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TRUSTS & ESTATES

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By **Jennifer B. Goode**

Sizing a Transfer-Tax Strategy for Success

A two-part solution

With a substantial drop in the basic exclusion from federal gift and estate tax (the federal exclusion amount) set for 2026,[1] high-net-worth individuals may feel intense pressure to move sizable amounts into trust in the next two years. Indeed, this pressure has led some individuals to fund trusts with assets they still wish to access. Many estate-planning attorneys have risen to this challenge by drafting trust agreements allowing for distributions to the creator of the trust (its grantor) and/or the grantor's spouse, while attempting to avoid estate inclusion under the agreement's terms. However, the success of any such strategy depends not only on the trust agreement but also on the facts and circumstances surrounding the trust's creation and its administration over time. Indeed, the administration period may prove especially fraught as a client may not involve the attorney who drafted the trust in subsequent trust distributions or transactions.

How then can an estate-planning attorney ensure the proper implementation of a transfer-tax strategy from beginning to end—especially given the oft-limited scope of the client engagement? I propose a two-part solution. First, evaluate how the trust will impact the client's liquidity needs and other financial goals to negate the presence of an implied understanding at the trust's inception. Second, anticipate pain points that may lead interested parties to mismanage the trust to their own detriment.

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Drafting Issues

Individuals who wish to retain potential use of assets transferred to an irrevocable trust may employ trust structures incorporating one or more direct or indirect avenues of access. Such avenues include:

- creating an irrevocable trust that benefits the grantor's spouse (otherwise known as a "spousal lifetime access trust" (SLAT));
- conferring a power on the grantor's spouse—often exercisable at such spouse's death—to redirect some or all of the trust's assets to a new trust for the grantor's benefit;[2]
- authorizing a third party to add trust beneficiaries, including the grantor, at a future date; and
- establishing a self-settled asset protection trust that names the grantor as a discretionary beneficiary.[3]

When building any of the above strategies into a trust agreement, a drafting attorney will likely pay particular attention to its interplay with Internal Revenue Code Section 2036(a). For background, IRC Section 2033 provides that an individual's taxable estate includes all property owned by such individual at death. Were the IRC to stop there, an individual could easily sidestep a potential estate tax liability by transferring a property's legal title while retaining the right to its use or enjoyment post-transfer. For example, one might transfer the title to real property but retain the right to its rent-free use. Congress forestalled this potential abuse by enacting Section 2036(a), which links estate inclusion to an individual's relationship with previously transferred property, rather than mere legal ownership.[4] More specifically, this provision states that a decedent's

taxable estate includes any property previously transferred by the decedent by gift but over which the decedent still retained:[5]

(1) the possession or enjoyment of, or the right to income from, the property, or
(2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

Many defenses against trust inclusion under Section 2036(a) revolve around distancing the grantor from: (1) mandatory distributions of the trust's property or income, or (2) control of the use or enjoyment of such property, whether by excluding the grantor as a beneficiary or assigning specific legal authority over trust distributions to someone else. For example, a SLAT typically excludes the grantor as an initial beneficiary while limiting the grantor's discretion over the trust's distributions.[6] When the grantor remains a beneficiary of an asset protection trust, the trustee must hold a fully discretionary power over distributions to or for the benefit of the grantor.[7] Notably, the Internal Revenue Service has conceded in past rulings that this type of fully discretionary power won't, in and of itself, trigger inclusion under Section 2036(a)—provided the grantor can't exercise a power to remove and replace the trustee with a party deemed subservient to the grantor's wishes.[8]

