

DISCLAIMER

This presentation does not constitute legal, accounting, or other professional advice. Only through a personal, confidential consultation with qualified legal counsel can anyone properly evaluate their own unique estate planning challenges and determine what, if any, appropriate legal strategies and tactics should be implemented to meet those challenges.

IRS CIRCULAR 230 DISCLAIMER

Nothing in this presentation is intended or written to be used, and cannot be used, by any person for the purpose of avoiding tax penalties regarding any transactions or matters addressed herein. You should always seek advice from independent tax advisors regarding the same.



**AFTER PASSAGE OF OBBBA
WHAT TO DO, IF ANYTHING?**

Taxation of Trust Review

Grantor vs. Nongrantor Trust

- ▣ The grantor trust rules are found in Sections 671–679 of the Internal Revenue Code (I.R.C.) of 1986, as amended. I.R.C. Sections 671–679 comprise subpart E of part I of subchapter J of chapter 1 of the Code (Subpart E).
- ▣ If a trust is a “grantor” trust for tax purposes, income earned from the trust is attributable to the grantor/trustmaker/settlor even if that income is not distributed to the grantor/trustmaker/settlor

Taxation of Trust Review

Allocation vs. Distribution

- ▣ “Allocation” means to apportion, set apart, or earmark specific tax items for a specific purpose or to a particular person.
 - Specific tax items include ordinary income, interest income, principal, and basis for computing gain or loss.
 - See West’s Tax Law Dictionary
- ▣ “Distribution” means the actual giving out of money or property from a trust, corporation, partnership, etc. (See Black’s Law Dictionary)

Estate Tax Exemption

Year	Estate Tax Exemption
2000	\$675,000.00
2011	\$5,000,000.00
2023	\$12,920,000.00
2024	\$13,610,000.00
2025	\$13,990,000.00
2026	\$15,000,000.00

Individual Income Tax Rates 2026

Taxable Income	Marginal Tax Rate
Not over \$12,400	10%
Over \$12,400 but not over \$50,400	12%
Over \$50,400 but not over \$105,700	22%
Over \$105,700 but not over \$201,775	24%
Over \$201,775 but not over \$256,225	32%
Over \$256,225 but not over \$640,600	35%
Over \$640,600	37%

Estate and Trust Income Tax Rates 2026

Taxable Income	Marginal Tax Rate
Not over \$3,300	10%
Over \$3,300 but not over \$11,700	24%
Over \$11,700 but not over \$16,000	35%
Over \$16,000	37%

Traditional Grantor Trust Planning for Federal Transfer Taxes

One successfully achieves grantor trust status while removing the assets from his or her estate for estate tax purposes if:

The trust includes a power exercisable in a nonfiduciary capacity to reacquire the assets by substituting assets of equivalent value, without the approval or consent of any person in a fiduciary capacity;

IRC § 674 (4)(c) and Treas. Reg. § 1.675-1(b)(4)(iii).

The trust includes a power to add the class of beneficiaries (other than to provide for after-born or after-adopted children), including, without limitation, a charitable beneficiary; or

IRC § 674(a).

The trust includes a power to enable the grantor to borrow money or assets from the trust without adequate interest or security.

IRC § 675.

Power Exercisable only by Will

Code § 674(b)(3) provides that a power exercisable solely by Will generally does not cause a trust to be owned by its grantor. If, however, the power of appointment governs income and principal, the trust will be a grantor trust.

Example:

- ▣ A trust instrument provides that trust income is to be accumulated during the life of the grantor's spouse, who may appoint the trust income by Will, without the consent of an adverse party.

Irrevocable Trusts

Limited Power of Appointment

I have the limited testamentary power to appoint the remaining principal and accrued or accumulated income of the trust to or for the benefit of any one or more of my descendants or any charities of my choosing. I may not exercise this power of appointment for the benefit of either of myself, my creditors, my estate, or the creditors of either of my estate.

Definition of “Gift”

- ▣ 2512(b): Property transferred for less than adequate and full consideration is deemed a gift
- ▣ Treas. Reg. § 25.2511-1(c)(1): An interest in property gratuitously conferred upon another constitutes a gift
- ▣ Treas. Reg. § 25.2511-2(b) Completed Gift Definition
 - “As to any property . . . of which the donor has so parted with dominion and control as to leave in him no power to change its disposition . . . the gift is complete.”

Completed Gift

- ▣ The gift tax applies only to completed gifts. A gift is complete as to property over which the donor has parted with dominion and control, leaving the donor with no power to change the disposition of the gift.

[Treas. Reg. § 25.2511-2.]

- ▣ A gift is incomplete if the donor retains lifetime or testamentary general or special power to appoint the property. If the donor releases the power or control, the transfer is complete.

Relinquishment of a Power

Treas. Reg. § 25.2511-2(f): Relinquishment of a Power

“The relinquishment or termination of a power to change the beneficiaries . . . is regarded as the event that completes the gift and causes the tax to apply.”

Example

Treas. Reg. § 25.2511-2(b) Example (Part 1)

Income to donor or accumulated in discretion of trustee

+ Retained testamentary LPOA

= Entire transfer is incomplete gift

Example

Treas. Reg. § 25.2511-2(b) Example (Part 2)

Income to donor or accumulated in discretion of trustee

+ No retained testamentary LPOA

= Entire transfer is completed gift

The Concept of Basis

- ▣ In general, the basis of property shall be the cost of such property
 - *See IRC § 1012.*

- ▣ Cost basis is the purchase price, plus certain other expenses, less allowable depreciation, casualty, and theft losses.

- ▣ When the property is sold, the taxpayer pays taxes on the capital gain that equals the amount realized on the sale, minus the basis of the sold property.

Carryover Basis

- ❑ Carryover basis applies to lifetime gifts and transfers to trusts. The basis in the gifted or transferred property is the same as it would be in the hands of the donor [IRC § 1015].
- ❑ Basis for calculating a gain on a gift is the same as the donor's adjusted basis.
- ❑ A loss on a gift is the fair market value of the property when the gift was received, plus or minus any required adjustments to basis while the donee held the gift.

Stepped-Up Basis

- ▣ The basis of property acquired from a decedent is the fair market value of the property at the date of the decedent's death.
- ▣ Property acquired from a decedent includes a bequest, devise, or inheritance, among other types of property.
- ▣ In general, the cost basis of property transferred at death “steps up” to its fair market value so that the beneficiary's capital gains tax is minimized.

[IRC Section 1014]

**CONSEQUENCES OF MAKING
TAXABLE (I.E. COMPLETED) GIFTS OF
DEPRECIATED PROPERTY**

Depreciation Recapture Overview

- ❑ Allows the IRS to reclaim depreciation expenses that the taxpayer had claimed in years prior
- ❑ Section 1245 property is all depreciable personal property (and certain depreciable real property that performs specific functions, such as a storage tank)
- ❑ Section 1250 property is any real property (buildings and their structural components) that is subject to the allowance for depreciation
- ❑ Recapture is triggered when there is a taxable disposition (i.e. sale) of property

Depreciation Recapture & Gifting

- ▣ The recapture rules do not apply to gifts of Section 1245 or 1250 property.
 - ▣ Note that this general rule is subject to three special rules for gifts to trust, gifts to charity, and part-gift/part-sale transfers.
- ▣ A gift is a transfer of property where the recipient has a basis equal to the donor's basis plus the amount of gift tax the donor paid on that gift.
- ▣ Gifting business property merely shifts the burden of the recapture rules to another taxpayer (the recipient).
 - ▣ Example: Property is gifted to the donor's children, who are in a lower tax bracket than donor. When subsequently sold, the after-tax return will be higher.

Depreciation Recapture & Gifting: Gifts in Trust

- ❑ Recapturable depreciation gain is not recognized where a gift of Section 1250 property is either:
 - made in trust or
 - when (after the death of the life beneficiary) the trustee distributes the *same* property to the remainderman, if the basis of the property to the trustee and remainderman is the same as the donor's basis and the trustee and remainderman both acquired their interest in the property at the time the donor had relinquished dominion over it.
- ❑ If the trustee sells the property and reinvests the proceeds in other Section 1250 property, and then distributes it to the remainderman, depreciation recapture will be triggered on the sale. . . .

Basis Adjustment at Death

- ❑ The basis of property acquired from a decedent is the fair market value of the property at the date of the decedent's death.
- ❑ Property acquired from a decedent includes a bequest, devise, or inheritance, among other types of property (e.g., property in incomplete gift irrevocable trust).
- ❑ In general, the cost basis of property transferred at death “steps up” to its fair market value so that the beneficiary's capital gains tax is minimized.

Basis Adjustment at Death

- ▣ Because property included in the decedent's estate benefits from the basis adjustment (usually a step up), such assets would not be subject to Section 1245 and 1250 depreciation recapture.
- ▣ This benefit is not available to property transferred during the individual's lifetime because the transferee would then take the transferor's tax basis in the property and retain any built-in gain that exists due to the FMV exceeding the basis.

IRC § 1250 Recapture Example

Suppose a taxpayer purchased a nonresidential commercial building (Section 1250 property) for \$1,000,000. Over the years, the taxpayer claimed \$200,000 in straight-line depreciation. The taxpayer then sells the building for \$1,300,000.

