obligated to pay the trust's income taxes while not giving him any powers specified in §2036 – 2041. This planning technique increases the amount of tax-free transfers one can make as the trust assets are not diminished by the requirement to pay income taxes. Additionally it is possible that the grantor pays less tax than the trust would due to the compressed tax brackets which trusts are subject to.

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Calculation of Gift Value for QPRTs

A QPRT is an irrevocable trust that holds a person's home. The donor retains the right to live in the property for a term of years. At the end of the term, the QPRT can distribute the property to another trust for the beneficiaries or it can give the residence to them outright. A QPRT allows the donor to:

- Transfer by way of a current gift his home at a substantially discounted value.
- Remove the home and its future appreciation from the gross estate (as long as he survives the trust term).
- Retain the right to live in the property during the term of the trust.

The calculation of the discounted value of the gift requires referring to two tables in IRS publication 1457 – Actuarial Values. (Of course there is software available to do the calculation). First is Table 90CM – the Mortality Table, which computes the odds of a person surviving a term of years. Second is Table B – Term Certain Factors, which computes, among other things, a remainder interest. Table B is presented for a variety of interest rates which for QPRT purposes is the §7520 rate, currently at 2.0%.

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IDGTs (continued from page 1)

(Estates & trust reach the top tax rate of 35% at income of $11,150 compared to individuals who don't hit the top rate until $372,950). The IRS has ruled that the grantor's payment of income tax on trust earnings does not constitute an additional gift by the grantor to the trust. (Rev Rul. 2004-64; 2004-27 I.R.B.)

The following is a summary of the sections describing actions which create a grantor trust:

- §673 Reversionary interest in trust corpus or income exceeding 5%.
- §674 Retension of power to control beneficial enjoyment of trust property or income.
- §675 Retension of certain administrative powers.
- §676 Power to revoke the trust.
- §677 Right to have income or principal paid to grantor or grantor's spouse.
- §678 A third party has a power to vest corpus or income in such third person.
- §679 U.S. person who transfers property to a foreign trust.

While the following sections govern the inclusion of incomplete transfers:

- §2035 Transfer of life insurance within three years of death.
- §2036 Transfers with a retained life estate.
- §2037 Transfers taking effect at death.
- §2038 Revocable transfers.
- §2039 Value of annuity payable to decedent during lifetime & payable to surviving beneficiary.
- §2040 Joint interest values.
- §2041 General powers of appointment.

Two provisions of §675 are frequently used in trust documents to achieve the desired results –

A power to borrow trust principal or income without adequate consideration or security.

The power to substitute assets of equal value.

Either of these will invoke grantor trust status without causing inclusion in the grantor's estate.

Many common and useful estate planning trusts such as ILITS, CLTs, GRATs, GRUTs and QPRTs are also IDGTs while a super-charged credit shelter trust involves similar planning intensions with the surviving spouse as grantor.

AFR *	
Short Term	0.35%
Mid-Term	1.59%
Long-Term	3.35%
Sec. 7820 **	2.0%
Rate on Underpayments	
Individual	4.0%
Corporate	4.0%
Large Corporate	6.0%

* Interest rate used for loans between a shareholder and corporation or for installment sales.

** Rate used for determining the present value of an annuity, an interest for life, or a remainder or reversionary interest.

IRS Interest Rates (Nov. 2010)

QPRTs (continued from page 1)

An example illustrating the calculation:

Donor aged 65
A trust term of 10 years
A personal residence worth $750,000
As noted, the current §7520 rate of 2.0%

First we compute the probability of the donor surviving the term of the trust.
The factor for a 65 year old from Table 90CM is 79519 (the factors are a percentage of 100,000)
The factor for a 75 year old from the same table is 60449.
Dividing 60449 by 79519 we get .76018 (the probability that the donor will live 10 more years)

Next from Table B (at a rate of 2%), the remainder interest for 10 years is .82035

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Income Taxation of Trusts & Estates

State	Domicile of Settlor / Decedent	Resident Trustee	Resident Beneficiary	Estate Tax	Exemption Amount	Inheritance Tax
Connecticut	x			x	3,500,000	
Delaware	x	x		x	3,500,000	
Florida						
New Jersey	x			x	675,000	x
New York	x			x	1,000,000	
North Carolina			x	x	2,000,000	
Pennsylvania	x					x
Virginia	x	x				

State Fiduciary & Estate Facts

IRS	General Information	800-829-1040
	EINs	800-829-4933
	Form 706 & 709	866-699-4083
NJ	General Information	609-826-4400
	Estate & Inheritance	609-292-5033
NY	General Information	518-457-5181
	Estate Tax	518-457-5387

Important Phone Numbers

QPRTs (continued from page3)

Multiplying the survival probability (.76018) by the remainder interest factor of .82035 we get the taxable gift value rate of .62361
The value of the taxable gift is then $750,000 multiplied by 62.361% or $467,708.

By using $467,708 of our remaining gift tax exemption (if any is left), we have eliminated $750,000 plus all future appreciation in the home from the donor's estate.

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