The drafting process plays a crucial role in determining Section 2036(a)(2)'s impact, as the U.S. Supreme Court previously interpreted use of the word "right" in this provision as requiring an "ascertainable and legally enforceable power."[9] Thus, any Section 2036(a)(2) inclusion argument must build on a grantor's legal right—including one created under the trust agreement—to impact the property's enjoyment, whether exercised by the grantor alone or in concert with others. Additionally, courts have noted that fiduciary or economic constraints may place a grantor's legal right beyond Section 2036(a)(2)'s reach.[10] This means that an estate-planning attorney may successfully prevent inclusion by placing a fiduciary between the grantor and the right to control the trust property's use, despite the theoretical possibility of joint action to enact the decedent's will. Even if a fiduciary appears friendly to the grantor's interests or thoughts on the subject, the IRS has been largely unsuccessful in arguing that this close relationship amounts to the type of "right" required for estate inclusion under Section 2036(a)(2), provided the fiduciary owes duties to someone other than the grantor.[11]

Section 2036(a)(1) can trigger estate inclusion based on an understanding–whether express or implied–that the grantor will retain use or enjoyment of the trust property or its income.

Beyond the Written Page

While a vigilant estate planner may address many of Section 2036(a)(2)'s tricks and traps at the drafting stage, Section 2036(a)(1) ultimately opens the door for inclusion regardless of the trust agreement's wording.[12] In contrast to the legal right required under Section 2036(a)(2), Section 2036(a)(1) can trigger estate inclusion based on an understanding—whether express or implied—that the grantor will retain use or enjoyment of the trust property or its income.[13] This holds true even if the understanding isn't legally enforceable and the retained interest or right is conferred after the trust's creation.[14] The existence of this type of arrangement is determined retrospectively based on the facts and circumstances surrounding the trust's creation and later administration.[15] Further, the burden of disproving such arrangement's existence via circumstantial evidence typically falls on the estate.[16] Courts have noted on numerous occasions the heavy nature of such burden when the case involves an intrafamily arrangement.[17]

Liquidity Reserve

Which situations and behaviors prove especially salient when applying Section 2036(a)(1)? Although case law decided under this provision highlights a

handful of bad facts evidencing an implied retained interest,[18] let's focus on two. First, a grantor's failure to retain sufficient liquid assets outside the trust for ongoing personal expenses may support Section 2036(a)(1) inclusion. For example, consider the facts in *Estate of Strangi v. Commissioner*.[19] The decedent transferred 98% of his assets to a limited partnership in exchange for a 99% limited partner interest.[20] In holding for estate inclusion of the partnership's assets (as opposed to an entity interest), the Tax Court noted that the decedent's lack of reserved liquidity to support spending demonstrated an implied understanding that the decedent would meet such needs with retained use of the transferred assets.[21] The decedent's estate countered, to no avail, that the decedent had kept "liquifiable" assets sufficient to satisfy his personal expenses, but the Tax Court held that it would be unreasonable to assume that the decedent would sell his remaining illiquid assets solely for this purpose.[22]

Before tying up a substantial sum, an individual contemplating an irrevocable trust should first consider what level of assets to keep outside of the trust to support lifestyle spending.

Thus, before tying up a substantial sum, an individual contemplating an irrevocable trust should first consider what level of assets to keep outside of the trust to support lifestyle spending. This includes not only previously established needs but also any additional expenses created by the trust or a related transfer-tax strategy. Will the strategy generate additional income tax liabilities, rental payments or life insurance premiums? If the grantor wants to use a power of substitution or a sale to regain access to a particular trust asset, are there sufficient liquid or otherwise transferable assets outside the trust to complete the swap or purchase? What about future extraordinary expenses, such as a major purchase or starting a business? How will prevailing market conditions—whether higher interest rates, stubborn inflation or muted market returns—impact spending needs? All these possibilities merit careful consideration.