- Step 1: Calculate Adjusted Basis
 - Original cost: \$1,000,000
 - Less: Depreciation taken: \$200,000
- Adjusted basis: \$800,000

- Step 2: Calculate Total Gain on Sale
 - Amount realized (sale price): \$1,300,000
 - Less: Adjusted basis: \$800,000
- Total gain: \$500,000

IRC § 1250 Recapture Example

- ▣ Step 3: Determine Additional Depreciation
 - **Depreciation taken:** \$200,000
 - **Depreciation allowable under straight-line:** \$200,000
 - **Additional depreciation:** \$0
 - ▣ For Section 1250 property held more than one year, "additional depreciation" is the amount of depreciation taken in excess of what would have been allowed under the straight-line method. However, for most property placed in service after 1986, only straight-line depreciation is allowed, so "additional depreciation" is typically zero. If only straight-line depreciation was taken, there is no ordinary income recapture under Section 1250(a); instead, the gain attributable to depreciation is taxed as "unrecaptured Section 1250 gain" at a maximum 25% rate.

IRC § 1250 Recapture Example

- ▣ Step 4: Section 1250 Recapture as Ordinary Income
 - ▣ Section 1250 recapture (ordinary income): \$0 (since all depreciation was straight-line)
- ▣ Step 5: Unrecaptured Section 1250 Gain
 - ▣ The portion of the gain attributable to depreciation (up to \$200,000) is taxed at a maximum 25% rate as "unrecaptured Section 1250 gain." The remainder of the gain (\$500,000 - \$200,000 = \$300,000) is taxed at the long-term capital gains rate.
- ▣ **Unrecaptured Section 1250 gain:** \$200,000 (taxed at up to 25%)
- ▣ **Remaining gain:** \$300,000 (taxed at long-term capital gains rates)

IRC § 1250 Recapture Example

Summary Table

Calculation Step	Amount
Original Cost	\$1,000,000
Depreciation Taken	\$200,000
Adjusted Basis	\$800,000
Sale Price	\$1,300,000
Total Gain	\$500,000
<u>Section 1250</u> Recapture (Ordinary)	\$0
Unrecaptured <u>Section 1250</u> Gain	\$200,000
Remaining Long-Term Capital Gain	\$300,000
Total Tax (Estimate)	\$110,000

Revenue Rulings
Every
Estate Planner Should Know

What is a Revenue Ruling?

- ▣ Revenue Rulings are official pronouncement from the IRS National Office.
- ▣ Each Revenue Ruling Concerns the application of the Code and Regulations to a specific situation.
- ▣ Format of a Revenue Ruling
 - Issue
 - Facts
 - Law and Analysis
 - Holding

Citation of a Revenue Ruling: Rev. Rul. 85-13; 1985-1 C.B. 184

What is a Revenue Procedure?

- ❑ Revenue Procedures are also official pronouncements from the IRS National Office.
- ❑ Revenue Procedures concern internal practices and procedures of the IRS when administering tax laws.
- ❑ Cited similarly to Revenue Rulings

What is a Private Letter Ruling?

- ❑ The IRS National Office will issue responses to taxpayer's request for the IRS' position regarding a specific tax issue
- ❑ Revenue Procedures concern internal practices and procedures of the IRS when administering tax laws.
- ❑ These Rulings are issued to and binding on only the taxpayer that requested the ruling.

What is a Private Letter Ruling?

- ▣ Although letter rules don't bind the IRS with respect to other taxpayers, they can be very informative and are included in the list of "substantial authority upon which a taxpayer may rely to avoid penalties. *Treas. Reg. § 1.6662-4(d)(3)*.
- ▣ Cited similarly to Revenue Rulings: Private Letter Ruling 200620025, 05/19/2006.

Hierarchy of Federal Tax Authority

Internal Revenue Code

Treasury Regulations

Revenue Rulings and Revenue Procedures

Private Letter Rulings

List of Revenue Rulings Covered

- Rev. Rule 70-155: Retaining Occupancy of Residence
- Rev. Rul. 73-143: Settlor Serving as Trustee with Ascertainable Standards
- Rev. Rul. 85-13: Transactions with Grantor Trusts
- Rev. Rul. 2002-2: QTIPing an IRA
- Rev Rul. 2008-22: Substitution Power
- Rev Rul. 95-58: Removal and Replacement of Trustee
- Rev Rul. 2023-2: Basis of Property Acquired From Decedent

Rev. Rul. 70-155

Retaining Occupancy in a Residence

- ❑ Elderly man transferred title to his residence to his son and daughter-in-law.
- ❑ Understanding by all parties at the time of the transfer that elderly man would retain the use of the property
- ❑ Elderly man's son and daughter-in-law neither occupied the property nor received reasonable income therefrom during his lifetime.

Rev. Rul. 70-155

Retaining Occupancy in a Residence

- ▣ IRC §2036(a)(1): value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has, at any time, made a transfer ... by trust or otherwise, under which he has retained for his life ... the possession or enjoyment of the property.
- ▣ Because elderly man continued in exclusive possession or enjoyment of the residence after making the transfer ... it is held that the value of the property is includible in his gross estate under IRC §2036(a)(1)

Rev. Rul. 70-155

Retaining Occupancy in a Residence

- ▣ Retained interest need not be stated in the instrument of transfer, nor need it be a legally enforceable right. An understanding or agreement, express or implied, as to the donor's retained use of the transferred property is sufficient to bring the transfer within the provisions of IRC §2036(a)(1)
- ▣ Note: Co-occupancy, where the donor and donee are husband and wife, does not of itself support an inference of an agreement or understanding as to retained possession or enjoyment by the donor

Rev. Rul. 73-143

Settlor Serving as Trustee with Ascertainable Standards

- ▣ Decedent established two trusts prior to death: one for son and one for daughter
 - Daughter's Trust: In the event of special need ... Trustee, in his sole discretion, may pay to her or use for her benefit such amount or amounts of the principal of the Trust Estate as shall seem to him advisable for her support and education.
 - Son's Trust: In the event of special need ... Trustee, in his sole discretion, may pay to said beneficiary or use for his benefit such amount or amounts of the principal of the Trust Estate as shall seem to him advisable.

Rev. Rul. 73-143

Settlor Serving as Trustee with Ascertainable Standards

- ▣ IRC § 2038: the value of the gross estate shall include the value of all property transferred by the decedent, in trust or otherwise, over which he holds at his death, either alone or in conjunction with any other person, the power to alter, amend, revoke, or terminate the enjoyment of the beneficial interest.
- ▣ Nondiscretionary powers to vary the beneficial interests of a trust held by a settlor-trustee do not render the value of the property subject to the trust includible in his gross estate. Nondiscretionary powers are those limited by an ascertainable standard.

Rev. Rul. 73-143

Settlor Serving as Trustee with Ascertainable Standards

- ▣ Invasion clause for daughter's trust: Trust may be invaded only for her support and education and then only in the event of special need. The power to distribute corpus for support and education is an ascertainable standard which can be objectively applied.
- ▣ Invasion clause for son's trust: Trust may be invaded in the event of special need but no restriction upon the purpose for which the trust corpus may be invaded. "Special need" as used in this trust would cover any need that is out of the ordinary or that arises from unexpected circumstances.

Rev. Rul. 73-143

Settlor Serving as Trustee with Ascertainable Standards

Holding

Accordingly, it is held that the value of the property held in trust for the decedent-trustee's daughter is not includible in his gross estate under IRC § 2038 because his power to invade corpus was governed by a determinable standard. On the other hand, the value of the trust for the decedent-trustee's son is includible in his gross estate because the power to invade corpus was not so limited.

Ascertainable Standards

- ▣ Grantor or beneficiary should not serve as trustee for trusts permitting broad discretionary powers. For example, if a trustee is given an unlimited discretion to distribute income and/or principal among a group of beneficiaries and the trustee is one of those beneficiaries, then the entire principal of the trust will be included in the trustee's gross if the trustee dies before the trust terminates.
- ▣ But, if the trustee's power is limited by an ascertainable standard, the power will not be considered a general power of appointment, thereby avoiding gross estate inclusion of the trust assets.

Ascertainable Standards Teas. Reg. § 20.2041-1(c)

- ▣ If trustee/donnee's duty to exercise and not to exercise the power is reasonably measurable in terms of the donee's needs for health, education, or support, or any combination of them, then it is an ascertainable standard.
- ▣ Examples:
 - health, education, maintenance, or support
 - support in reasonable comfort
 - maintenance in health and reasonable comfort
 - support in his accustomed manner of living
 - medical, dental, hospital and nursing expenses and expenses of invalidism.”

Rev. Rul. 85-13

Transactions with Grantor Trusts

- ▣ Rev. Rul. 85-13 has become a cornerstone of modern estate planning.
- ▣ Provided the basis for planning with ILITs, Installment Sales, CLATs, and other transactions where settlor wants the ability to engage with the trust without triggering adverse income tax consequences.

Rev. Rul. 85-13

Transactions with Grantor Trusts

- ❑ “A” created an irrevocable trust, named his wife as trustee, and funded the trust with 100 shares of stock in Corporation Z.
- ❑ No retained power over trust that would cause the trust to be treated as grantor trust with respect to A.
- ❑ One year later, A borrowed the entire trust corpus, which had appreciated in value, in exchange for promissory note, bearing appropriate interest.
- ❑ The grantor sold the Corporation Z shares a few years later.

Rev. Rul. 85-13

Transactions with Grantor Trusts

- ▣ Rev. Rul. 85-13 viewed the transaction as equivalent to borrowing entire trust corpus and treated grantor as owner of entire trust corpus.
- ▣ Thus, grantor was the maker and owner of promissory note held by the trust.
- ▣ Transfer of the shares is not recognized as sale because the same person owned the promissory note before and after the transaction.

Rev. Rul. 85-13
Transactions with Grantor Trusts

Holding

A sale or exchange between a settlor and her grantor trust is disregarded and is not recognized as a sale for federal income tax purposes.

Rev. Rul. 2000-2 QTIPing an IRA

- ▣ An executor may elect to treat an IRA and a trust as QTIP when :
 - the trustee of the trust is the named beneficiary of the IRA.
 - The surviving spouse can compel the trustee to withdraw from an IRA an amount equal to all the income earned on the IRA assets at least annually and to distribute that amount to the spouse.
 - No person has a power to appoint any part of the trust property to any person other than the spouse.

Rev. Rul. 2008-22

Settlor's Substitution Power

- ▣ “A” established an irrevocable trust for benefit of their descendants.
- ▣ A was prohibited from serving as trustee of the trust under the trust's terms.
- ▣ However, A retained substitution power.
 - ▣ Substitutions did not require trustee's consent, but did require A to certify in writing that substituted property and the trust property exchanged for were equal in value.
 - ▣ Under local law, the trustee had a fiduciary obligation to ensure the exchanged property was of equivalent value.
 - ▣ Additionally, the trustee had a duty under local law to act impartially toward all beneficiaries.

Rev. Rul. 2008-22 - Settlor's Substitution Power

- ▣ A retained substitution power does not trigger estate inclusion under I.R.C. §§ 2036(a) or 2038(a) so long as:
 - ▣ the power is subject to a fiduciary obligation ensuring substitutions are of equal value, and
 - ▣ the power does not create the ability to shift benefits between beneficiaries.
- ▣ Although “A” was not himself subject to either of these limitations, the power was so subject because of the trustee’s fiduciary obligation under local law.

Rev. Rul. 2008-22

Settlor's Substitution Power

- ▣ Confirms the idea from *Estate of Jordahl v. Commissioner*, 65 T.C. 92 (1975).
- ▣ Therefore, the substitution power is an effective tool for creating a grantor trust without triggering estate tax inclusions.

Rev. Rul. 2008-22- Settlor's Substitution Power

Holding

A retained power of substitution does not trigger estate inclusion as long as the power cannot be used to alter the value of the trust or shift the benefits among beneficiaries.

Rev. Rul. 95-58

Removal & Replacement of Trustees

- ▣ IRC § 2036(a): the value of the gross estate includes the value of all property to the extent of any interest in the property that was transferred by the decedent ... if the decedent has retained for life the right, alone or in conjunction with any person, to designate the person who shall possess or enjoy the property or the income therefrom.

Rev. Rul. 95-58

Removal & Replacement of Trustees

- ▣ IRC §2038(a)(1): the value of the gross estate includes the value of all property to the extent of any interest in the property that was transferred by the decedent ... if the decedent held a power, exercisable alone or in conjunction with any person, to change the enjoyment of the property through the exercise of a power to alter, amend, revoke, or terminate.
- ▣ Treas. Reg. § 25.2511-2(c): gift of property is incomplete to the extent that the donor reserves the power to revest the beneficial title to the property in himself or herself or the power (other than a fiduciary power limited by a fixed or ascertainable standard) to name new beneficiaries or to change the interest of the beneficiaries among themselves.

Rev. Rul. 95-58

Removal & Replacement of Trustees

- ▣ *Estate of Wall v. Commissioner*, 101 T.C. 300 (1993)
 - ▣ Decedent created a trust for the benefit of others and designated an independent corporate fiduciary as the trustee.
 - ▣ Decedent reserved the right to remove and replace the corporate trustee with another independent corporate trustee.
 - ▣ Court held that this retained power was not equivalent to a power to affect the beneficial enjoyment of the trust property as contemplated by I.R.C. §§ 2036 and 2038

Rev. Rul. 95-58

Removal & Replacement of Trustees

- ▣ *Estate of Vak v. Commissioner*, 973 F.2d 1409 (8th Cir. 1992)
 - ▣ Decedent created a trust and appointed a family member as the trustee with discretionary powers of distribution.
 - ▣ Decedent reserved the right to remove and replace the trustee with successor trustees who were **not** related or subordinate to the decedent.
 - ▣ The court concluded that the decedent had not retained dominion and control over transferred assets by reason of decedent's removal and replacement power, so the gift was complete

Rev. Rul. 95-58

Removal & Replacement of Trustees

Holding

A settlor's retained power to remove and replace the trustee does not cause estate inclusion so long as the new trustee who may be appointed is not the settlor and is not related or subordinate within the meaning of I.R.C. § 672(c) to the settlor.

Rev. Rul. 95-58

Removal & Replacement of Trustees

- ❑ The trust corpus is not included in the decedent's gross estate under I.R.C. §§ 2036 or 2038.
- ❑ The settlor's reservation of such removal and replacement power does not affect the completed nature of a gift to the trust.
- ❑ Beneficiaries and other individuals may also possess the power.

Revenue Ruling 2023-2

Latest Tax Controversy

Rev. Rul. 2023-2

Basis of Property Acquired from Decedent

- ❑ In Year 1, A, an individual, established an irrevocable trust, T, funded with an asset transfer that was a completed gift for tax purposes.
- ❑ A retained power over T that causes A to be treated as the owner of T for income tax purposes .
- ❑ A did not hold a power over T that would cause the inclusion of T's assets in A's gross estate under the provisions of Chapter 11.
- ❑ By the time of A's death in Year 7, the fair market value of the asset had appreciated.
- ❑ At the time of A's death, the liabilities of T did not exceed the basis of the assets in T, and neither T nor A held a note on which the other was the obligor.

Rev. Rul. 2023-2

Basis of Property Acquired from Decedent

- ▣ IRC § 1.1014-1(a) generally provides that the basis of property acquired from a decedent is equal to the value placed upon such property for purposes of chapter 11.
- ▣ Accordingly, generally the basis of property acquired from a decedent is the fair market value of such property at the date of the decedent's death, or, if the decedent's executor so selects, at the alternative valuation date provided in § 2032.

Rev. Rul. 2023-2

Basis of Property Acquired from Decedent

- ▣ For property to receive a basis adjustment under § 1014(a), the property must be acquired or passed from a decedent.
- ▣ A “bequest” is the act of giving personal property by will.
- ▣ A “devise” is the act of giving property, especially real property, by will.
- ▣ An “inheritance” is property received from an ancestor under the laws of intestacy, or property that a person receives by bequest or devise.

Rev. Rul. 2023-2

Basis of Property Acquired from Decedent

- ❑ A creates T, an irrevocable trust, retaining a power which causes A to be the owner of the entire trust for income tax purposes under chapter 1, but does not cause the assets to be included in A's gross estate for purposes of chapter 11.
- ❑ If A funds T with an asset in a transaction that is a completed gift for gift tax purposes, the basis of the asset is not adjusted to its fair market value on the date of A's death under § 1014 because the asset was not acquired or passed from the decedent.
- ❑ Accordingly, under these facts, the basis of the asset immediately after A's death is the same as the basis of the asset immediately prior to A's death.

**Decanting Trusts
&
Removing Trustees**

Introduction to Decanting

What is Decanting?

- ▣ Decanting is the process by which a trustee transfers assets from one irrevocable trust to another trust with modified terms.

- ▣ **Purpose and Benefits:**
 - ▣ Provides flexibility to address changes in law, technology, or beneficiary needs.
 - ▣ Allows for modernization of trust terms without court approval in many cases.

Legal Basis for Decanting

▣ **Statutory Authority:**

- ▣ Many states have enacted laws granting trustees the power to decant under specific conditions.

▣ **Common Law Principles:**

- ▣ In the absence of statutes, courts may recognize decanting based on a trustee's discretionary authority.

▣ **Trust Instrument Provisions:**

- ▣ Some trusts explicitly grant the trustee the power to decant, subject to applicable laws.

Statutes & Revenue Rulings Covered

- ▣ N.D. Cent. Code, § 59-09-11 & S.D. Codified Laws § 55-3-24:
Binding nonjudicial settlement agreement.
- ▣ NN.D. Cent. Code, § 59-16.1-16 & S.D. Codified Laws § 55-2-15:
Distribution to Another Trust
- ▣ N.D. Cent. Code, § 59-12-10 & S.D. Codified Laws § 55-3-24:
Power to direct termination of an irrevocable trust
- ▣ N.D. Cent. Code, § 59-15-06 & S.D. Codified Laws § 55-3-20.1:
Removing a Trustee
- ▣ Rev. Rul 95-58: Removal & Replacement of Trustees

N.D. Cent. Code, § 59-09-11

Binding Nonjudicial Settlement Agreement

- ❑ 1. For purposes of this section, “interested persons” means a trustee and persons whose consent would be required in order to achieve a binding settlement were the settlement to be approved by the court.
- ❑ 2. Except as otherwise provided in subsection 3, interested persons may enter into a binding nonjudicial settlement agreement with respect to any matter involving a trust.
- ❑ 3. A nonjudicial settlement agreement is valid only to the extent it does not violate a material purpose of the trust and includes terms and conditions that could be properly approved by the court under chapters 59-09, 59-10, 59-11, 59-12, 59-13, 59-14, 59-15, 59-16, 59-17, 59-18, and 59-19 or other applicable law. A spendthrift provision in the terms of a trust is presumed to constitute a material purpose of the trust.

N.D. Cent. Code, § 59-09-11

Binding Nonjudicial Settlement Agreement

- ▣ 4. Matters that may be resolved by a nonjudicial settlement agreement include the interpretation or construction of the terms of the trust, the approval of a trustee's report or accounting, direction to a trustee to refrain from performing a particular act or the grant to a trustee of any necessary or desirable power, the resignation or appointment of a trustee and the determination of a trustee's compensation, transfer of a trust's principal place of administration, liability of a trustee for an action relating to the trust, the extent or waiver of bond of a trustee, and the criteria for distribution to a beneficiary where the trustee is given discretion.
- ▣ 5. Any interested person may request the court to approve a nonjudicial settlement agreement to determine whether the representation as provided in chapter 59-11 was adequate and to determine whether the agreement contains terms and conditions the court could have properly approved.