Example: Amir and Dalia are a 60-year-old married couple with $40 million in assets. While the pair currently generates enough income to support their $300,000 in annual spending, they'll need to draw down their liquid assets to maintain this lifestyle once they retire in five years. At the same time, they're concerned about preserving use of today's federal exclusion amount prior to its scheduled 2026 drop. To that end, they've discussed the possibility of funding two SLATs—one created by each of them for the benefit of the other and their children as follows:

- Amir plans to fund his trust with $6.92 million of his individually held marketable securities and $6 million of the couple's rental properties. Because he's still actively involved in his business, he doesn't want to transfer his ownership interest to the trust.
- Dalia plans to fund her trust with $5 million of her inherited stake in a family business and $7.92 million of individually held marketable securities.

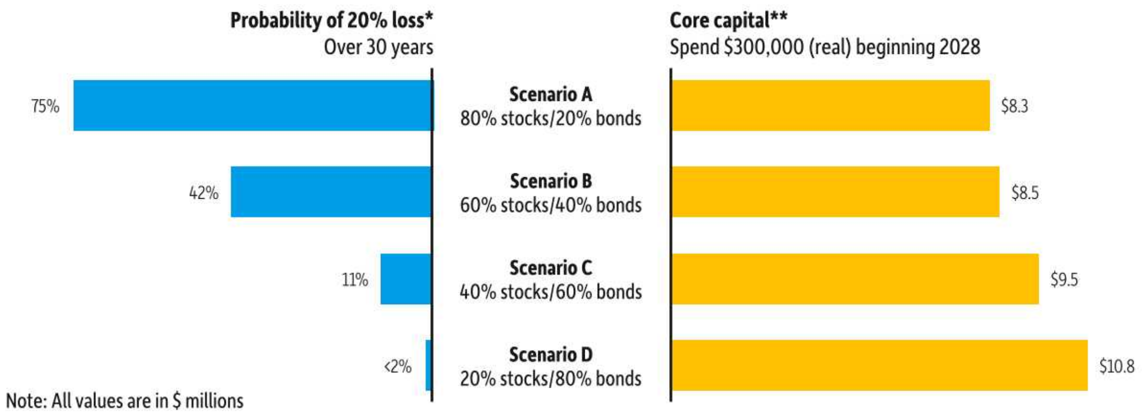
Before moving forward, their counsel suggests conducting a cash flow analysis to confirm the gifts won't infringe on their long-term spending habits and other financial goals.

The resulting analysis suggests that Amir and Dalia should retain access to between $8.3 to $10.8 million in liquid assets to sustain their current lifestyle for the balance of their lifetimes, depending on their asset allocation. (See "Core Capital Needs," p. 31.) In contrast, their current plan would leave them with just over $7 million in liquid assets—including tax-deferred retirement accounts that they hoped to let grow untouched for as long as possible.[23] (See "Distribution of Assets After Trust Funding," p. 31.)

Further, this "core capital"—the amount the couple needs to keep outside of the trust to

Core Capital Needs

They vary by asset allocation



Note: All values are in $ millions

* Projections indicate the probability of a peak-to-trough decline in pre-cash-flow cumulative returns of 20% over the next 30 years. Because the Wealth Forecasting System uses annual capital market returns, the probability of peak-to-trough losses measured on a more frequent basis (such as daily or monthly) may be understated. The probabilities depicted above include an upward adjustment intended to account for the incidence of peak-to-trough losses that don't last a number of years.

** Core capital represents the assets required today to support annual inflation-adjusted spending of $300,000 beginning in five years for the mortality-adjusted lifetime at a 90% level of confidence. Assumes no income or spending during first five years of the analysis. Based on Bernstein's estimates of the range of returns for the applicable capital markets over the periods analyzed. **Data don't represent past performance and aren't a promise of actual future results or a range of future results.**

— Bernstein Capital Markets Engine

confidently support their lifelong spending—doesn't account for the SLATs' income taxes over time. Because the grantor's spouse is named as a beneficiary, each trust qualifies as a grantor trust for income tax purposes. This means that the trusts' income tax liabilities would flow back to Amir and Dalia individually, resulting in an additional drag on their liquid investments. Ignoring their illiquid assets and assuming each SLAT's liquid assets and any tax reserves were invested in 60% stocks and

Distribution of Assets After Trust Funding

What does the allocation look like?