S.D. Codified Laws § 55-18-1

Binding Nonjudicial Settlement Agreement

- ▣ “Nonjudicial settlement,” an agreement, release, or other action whether or not approved by a court, which may include, without limitation:
 - ▣ (a) The interpretation or construction of the terms of a trust;
 - ▣ (b) The approval of any fiduciary’s report or accounting;
 - ▣ (c) Direction to any fiduciary to refrain from performing a particular act or the grant to a fiduciary of any necessary or desirable power;
 - ▣ (d) The resignation or appointment of any fiduciary;
 - ▣ (e) The determination of a fiduciary or a representative’s compensation;
 - ▣ (f) The transfer of a trust’s principal place of administration or situs;
 - ▣ (g) The liability of any fiduciary’s action or omission relating to a trust;
 - ▣ (h) Partial or final settlement agreements regarding a trust or its administration; or
 - ▣ (i) The modification, amendment, reformation, or termination of a trust;

N.D. Cent. Code, § 59-16.1-16

Distribution to a Second Trust

An authorized trustee may exercise a power authorized by this chapter to appoint a trust that is a supplemental needs trust that conforms to chapter 59-08. However, an authorized trustee may not exercise a power authorized by this chapter to effect the following:

- ▣ 1. To reduce, limit, or modify any beneficiary's current right to:
 - a. A mandatory distribution of income or principal;
 - b. A mandatory annuity or unitrust interest;
 - c. A current right to withdraw a percentage of the value of the trust; or
 - d. A current right to withdraw a specified dollar amount;

N.D. Cent. Code, § 59-16.1-16

S.D. Codified Laws § 55-2-15

Distribution to a Second Trust

- ▣ Unless the terms of the governing instrument expressly provide otherwise, if a trustee has discretion under the terms of a governing instrument to make a distribution of income or principal to or for the benefit of one or more beneficiaries of a trust (the “first trust”), whether or not restricted by any standard, then the trustee, independently or with court approval, may exercise such discretion by appointing part or all of the income or principal subject to the discretion in favor of a trustee of a second trust (the “second trust”) under a governing instrument separate from the governing instrument of the first trust. Before exercising the discretion to appoint and distribute assets to a second trust, the trustee of the first trust shall determine whether the appointment is necessary or desirable after taking into account the purposes of the first trust, the terms and conditions of the second trust, and the consequences of the distribution.
- ▣ For the purposes of this section, a trustee of the first trust is a restricted trustee if either the trustee is a beneficiary of the first trust or if a beneficiary of the first trust has a power to change the trustees within the meaning of § 55-2-17.

S.D. Codified Laws § 55-2-15

Distribution to a Second Trust

▣ For the purposes of this section, a trustee of the first trust is a restricted trustee if either the trustee is a beneficiary of the first trust or if a beneficiary of the first trust has a power to change the trustees within the meaning of § 55-2-17.

▣ S.D. Codified Laws § 55-2-15

S.D. Codified Laws § 55-2-15 Distribution to a Second Trust

In addition, the following apply to all appointments made under this section:

- ▣ (1) The second trust may only have as beneficiaries one or more of the beneficiaries of the first trust:
 - (a) To or for whom a discretionary distribution of income or principal may be made from the first trust;
 - (b) To or for whom a distribution of income or principal may be made in the future from the first trust at a time or upon the happening of an event specified under the first trust; or
 - (c) Both subsections (a) and (b);

S.D. Codified Laws § 55-2-15

Distribution to a Second Trust

- ▣ (2) No restricted trustee of the first trust may exercise such authority over the first trust to the extent that doing so could have the effect of:
 - (a) Benefiting the restricted trustee as a beneficiary of the first trust, unless the exercise of such authority is limited by an ascertainable standard based on or related to health, education, maintenance, or support; or
 - (b) Removing restrictions on discretionary distributions to a beneficiary imposed by the governing instrument under which the first trust was created, except that a provision in the second trust, which limits distributions by an ascertainable standard based on or related to the health, education, maintenance, or support of any such beneficiary, is permitted, or to a trust established pursuant to 42U.S.C. § 1396p(d)(4) (January 1, 2025);

• S.D. Codified Laws § 55-2-15

N.D. Cent. Code, § 59-12-10 & S.D. Codified Laws § 55-3-24
Power to Direct Termination or Modification of an Irrevocable Trust

- ▣ A trust instrument may grant a trustee or another person the power to modify or terminate the trust without court approval for both jurisdictions.
 - ▣ N.D. Cent. Code, § 59-12-10
 - ▣ S.D. Codified Laws § 55-3-24

N.D. Cent. Code, § 59-12-10

Power to Direct Termination or Modification of an Irrevocable Trust

- ▣ 1. In addition to the methods of termination prescribed by sections 59-12-11, 59-12-12, 59-12-13, and 59-12-14, a trust terminates to the extent the trust is revoked or expires pursuant to its terms, no purpose of the trust remains to be achieved, or the purposes of the trust have become unlawful or impossible to achieve.

- ▣ 2. A proceeding to approve or disapprove a proposed modification or termination under sections 59-12-11, 59-12-12, 59-12-13, 59-12-14, 59-12-15, and 59-12-16, or trust combination or division under section 59-12-17, may be commenced by a trustee or beneficiary. The settlor of a charitable trust may maintain a proceeding to modify the trust under section 59-12-13.
 - ▣ N.D. Cent. Code, § 59-12-10

N.D. Cent. Code, § 59-12-10

Power to Direct Termination or Modification of an Irrevocable Trust

1. Upon petition by the trustee, the attorney general, or an interested party other than the settlor, the court may modify the administrative or dispositive terms of a trust or terminate the trust if, because of circumstances not anticipated by the settlor, modification or termination will further the purposes of the trust. To the extent practicable, the modification must be made in accordance with the settlor's probable intention.
2. The court may modify the administrative terms of a trust if continuation of the trust on its existing terms would be impracticable or wasteful or impair the trust's administration.
3. Upon termination of a trust under this section, the trustee shall distribute the trust property in a manner consistent with the purposes of the trust.

S.D. Codified Laws § 55-3-24

Power to Direct Termination or Modification of an Irrevocable Trust

- ▣ An irrevocable trust may be modified or terminated by judicial action or by the written consent of all beneficiaries, if continuance of the trust on its existing terms is not necessary to carry out a material purpose. Whether or not continuance of the trust on its existing terms is necessary to carry out a material purpose, an irrevocable trust may be modified or terminated by the written consent of the trustor and all beneficiaries. Upon termination of a trust under this section, the trustee shall distribute the trust property in accordance with the trustor's probable intention or in any other manner as agreed by all the beneficiaries. No person is required to seek court affirmation of a nonjudicial settlement agreement made pursuant to this section. The provisions of chapter 55-18 apply to this section.

S.D. Codified Laws § 55-3-24

Power to Direct Termination or Modification of an Irrevocable Trust

- ▣ Thirty days prior to the effective date of a modification or termination of a trust under this section, the trustor or beneficiaries shall provide notice in writing of the modification or termination, including a copy of the modification or termination to all fiduciaries, as defined in subdivision 21-22-1(3) serving as of the date of the notice. The modification or termination is effective no earlier than thirty days after the notice is given, unless the notice is waived.

○ S.D. Codified Laws § 55-3-24

Legal Basis for Removing Trustees

Statutory Grounds:

- Serious breach of trust
- Unfitness or unwillingness to administer the trust effectively.
- Substantial change in circumstances making removal in the best interests of beneficiaries.
- Beneficiary requests, provided removal aligns with the trust's purpose.
- Authority:
- Certain law allows removal under the trust instrument or by court petition.

Judicial Standards for Removal

- Primary Standard:
- The trustee's continuance must not be detrimental to the proper administration and best interests of the trust.
- Additional Considerations:
 - Breaches of trust or mismanagement.
 - Conflicts of interest with beneficiaries.
 - Legal incapacity or unfitness to serve.

N.D. Cent. Code, § 59-15-05

Resignation of Trustees

- ▣ 1. A trustee may resign:
 - ▣ a. Upon at least thirty days' notice to the settlor, if living, to all cotrustees, and the qualified beneficiaries, except those qualified beneficiaries under a revocable trust that the settlor has the capacity to revoke; or
 - ▣ b. With the approval of the court.
- ▣ 2. In approving a resignation, the court may issue orders and impose conditions reasonably necessary for the protection of the trust property.
- ▣ 3. Any liability of a resigning trustee or of any sureties on the trustee's bond for acts or omissions of the trustee is not discharged or affected by the trustee's resignation.

S.D. Codified Laws § 21-22-12 Resignation of Trustees

- In case of the vacancy of the office of trustee, unless the instrument creating the trust names the successor, or allows the resigning trustee or another person to appoint its successor, the successor shall be appointed by the court upon hearing and notice as provided in this chapter. In case of necessity the court may appoint a temporary trustee pending a permanent appointment.
- If the office of trustee remains vacant for more than thirty days, then any resigned trustee in possession of trust property may petition the court for the appointment of a successor trustee. If no successor trustee can be secured within ninety days following a hearing held of the resigned trustee's petition, the resigned trustee shall deliver the trust property within its possession to any other fiduciary or other persons, as ordered by the court.

■ S.D. Codified Laws § 21-22-12

S.D. Codified Laws § 21-22-12 Resignation of Trustees

- ❑ The resigned trustee shall be held harmless from any liability, absent the resigned trustee's gross negligence or willful misconduct, for any action taken pursuant to this section.
- ❑ The resigned trustee is entitled to reimbursement for advances it has made on behalf of the trust and for reasonable compensation for the performance of its duties as trustee. Such advances and compensation shall act as a lien on trust assets under Section 55-1A-34.
- ❑ Following a trustee's resignation, the resigned trustee shall be deemed to be serving only as a custodian of the documents and assets of the trust then in its possession and shall be relieved of its fiduciary and administrative duties under the terms of the trust instrument and pursuant to state law. The resigned trustee is entitled to reimbursement for advances it has made on behalf of the trust and for reasonable compensation as a custodian. Such advances and compensation shall act as a lien on trust assets under Section 55-1A-34.
- ❑ The relief afforded to the trustee under this section does not limit other relief that may be requested or authorized under this chapter.

▪ S.D. Codified Laws § 21-22-12

N.D. Cent. Code, § 59-15-06

Removal of Trustees

- ▣ 1. The settlor, a cotrustee, or a beneficiary may request the court to remove a trustee, or a trustee may be removed by the court on its own initiative.
- ▣ 2. The court may remove a trustee if the trustee has committed a serious breach of trust; if lack of cooperation among cotrustees substantially impairs the administration of the trust; if because of unfitness, unwillingness, or persistent failure of the trustee to administer the trust effectively, the court determines that removal of the trustee best serves the interests of the beneficiaries; or if there has been a substantial change of circumstances or removal is requested by all of the qualified beneficiaries, the court finds that removal of the trustee best serves the interests of all of the beneficiaries and is not inconsistent with a material purpose of the trust, and a suitable cotrustee or successor trustee is available.

N.D. Cent. Code, § 59-15-06

Removal of Trustees

- ▣ 3. Pending a final decision on a request to remove a trustee, or in lieu of or in addition to removing a trustee, the court may order such appropriate relief under subsection 2 of section 59-18-01 as may be necessary to protect the trust property or the interests of the beneficiaries.
 - ▣ N.D. Cent. Code, § 59-15-06

S.D. Codified Laws § 55-3-20.1

Removal of Trustees

In addition to other remedies available by law and procedures or powers set out in a trust instrument, the settlor, or the settlor's agent, a trust protector, a cotrustee, or a qualified beneficiary as defined in § 55-2-13, or an enforcer, as defined in § 55-1-21.4, may request the court to remove a trustee, or a trustee may be removed by the court on the court's own initiative.

- ▣ In addition to the powers otherwise granted the court, the court may remove a trustee if:
 - ▣ (1) The trustee commits a serious breach of trust;
 - ▣ (2) Lack of cooperation among cotrustees substantially impairs the administration of the trust;
 - ▣ (3) Because of unfitness, unwillingness, persistent failure of the trustee to administer the trust effectively, the court determines that removal of the trustee best serves the interests of the beneficiaries;

S.D. Codified Laws § 55-3-20.1

Removal of Trustees

- ▣ (4) There is a substantial change of circumstances or removal is requested by all of the qualified beneficiaries, the court finds that removal of the trustee best serves the interests of all of the beneficiaries and is not inconsistent with a material purpose of the trust, and a suitable cotrustee or successor trustee is available; or
- ▣ (5) If the trustee merges with another institution or the location or place of administration of the trust changes, and the court finds that removal of the trustee best serves the interests of all of the beneficiaries, and a suitable cotrustee or successor trustee is available.
- ▣ Pending a final decision on a request to remove a trustee, the court may order such appropriate relief as may be necessary to protect the trust property or the interests of the beneficiaries.

○S.D. Codified Laws § 55-3-20.1

Rev. Rul. 95-58

Removal & Replacement of Trustees

Holding

A settlor's retained power to remove and replace the trustee does not cause estate inclusion so long as the new trustee who may be appointed is not the settlor and is not related or subordinate within the meaning of I.R.C. § 672(c) to the settlor.

Key Takeaways

- ❑ Irrevocable Trust Can Be Modified and Terminated
- ❑ Rules Regarding Modification Are Complex
- ❑ Trustees Can Be Removed Judicially But It's in the Court's Discretion
- ❑ A Carefully Drafted Trust Can Provide for Decanting, Modification, Termination, and Trustee Removal Without Court Oversight

**ASSET PROTECTION PLANNING
AS AN ALTERNATIVE TO
ESTATE TAX PLANNING**

Types of Asset protection Planning

- ▣ Assigned Assets to a Spouse
- ▣ Life Insurance & Retirement Plans
- ▣ Irrevocable Trusts
- ▣ Limited Liability Companies

Retirement Plans and ERISA

- Employee Retirement Income Security Act (ERISA)
 - A federal law which sets minimum standards for most voluntarily established retirement and health plans to provide protection for individuals.
 - Funds retained in a qualified ERISA plan are protected from most asset seizures by creditors.
 - It does not cover all retirement accounts, only those that qualify:
 - Defined benefit plans – includes employee pensions, which provide a fixed monthly benefit once an employee retires.
 - Defined contribution plans – includes those funded by fixed contributions taken from an employee's paycheck. Most employer-sponsored retirement plans (traditional, Roth 401(k), certain 403(b) plans) are covered.

Asset Protection with Life Insurance

- N.D. Cent. Code, § 26.1-33-40
 - The avails of a life insurance policy or of a contract payable by any mutual aid or benevolent society, when made payable to the deceased, to the personal representatives of the deceased, to the deceased's heirs, or to the deceased's estate, is not subject to the debts of the decedent upon the death of the insured or member of the society except by special contract. The avails must be inventoried as a part of the estate of the decedent and must be considered as part of the general assets of the estate. The insured may transfer the avails of the life insurance policy or contract either by will or by contract. Nothing contained in this section affects, in any manner, any life insurance policy or beneficiary certificate which is made payable to a designated person, including the spouse of the insured, or to persons or to members of a family designated as a class, such as "all children" or "all brothers and sisters", even though the members of the class are not designated by name; or permits any insured to dispose of the avails of a contract by a mutual or fraternal society by will to anyone who could not be a beneficiary in the contract under the charter or bylaws of the society.
- Protects the cash value of life insurance policy from creditor claims.
- Protects proceeds if paid to a beneficiary other than the insured or insured's estate (unless the policy says otherwise).

Asset Protection with Life Insurance

- S.D. Codified Laws § 58-12-4
 - The proceeds of a policy of life or health insurance to the total amount of twenty thousand dollars only, in the absence of any agreement or assignment to the contrary, shall inure to the separate use of the insured, his surviving spouse or children, as the case may be, independently of the creditors of any of them and shall not be subject to the payment of the debts of any one or all of such persons, notwithstanding that the proceeds may be payable directly to the insured or surviving spouse or children as the named beneficiary or beneficiaries or otherwise; and the proceeds of an endowment policy, payable to the insured on attaining a certain age, to the extent of twenty thousand dollars shall at all times be exempted from the debts of such spouse or children of the insured; and the avails of any life or health insurance or other sum of money not exceeding twenty thousand dollars made payable by any mutual aid or benevolent society to any member or beneficiary spouse or children or both shall likewise be exempt.

Asset Protection with Life Insurance

- Protects the cash value of life insurance policy from creditor claims.
- Protects proceeds if paid to a beneficiary other than the insured or insured's estate (unless the policy says otherwise).

North Dakota Code Spendthrift Provisions

N.D. Cent. Code, § 59-13-02

- 1. A spendthrift provision is valid if it restrains either the voluntary or involuntary transfer or both the voluntary and involuntary transfer of a beneficiary's interest.
- 2. A term of a trust providing that the interest of a beneficiary is held subject to a spendthrift trust, or words of similar import, is sufficient to restrain both voluntary and involuntary transfer of the beneficiary's interest.
- 3. A beneficiary may not transfer an interest in a trust in violation of a valid spendthrift provision and, except as otherwise provided in this chapter, a creditor or assignee of the beneficiary may not reach the interest or a distribution by the trustee before its receipt by the beneficiary.

South Dakota Code Spendthrift Provisions

S.D. Codified Laws § 55-1-35

- A declaration in a trust that the interest of a beneficiary shall be held subject to a spendthrift trust is sufficient to restrain voluntary or involuntary alienation of a beneficial interest by a beneficiary to the maximum extent provided by law. Regardless of whether a beneficiary has any outstanding creditor, a trustee of a spendthrift trust may directly pay any expense on behalf of such beneficiary and may exhaust the income and principal of the trust for the benefit of such beneficiary. No trustee is liable to any creditor for paying the expenses of a beneficiary of a spendthrift trust.

Recent IRS Guidance on Spendthrift Provisions

- Beware! There are limits to the protection of a spendthrift provision against the IRS.
- The IRS recently released guidance regarding the issue of whether a levy may reach the corpus of a trust when the taxpayer is a beneficiary of a trust.
- ANSWER: The IRS can levy any mandatory distribution right the beneficiary has, but it cannot demand assets that are subject only to a discretionary standard (until the trustee decides to distribute assets to the beneficiary).

Recent IRS Guidance on Spendthrift Provisions

- A levy can reach any subsequent distributions that are of a fixed interest in the trust document.
 - The levy does not accelerate the interest, so the IRS has to wait for the future fixed payments (it would apply to an income right since that is a fixed interest).
- However, if a beneficiary has no right to demand the principal of the trust and the trustee was not required to distribute the principal, then the levy is prevented from reaching the trust's principal.