	Amir	Dalia	Joint	Total
Marketable securities/cash (contributed to trusts)	$6.92 million	$7.92 million		$14.84 million
Marketable securities/cash (remaining in estate)	$0.08 million	$2.08 million	$2.0 million	$4.16 million
Real estate	$6.0 million (rental)		$3.0 million (home)	$9.0 million
Retirement assets	$2.0 million	$1.0 million		$3.0 million
Business interests	$4.0 million (active)	$5.0 million (passive)		$9.0 million
Total	$19.0 million	$16.0 million	$5.0 million	$40.0 million

Assets contributed to trusts

Liquid assets remaining in estate

— Bernstein Capital Markets Engine

40% bonds, Amir and Dalia would need to put aside $6.5 million to pay this tax bill over time without relying on trust distributions. This amount is almost all of their retained liquid assets!

Amir and Dalia could consider converting one or both trusts to non-grantor trusts in the future by eliminating the beneficiary spouse's interest; however, this may aggravate their liquidity crunch.[24] Indeed, were they to eliminate one spouse's beneficial interest, this could force the couple to rely exclusively on the remaining SLAT to support their spending needs—including those of the SLAT's grantor. The lessened income tax burden then would come at the cost of behaviors that could undermine the SLAT's estate tax treatment. Further, this strategy would subject the modified trust's assets to the compressed income tax brackets applicable to non-grantor trusts, creating an otherwise unnecessary tax liability.[25]

Another consideration in avoiding estate inclusion from an implied agreement is the need for a meaningful change in the grantor's relationship with the transferred property.

Amir and Dalia are also concerned that their liquidity needs might climb. Amir's business involves periodic capital calls, and the couple had weighed renovating their primary home. Accordingly, if the couple decides to put two SLATs into place, they'll almost certainly need to pull from the SLATs to cover their personal expenses at some point. Does this mean that they can't or absolutely shouldn't pursue the strategy? No. Could their situation support an argument that there was an implied understanding of retained access to the trust assets for their shared spending needs? Possibly.[26] However, because Section 2036(a)(1) inclusion is based on the totality of the decedent's facts and circumstances, Amir and Dalia should consider other aspects of the proposed strategy before moving forward.

Change in Relationship

A second consideration in avoiding estate inclusion from an implied agreement is the need for a meaningful change in the grantor's relationship with the transferred property. Consider the facts of *Estate of Maxwell v. Comm'r.*[27] Lydia Maxwell, the decedent, sold her home to her son and his wife and took back a $250,000 mortgage note as payment.[28] The buyers then made mortgage payments to Lydia, and she paid rent for the property's continued use.[29] Despite the attention paid to the administrative details, the court found an implied agreement under Section 2036(a)(1), in part due to the nearly identical payments flowing from Lydia to the buyers and back again.[30] More specifically, the buyers' interest payments under the note differed from Lydia's rent payments by an insignificant margin. The similarity in these payments left Lydia with use of her home and no substantial debit to her liquid assets—despite her attempt to exclude the value of her home from her taxable estate.[31] As such, the court held that Lydia retained use of her home due to an implied understanding, rather than a bona fide sale and lease agreement.

A grantor's retention of indirect access to trust assets may also demonstrate continuity in the grantor's relationship to such assets pre- and post-transfer. For example, in *Estate of McCabe v. U.S.*, Eugene McCabe created a trust for the benefit of his wife and children, with distributions to his wife for her illness or an emergency and as necessary to provide for her proper care.[32] The trust made no distributions during its first 19 years of existence—until Eugene retired and required supplemental liquidity.[33] Thereafter, the trust distributed funds six separate times, with four cash payments made to Eugene's checking account pursuant to written distribution requests Eugene prepared and his wife signed.[34] At no point did the trustee inquire into the wife's circumstances to determine if a distribution was warranted under the trust's terms.[35] The cash distributions then underwrote the couple's joint and personal expenses, including the costs of their children's weddings and personal vacations.[36] The

court held that the combination of distributions in response to Eugene's change in financial circumstances and his involvement in the request for funds was evidence of a pre-existing arrangement, and the trust assets were included in Eugene's taxable estate. In fact, the court noted that "a pretended transfer to a wife, with the retention of a life estate by the husband so apparent from the facts as here, is the archetypal situation reached by subdivision (1) of Section 2036(a)."[37]