Recent IRS Guidance on Spendthrift Provisions

- Conclusion: Spendthrift provisions cannot thwart an IRS tax lien. A levy against a trust, in which the tax debtor is a beneficiary of the trust, can reach distributions but not the trust corpus.
- This poses a question: If a trustee has wide discretion in making payments on behalf of the beneficiary instead of to the beneficiary, what happens if the trustee elected to pay expenses directly instead of making a distribution?
 - THIS WOULD THWART the levy... but could result in a penalty!
 - IRC § 6332(d)(2) imposes a 50% penalty for any failure to surrender property that is not due to reasonable cause.

Spousal Lifetime Access Trust - "SLAT"

SLAT

- ▣ A grantor-spouse gifts assets to an irrevocable trust for the benefit of the beneficiary-spouse and other beneficiaries (children and grandchildren).
- ▣ An independent trustee is named and has discretion to make distributions to the beneficiaries.
- ▣ The grantor-spouse uses the gift and estate tax exemption when making these gifts.
- ▣ Appreciation of the assets passes to the beneficiaries free of future gift and estate tax.
- ▣ The grantor-spouse can use all of the available gift and estate exemption to lock into historically high exemption amounts and protect against future decreases in the exemption.
- ▣ As a bonus, the assets are generally protected against creditor claims of the grantor if the trust is funded before any creditor problems emerge.

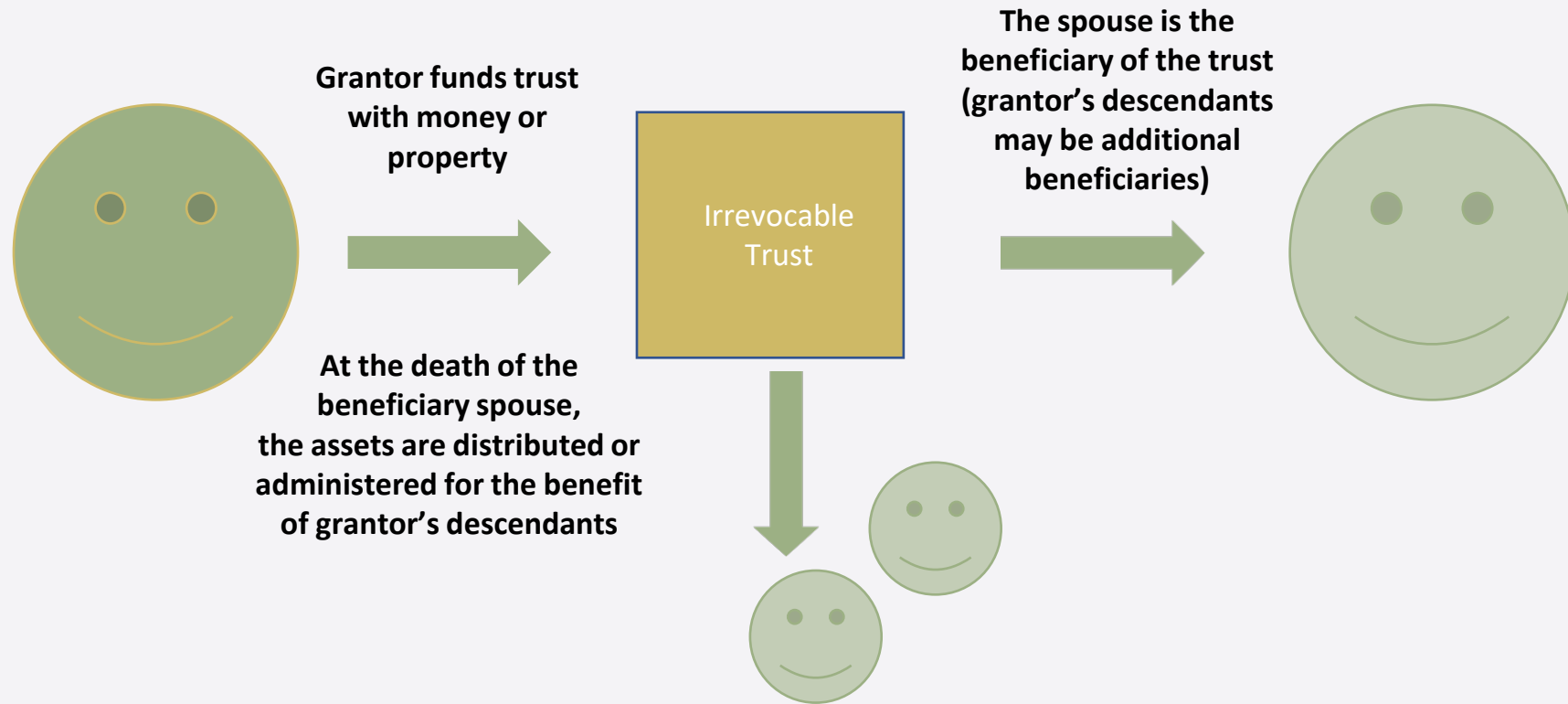
Benefits of a SLAT

- ❑ The SLAT donor-spouse uses the donor-spouse's transfer tax exclusion before it may be lost due to future changes in tax legislation. The donor-spouse's exemption is utilized and the appreciation on the assets transferred will not be subject to future gift and estate tax.
- ❑ The SLAT allows spouses to gift assets while retaining indirect control.
- ❑ The SLAT is similar to a bypass trust because it holds assets up to the amount of the donor-spouse's exemption for the benefit of the surviving spouse. Like the bypass trust, the value of the SLAT (assets transferred to the trust and the appreciation on those assets) is not included in the surviving beneficiary-spouse's estate.

SLAT & the Gift Tax Marital Deduction

- ▣ The unlimited marital deduction allows an individual to transfer an unrestricted amount of assets to a spouse at any time, during lifetime or at death, free from transfer tax. IRC § 2523.
- ▣ The transfer to the SLAT will not qualify for the gift tax marital deduction if the beneficiary spouse has only a discretionary interest in the trust as per the trust instrument.

Spousal Lifetime Access Trust



Sample Spendthrift Clause

All trusts created under this agreement shall be spendthrift trusts as defined in N.D. Cent. Code, § 59-13-02, S.D. Codified Laws § 55-1-35, and the income and principal of all trusts created under this agreement shall be held subject to this spendthrift trust provision.

Neither the income nor the principal of any trust created under this agreement may be assigned, anticipated, encumbered, alienated, or otherwise voluntarily transferred in any manner by any beneficiary. In addition, neither the income nor the principal of any trust created under this agreement is subject to attachment, bankruptcy proceedings or any other legal process, to the interference or control of creditors or others, or otherwise subject to any involuntary transfer.

If the Trustee determines that a beneficiary would not benefit as greatly from any outright distribution of trust income or principal because of the availability of the distribution to the beneficiary's creditors, the Trustees shall instead expend those amounts for the benefit of the beneficiary. This direction is intended to enable the Trustee to give the beneficiary the maximum possible benefit and enjoyment of all of the trust income and principal to which the beneficiary is entitled.

This section does not restrict a beneficiary's right to disclaim any interest or the exercise of any power of appointment granted in this agreement.

Sample Distribution Provision

My Independent Trustee **may** distribute to Jane Doe as much of the income and principal of his trust as my Independent Trustee may determine advisable for any purpose. If no Independent Trustee is then serving, my Trustee **shall** distribute to Jane Doe as much of the income and principal of his trust as my Trustee determines necessary or advisable for her health, education, maintenance, or support.

When I use the word "may" I intend to empower my Trustee to act with the Trustee's sole and absolute discretion unless otherwise stated in this trust.

Irrevocable Life Insurance Trust - “ILIT”

Irrevocable Life Insurance Trust “ILIT”)

- An insurance policy is transferred into the ILIT or the trustee can purchase an insurance policy.
- Cash gifts are made to the trust each year to pay the policy premiums.
- The premium payments and the full death benefit of the policy are not included in the insured’s and surviving spouse’s taxable estates.
- The insurance proceeds at the death of the insured will be exempt from income taxes.

Benefits of an ILIT

- Minimize federal estate tax
- Avoid gift tax
- Asset protection
- Liquidity
- Multigenerational planning

ILIT

- An ILIT is designed to remove life insurance death benefits from the estate of the deceased insured.
- Life insurance death benefits are includable in the gross estate for purposes of federal estate tax, if the decedent possesses “incidents of ownership” in the life insurance policy at the time of his or her death.
- Under Treas. Reg. § 20.2041-1(c)(4) incidents of ownership include:
 - the right to change beneficiaries,
 - the right to dividends or cash surrender values,
 - ownership of the insurance policy, and
 - payment of premiums

Benefits of an ILIT

- An ILIT, properly constructed and maintained, generally removes incidents of ownership of the grantor in the ILIT assets.
- Death benefits of the insurance policy in the ILIT are not part of the taxable estate through use of the ILIT, shifting the tax burden on income related to the ILIT assets to the next generation.
- Death benefit proceeds in the ILIT can provide for beneficiaries, create greater liquidity for the estate for the payment of taxes or other liabilities, or fund buy-sell agreements in the case of business succession arrangements.

General ILIT Elements

- ❑ The grantor creates an irrevocable trust to hold an existing life insurance policy or uses cash to purchase an insurance policy on the grantor's life.
- ❑ Each time an annual contribution is made to the trust (to pay the insurance policy premium), the amount is less than the annual gift tax exclusion per trust beneficiary.
- ❑ Under *Crummey*, each beneficiary must have a reasonable withdrawal right to the contribution, with notice of such right, typically by a Crummey letter.
- ❑ The IRS has ruled that thirty days is a reasonable right of withdrawal period.

Domestic Asset Protection Trust

“DAPT”

Domestic Asset Protection Trust ("DAPT")

- ❑ A DAPT is a self-settled asset protection trust, allowing a grantor to transfer assets into trust for their own benefit while maintaining a spendthrift clause.
- ❑ DAPTs are only available in certain states, and to protect assets from creditors, they must meet three conditions:
 - the grantor/beneficiary must live in the trust state;
 - the trust assets must be located in that state; and
 - the grantor must stay out of bankruptcy.
- ❑ If any of the requirements are not met, the DAPT is unlikely to provide any asset protection.

DAPT Case Study: U.S. v. Huckaby, E.D.Cal., March 3, 2026

- ❑ Grantor placed California real estate into a Nevada DAPT before becoming embroiled in tax controversy
- ❑ Nevada allows DAPTs, California does not.
- ❑ California Court applied California law, and the spendthrift clause did not attach
- ❑ IRS won on summary judgment, and was able to put a lien on all trust property to the extent that Grantor was a beneficiary

DAPT

- ❑ A DAPT can be useful for asset protection, but it is a delicate and risky option
- ❑ If any of the three requirements are broken, the DAPT becomes inert as an asset protection tool
- ❑ For asset protection, it is generally ill-advised for a trust beneficiary to also be a trustee, even in a DAPT.

Limited Liability Companies (LLCs)

Asset Protection with LLCs: Generally

- An LLC is formed by filing very brief articles of organization with the Secretary of State, while the full terms of the agreement among the members are contained in an operating agreement
- A properly structured LLC is a pass-through tax entity, but its members are not personally liable for the debts of the entity.
- Members can invest capital in the business of the LLC and take a share in the profits without becoming liable for the entity's debts and without having the profits taxed at the entity level.

Charging Orders for LLCs

A Charging Order is a lien.

- This charging order is a lien on the member's LLC interest. To the extent of the debt plus interest, the charging order entitles the creditor to receive from the LLC all distributions that the LLC would otherwise make to the member.

What are a creditor's rights under a charging order?

- A creditor that obtains a charging order against an LLC member receives only the right to the above distribution.
- The charging order does not entitle the creditor to any other rights, including LLC information rights.
- The creditor does not become an assignee of the LLC interest of the LLC member-debtor.

Whom do charging order provisions protect?

- All charging order provisions protect LLC assets from creditors.
- Exclusive charging order provisions protect member-debtors-in-default from garnishments and other remedies affecting their distribution rights.
- Charging order non-foreclosure provisions protect the ownership interest of member-debtors-in-default in their LLC interests.
- All charging orders give creditors the right to levy on the distribution rights of member-debtors-in-default.

LLC Assets

- A creditor of an LLC member has no right to levy on the LLC's assets in satisfaction of the debt under a charging order or otherwise.

Exclusivity

- Is the charging order provision an “exclusive” provision? Or may the creditor also use other means to levy on these distributions, such as non-charging order liens or garnishments?
- About 32 statutes have exclusivity.

Corporate Charging Order Provisions

- Only of Nevada contains charging order protections for corporations

6 DE Code § 18-703. Member's limited liability company interest subject to charging order.

- (a) On application by a judgment creditor of a member or of a member's assignee, a court having jurisdiction may charge the limited liability company interest of the judgment debtor to satisfy the judgment. To the extent so charged, the judgment creditor has only the right to receive any distribution or distributions to which the judgment debtor would otherwise have been entitled in respect of such limited liability company interest.
- (b) A charging order constitutes a lien on the judgment debtor's limited liability company interest.
- (c) This chapter does not deprive a member or member's assignee of a right under exemption laws with respect to the judgment debtor's limited liability company interest.
- (d) The entry of a charging order is the exclusive remedy by which a judgment creditor of a member or of a member's assignee may satisfy a judgment out of the judgment debtor's limited liability company interest.
- (e) No creditor of a member or of a member's assignee shall have any right to obtain possession of, or otherwise exercise legal or equitable remedies with respect to, the property of the limited liability company.

North Dakota. Rights of Judgment Creditor.

- Judgment Liens on Real Property: A judgment becomes a lien on all real property, except the homestead, owned by the judgment debtor in the county where the judgment is docketed. For judgments docketed after August 1, 2021, the lien lasts for 20 years from the time of docketing. For judgments docketed before that date, the lien lasts for 10 years. N.D. Cent. Code, § 28-20-13.
- Execution on Property: Judgment creditors may enforce judgments through execution. Execution allows the sheriff to levy on the debtor's property, including real property, personal property, and intangible assets such as debts and credits. The sheriff must follow specific procedures, such as filing a notice of levy for real property or taking custody of personal property . N.D. Cent. Code, § 28-21-08.

S.D. Codified Laws § 15-16-7

Rights of Judgment Creditor

- When a judgment has been docketed with a clerk of the circuit court, it shall be a lien on all the real property, except the homestead, in the county where the same is so docketed, of every person against whom any such judgment shall be rendered, and which he may have at the time of the docketing thereof in the county in which such real property is situated, or which he shall acquire at any time thereafter, for ten years from the time of docketing the same in the county where it was rendered, and no judgment shall become a lien on real property as herein provided unless it be docketed in the county where the land is situated.

Pick-Your-Partner and Charging Order Provisions

- Hypothetical example. The above advantages of LLC statutory law over corporate law are of tremendous importance in non-tax choice of entity – i.e., in choosing between LLCs and corporations on non-tax grounds in entity formations. To illustrate:
 - i) On January 1, 2013, Mary Jones forms MJ, a new Delaware company whose purpose is to manufacture and sell widgets. She is MJ's CEO and she is its 51% owner. Her husband James is the 49% owner. Her lawyer forms MJ as a Delaware corporation, not as an LLC.
 - ii) MJ prospers and, by January 1, 2017, it has assets worth \$10 million. MJ pays out all of its annual net profits as compensation to Mary.

Pick-Your-Partner and Charging Order Provisions

- On January 30, 2013, while driving her car on non-MJ business, Mary accidentally, but negligently, runs over and kills Smith, a brain surgeon, and incurs a negligence judgment of \$20 million, which vastly exceeds her auto liability insurance.
- Smith's estate levies on Mary's MJ stock, takes control of MJ, sells its assets, and distributes 51% of them to itself.
- Mary loses her most valuable asset—her MJ stock, and she loses her job and her salary.
- James loses his interest in MJ's going concern value.

Corporation vs. LLC

- If Mary had formed MJ as a Delaware LLC, not as a Delaware corporation:
 - Pick-your-partner provisions of the DLLC Act would have prevented Smith's estate from levying on Mary's management rights. Thus, she would have retained control of MJ and Smith's estate would not have been able to force the sale of MJ's assets.
 - Mary would have retained her job with MJ and her MJ salary.
 - James would have retained his interest in MJ's going concern value.

Corporation vs. LLC

- Smith's estate would have been able to obtain a charging order against Mary's LLC interests, but, since MJ had no history of making distributions and since Smith's estate could not compel these distributions, this charging order would be of no practical value to it unless MJ was liquidated while the charging order was still in effect.
- Smith's estate could not levy on Mary's LLC interest. Thus, if it settled its claim against Mary, it would never be able to obtain any liquidating distribution from MJ.

Asset Protection with LLCs: Operating Agreement

- Unanimous consent of transfers
 - Typically, membership interest can only be transferred with the unanimous consent of all members with voting power.
 - For a single-member LLC, no formal vote is needed to transfer ownership.
 - An operating agreement can modify or eliminate restrictions on transfers of LLC interests.
- Taxation
 - LLCs are pass-through entities, meaning the income passes through to the individual members who pay federal income tax earned from the LLC on their own tax returns.

**Fraudulent Conveyances
&
Voidable Transfers**

Fraudulent Conveyances:

Uniform Voidable Transactions Act (UVTA)

- A “voidable transfer” is defined as a transfer of assets made with the intent to defeat the rights of creditors or a transfer made without adequate consideration, leaving the debtor insolvent or nearly insolvent.
 - In certain situations, such transfers can be voided and the creditor can reach the assets to satisfy the debt.
- It allows creditors to void transfers without showing the debtor had any “intent to defraud” in certain situations.

Fraudulent Conveyances:

Uniform Voidable Transactions Act (UVTA)

- Creditors are able to void transfers on a “constructive” fraud theory, as well as by showing actual intent to defraud.
 - “Constructive” fraud is proven by showing the debtor made the transfer in exchange for less than “reasonably equivalent value” and was left with an unreasonably small amount of assets for the business or transaction in which they engaged or if the debtor intended to incur debts beyond their ability to pay them when they came due.

Alexander A. Bove, Jr., ABA Section of Real Property Trust & Estate Law,
Domestic Asset Protection Planning, Asset Protection Strategies (2d ed. 2019).

UFTA & Fraudulent Transfers: Attorney Fee Considerations

- Although UFTA does not expressly provide for attorney fees, numerous courts have awarded attorney fees to the creditor.
- Usually, the circumstances leading to an award involve a debtor engaging in a fraudulent transfer with actual intent to hinder, delay, or defraud an existing creditor.
- Courts have permitted this under either the catch-all UFTA provision or the fraudulent transfer common law.

J.L. Williamson

Law Group LLC

Longterm Care Planning

Medicare Not For Long-Term Care

- Not For Chronic Needs!
- Only for Acute Needs up to 100 Days!
- Subject to Strict Limitations!