There are certain situations in which a grantor may indirectly benefit from a spouse's beneficial trust interest without triggering estate inclusion. More specifically, some practitioners point to *Estate of Gutchess v. Comm'r*[38] as evidence that a retained benefit incidental to a normal marital relationship won't trigger inclusion under Section 2036(a)(1). In that case, the Tax Court held that a decedent's post-transfer use of a residence transferred to his spouse wasn't sufficient to trigger estate inclusion, as the decedent's use didn't detract from his spouse's use and enjoyment.[39] In contrast, one can easily distinguish this precedent from a situation in which a couple consumes trust assets to satisfy the grantor's legal obligation or personal expense, as this use would inherently restrict the beneficiary spouse's access. Additionally, the Tax Court circumscribed its *Gutchess* holding in a later case, stating that the *Gutchess* decision "should be carefully confined to its narrow factual situation and that it would be dangerous to abstract broad legal principles from it."[40]

Lastly, the creation of two SLATs that leave each grantor spouse with beneficial access to assets that are substantially similar to those transferred away may risk triggering the reciprocal trust doctrine and Section 2036(a)(1) inclusion. The reciprocal trust doctrine applies to interrelated trusts that "to the extent of mutual value, [leave] the [grantors] in approximately the same economic position as they would have been in had they created trusts naming themselves as life beneficiaries."[41] In determining whether trusts are interrelated, courts have looked to similarities in the trusts' terms, assets, trustees, beneficiaries and funding dates and involvement in a prearranged plan.[42] If the trusts are interrelated, the IRS will uncross them—meaning that each grantor is treated as the creator of the trust for such grantor's benefit—to determine the grantor's resulting economic position. This uncrossing then can trigger estate inclusion under Section 2036(a) due to retained access or control over the trust's assets. To avoid application of the reciprocal trust doctrine when two spouses each create an irrevocable trust, an estate-planning attorney may include a wide array of differences between the trusts. However, only those that significantly impact the grantors' respective beneficial interests have proven consistently successful.[43]

For tips on how to avoid Section 2036(a)(1) inclusion when creating a trust with retained access, consider the facts of *Estate of Wells v. Comm'r.*

Now, let's return to Amir and Dalia. If they each create a SLAT for the other, we know that they'll likely need to dip into the trusts to support their spending needs in their remaining years. The question then becomes, "How does this unfold, especially as they start to rely on the trusts for shared expenses?"[44] Are distributions directed to a joint account owned by both spouses? How could the couple then demonstrate at audit that trust funds were used to benefit a single spouse rather than both? Are their trusts making reciprocal distributions such that the pair retains substantially the same access to the trust assets as they had before funding?[45] Will one spouse's beneficial interest need to be severely restricted to avoid application of the reciprocal trust doctrine? If so, how might those constraints impact their living expenses? While the couple could potentially administer the trust assets in a way to avoid inclusion, their mutual beneficial interests and liquidity needs make successful trust administration more complicated and thus riskier.

A Winning Strategy

For tips on how to avoid Section 2036(a)(1) inclusion when creating a trust with retained access, consider the facts of *Estate of Wells v. Comm'r.* Here, Gizella Wells transferred property to an irrevocable trust of which her son was trustee and from which she could receive distributions in the trustee's discretion.[46] Her son proceeded to distribute the trust's income to her two to four times a year.[47] Yet her estate was able to successfully defend itself against a claim of an implied understanding of a retained interest. How? For starters, prior to making the transfer, Gizella consulted with her accountant about her cash flow and the gift's potential impact on her standard of living.[48] Only after receiving assurances that she could afford to freely give away the trust funds did she proceed.[49] The Tax Court relied on this analysis—and its findings that Gizella retained enough income to meet her spending needs—in concluding that she "never counted on, relied upon, or expected the income from the trust."[50] This fact also distinguished the case from those in which the grantor used trust income for ordinary living expenses or maintained an identical relationship with the assets post-transfer.[51] Additionally (and importantly), Gizella didn't request distributions from the trust. Rather, distributions were made at her son's discretion and applied at his urging towards her global travel adventures.[52]

Let's return to Amir and Dalia one last time and compare their situation to that of Gizella. Like Gizella, they were wise enough to undertake a cash flow analysis prior to funding their trusts.[53] Yet unlike Gizella, their analysis showed that they would likely need to draw from the trusts to support their basic spending needs down the road. To address this eventuality, they considered whether to distribute funds from one or both trusts. If they draw from only one trust for their shared expenses, they'll end up supporting the living expenses of the trust's grantor. On the other hand, if they structure the trusts to allow for a similar draw from both trusts, they risk eroding any change in their relationship to the transferred assets and potentially establishing a fact pattern favorable to the reciprocal trust doctrine. Ultimately, this Catch-22 sparks concerns that the proper long-term administration of the trusts may overly complicate the couple's lives, and they go back to the drawing board.

The pair then consider having only Dalia create a SLAT[54] and relying on less restrictive transfer-tax strategies to address their remaining estate tax concerns. Although smaller, simpler transfers—such as annual exclusion gifts and grantor retained annuity trusts (GRATs)—may seem underwhelming based on their short-term performance, the power of these strategies emerges over longer periods. For instance, consider if Dalia were to make one annual exclusion gift to the SLAT for the benefit of Dalia's and Amir's child each year for 30 years. (See "Boost the Benefit of Annual Gifts," p. 35.) This simple technique can move just under $1 million (adjusted for inflation) out of Dalia's taxable estate—all without making a taxable gift! What's more, this strategy can be discontinued at any time if the couple needs access to their property.

Amir can also play a role. He could sell marketable securities to an irrevocable trust for the benefit of their children in exchange for a 20-year, interest-only, balloon payment promissory note or by contributing this same amount to a series of rolling, 2-year GRATs over 20 years. All else being equal, Amir could significantly reduce any potential estate tax liability by making a gift of, selling or using rolling GRATs for such securities but preserve substantially more liquidity using an installment sale or rolling GRATs.[55] (See "Allocation of Family Wealth in Year 30," p. 35.) While these latter two strategies may not generate the greatest after-tax wealth (even assuming a flawless trust administration period), they certainly offer better after-tax benefits than a more restrictive strategy that triggers estate inclusion due to the grantor's need to access the trust funds.