Medicaid Eligibility Rules

Two Basic Tests Income Test & Asset Test

Asset Limits

- ▣ \$2,000.00 - Single;
- ▣ \$159,200.00 – Married

Income Limits

- ▣ \$2,901.00 per month
- ▣ MMMNA is \$3,948.00 per month

Medicaid Eligibility Rules

- ❑ The applicant's primary residence is not counted if equity value is less than \$730,000.00, the applicant remains institutionalized, retains ownership, and intends to return home.

See https://dss.sd.gov/economicassistance/medical_programs.aspx,
<https://www.hhs.nd.gov/medicaid-member-engagement/handbook>

- ❑ A transfer penalty of one month for every \$10,965.00 transferred beginning in the month the transfer was made, but the penalty period does not begin until the applicant is otherwise eligible for Medicaid.

- ❑ Look-back period: 60 months for uncompensated transfers.

See https://dss.sd.gov/economicassistance/medical_programs.aspx,
<https://www.hhs.nd.gov/medicaid-member-engagement/handbook>

Medicaid Eligibility Rules

Countable versus Non-Countable Assets

- Examples of Non-Countable Assets
 - Primary residence if equity is less than or equal to \$688,000.00 and applicant intends to return home and primary residence, regardless of equity, if spouse, child under age 21, or blind or disabled child of any age lives there
 - \$6,000 in equity in income-producing real property
 - One vehicle
 - Life insurance with no cash value and life insurance with cash value if the total face value of all such policies is less than or equal to \$1,500.00

Medicaid Eligibility Rules

Countable versus Non-Countable Assets

- ▣ Examples of Non-Countable Assets (Continued)
 - ▣ Irrevocable burial contracts
 - ▣ \$1,500.00 designated for burial expenses (revocable burial contracts, burial savings accounts, or life insurance policies)
 - ▣ One burial plot per family
 - ▣ IRAs (as long as taking distributions on a monthly basis)
 - ▣ Household Goods & Personal Effects
- ▣ If assets aren't specifically non-countable, then those assets are countable.

Understanding Medicaid Rules

- Uncompensated Transfers (i.e. “gifts”) have a 60-month lookback
- The penalty does not begin to run until “otherwise eligible” for Medicaid, but for the penalty. (Medical and financial)
- Charities are not exempt from the transfer penalty rules

Medicaid Eligibility Rules

How Transfer Penalties Are Calculated

- Sarah gives her grandson \$70,000.00 for college tuition on August 16, 2020.
- On June 17, 2025, Sarah enters the nursing home and applies for Medicaid.
 - The penalty for the 2020 gift is 6.38 months (\$70,000.00 divided by \$10,965.00).
 - The penalty begins April 2025 and ends in October 2025.
- Note, the inefficiency of subjecting the applicant to the penalty period of almost 3 months versus privately paying months to exhaust the look-back period.

Medicaid

Exempt Transfers of the Homeplace

Transfers of the Homeplace

A transfer of assets penalty does not apply if any one of the following conditions is met:

- The homeplace was transferred to the community spouse or child if the child is under the age of 21 or is blind or is permanently and totally disabled.
- The homeplace was transferred to a sibling if the sibling has an equity interest in the home and has been residing in the home for at least one year immediately prior to application.

Transfers of the Homeplace

The homeplace was transferred to a son or daughter who has been residing in the home for at least two years immediately prior to application for Medicaid, and the son or daughter was providing such care as to permit the applicant to continue to reside at home rather than enter a nursing home.

See https://dss.sd.gov/economicassistance/medical_programs.aspx

J.L. Williamson

Law Group LLC

**Advanced Planning Using
Irrevocable Trusts**

TRUST

The right to the beneficial enjoyment of property to which another person holds the legal title; a property interest held by one person (the trustee) at the request of another (the grantor) for the benefit of a third party (the beneficiary).

A trust is created only if the settlor has capacity to create a trust, the settlor indicates an intention to create the trust, the trust has a definite beneficiary or is a charitable trust, a trust for the care of an animal, as provided in section 59-12-08, or a trust for a noncharitable purpose, as provided in section 59-12-09; the trustee has duties to perform; and the same person is not the sole trustee and sole beneficiary.

- ▣ N.D. Cent. Code, § 59-12-02

Except as otherwise prescribed by chapters 43-4 and 43-25 relating to transfers, a trust may be created for any purpose for which a contract may lawfully be made.

- ▣ S.D. Codified Laws § 55-1-1

TRUSTEE

**TRUST
CORPUS**

GRANTOR



BENEFICIARY

INCOME-ONLY IRREVOCABLE TRUST

This type of trust allows you to transfer assets out of your probate estate, thereby exempting them for purposes of ABD Medicaid yet maintain more control over those assets than if you had made outright gifts to your children.

INCOME-ONLY IRREVOCABLE TRUST

Key Features

- ▣ Absolutely No Access to Principal (Corpus) by either the Grantor or the Grantor's Spouse
- ▣ Income Paid Directly to the Grantor gives the Grantor Greater Financial Independence

Permitted by Federal Law per 42 U.S.C. § 1396p(d)(3)(B)

Estate & Gift Tax Aspects

- ▣ May or may not be a completed gift for federal estate tax purposes
 1. Does the trust contain a Limited Power of Appointment over trust property?
 2. If so, not a completed gift and get basis adjustment at death.
 3. The Limited Power of Appointment provides a powerful incentive to children as well.

Advantages of an Irrevocable Trust

- ▣ Keeps Assets from Barring Medicaid Qualification
- ▣ Protects Assets from Medicaid Estate Recovery
- ▣ Protection From Creditors and Predators
- ▣ Provides Incentives and Sound Mechanism for Proper Asset Management
- ▣ Avoids Probate and Enhances Privacy
- ▣ Potentially Huge Capital Gains Tax Savings

Advanced Planning Example

- Assume Mary wishes to do some asset protection planning with your firm.
- Mary's assets are as follows:
 - 1 house valued at \$200,000.00 that she bought forty years ago for \$65,000.00.
 - 50 acres of farmland currently valued at \$150,000 that she inherited from her uncle 35 years ago (The value of the land at the uncles date of death is unknown).
 - 3 certificates of deposit totaling \$30,000.00
 - 1 checking account with a balance of \$2,100.00

Advanced Planning Example

▣ Planning Scenario 1

- ▣ Mary decides to give each of her two children undivided interests in her home and farm.
- ▣ To execute the gifts, Mary has an attorney prepare and file four gift deeds.

▣ Planning Scenario 2

- ▣ Based upon your advice, Mary puts her home, farm, and \$10,000 cash inside an irrevocable trust to which she retains a right to income and a limited testamentary power of appoint over the entire trust corpus and any undistributed income.

Advanced Planning Example

▣ Legal fees and costs of Scenario 1:

\$1,000.00

▣ Legal fees and costs of Scenario 2:

\$20,000.00

Advanced Planning Example

72 months after either scenario, assume Mary enters a skilled nursing facility, quickly qualifies for Medicaid, and stays in that skilled nursing facility until her death 30 months later.

Advanced Planning Example

- Under either scenario, Mary's assets won't be counted as available resources for purposes of Medicaid qualification, nor will those assets be subject to estate recovery.
- Further assume, however, that Mary's children want to liquidate, at her death, the assets Mary gave to them (the house and farm) and distribute the net proceeds equally to each surviving child.

Advanced Planning Example

- ▣ Tax Consequences of Planning Scenario 1
 - The federal capital gains tax resulting from the sale of the house and farm could be over \$60,000.00
- ▣ Tax Consequences of Planning Scenario 2
 - The federal capital gains tax resulting from the sale of the house and farm would, in most circumstances, be \$0.00!

Advanced Planning Example

■ Tax Consequences of Planning Scenario 1

- Assume each of Mary's children have AGI of \$200,000.00 (exclusive of the \$285,000.00 long-term capital gain).
- The additional tax resulting from the long-term capital gain of \$285,000.00 is about \$29,000.00 per child.
- Note: If each of Mary's children have AGI of \$100,000.00 (exclusive of the \$285,000.00 long-term capital gain), the additional tax is approximately \$23,000.00 per child.

Advanced Planning Example

▣ Tax Consequences of Planning Scenario 2

- ▣ Assume each of Mary's children have AGI of \$200,000.00 (exclusive of the \$285,000.00 long-term capital gain).
- ▣ Additional capital gains tax would be \$0.00 because the basis would equal the sales price of the real estate; therefore, no long-term capital gain.

DURABLE FINANCIAL POWER OF ATTORNEY

FIVE KEY PROVISIONS

- Does the POA Allow the Agent to Create Trusts on Behalf of the Principal?
- Does the POA Allow the Agent to Deal with the Principal's Retirement Plans?
- Does the POA Allow the Agent to Make Gifts to Herself?
- Does the POA Allow the Agent to Sign Caregiver Agreements?
- Does the POA Require the Agent to Give an Accounting When Requested?

Additional Resources

- ❑ Thriving in Estate Planning: Looking Ahead to the 2020 Election and Beyond, September 30, 2020
- ❑ Top 10 Revenue Rulings Every Estate Practitioner Should Know, ABA Tax Section Meeting, May 8, 2015, Authors: Christopher Sega, Taylor Bechel & Katherine Ward
- ❑ **LISI** Asset Protection Planning Newsletter #457 (March 30, 2026) at <http://www.leimbergservices.com>.
- ❑ Special thanks to Brian Albee for contributions to certain portions of this presentation. Those portions of this presentation that were adapted from materials produced by Elder Counsel, LLC, may be copyrighted and are used by permission only.

J.L. Williamson

Law Group LLC

Questions?

(912) 489-5573

jlw@jlwlawgroup.com

Twitter: @jlwilliamsonlaw