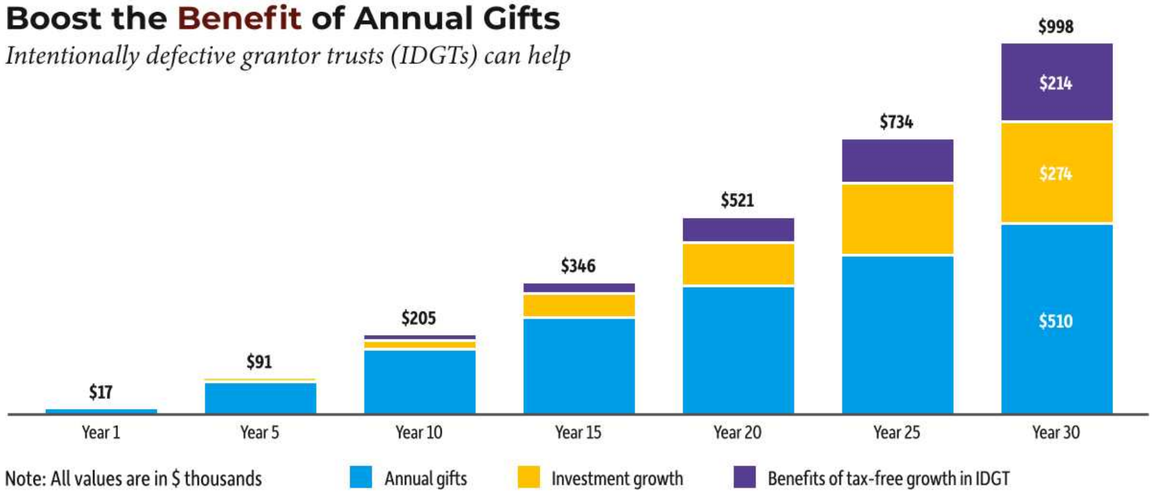
— *For illustrative purposes only; not an advertisement and doesn't constitute an endorsement of any particular wealth transfer strategy. Bernstein doesn't provide legal or tax advice. Consult with competent professionals in these areas before making any decisions.*

Endnotes

1. As of Jan. 1, 2023, each U.S. citizen and permanent resident may give away during life and/or at death up to $12.92 million free of federal gift and estate tax, subject to annual inflation adjustments. Internal Revenue Code Section 2010(c)(3). Barring congressional action,

Boost the Benefit of Annual Gifts

Intentionally defective grantor trusts (IDGTs) can help



Initial annual gift is $17,000, indexed for inflation. All accounts are invested 100% in stocks. Stocks are modeled as 13% U.S. diversified, 17% U.S. value, 17% U.S. growth, 7% U.S. small- and mid-cap, 10% U.S. low vol, 20% developed international, 11% emerging markets and 5% high risk international. Federal tax rates: top marginal; State tax rates: 5%. If the assets were liquidated, additional capital gains or losses would be realized that aren't reflected here. Based on Bernstein's estimates of the range of returns for the applicable capital markets as of March 30, 2020. **Data don't represent past performance and aren't a promise of actual future results or a range of future results.**

— Bernstein Capital Markets Engine

Allocation of Family Wealth in Year 30

SLAT vs. personal assets

SLAT-spousal lifetime access trust GRAT-grantor retained annuity trust

Year 30, "Typical Markets" results, meaning the 50th percentile results of 10,000 trials in Wealth Forecasting System.

Note: All values are in $ millions, nominal.

*Assumes a 40% federal estate tax rate and the applicable federal exclusion of $6.46 million (resulting from sunset of Tax Cuts and Jobs Act in 2025) adjusted with chained consumer price index in the median case. Assumes Dalia uses all of her federal exclusion in the first year of the analysis, and Amir has $6.4 million of federal exclusion remaining at Year 30.

Personal and spousal lifetime access trust (SLAT) liquid assets are modeled with an allocation of 60% global stocks and 40% bonds. Liquid assets includes $3 million of tax-deferred retirement assets. Grantor retained annuity trust (GRAT) assets are modeled with an allocation of 100% global stocks. Illiquid assets (real estate and business interest) are assumed to adjust by median headline inflation for 30 years. Assumes a long-term applicable federal rate of 3.98% for the installment sale and an Internal Revenue Code Section 7520 rate of 4.6% for the first rolling GRAT (July 2023 rates). Assumes income and expenses offset for the first five years of the analysis. Beginning in 2028, annual living expenses total $300,000 in today's dollars, adjusted with inflation. Assumes spending is sourced from liquid SLAT assets when the personal portfolio is depleted. Assumes top marginal tax rates for the first five years, then federal tax rates are automatically calculated thereafter.

Based on Bernstein's estimates of the range of returns for the applicable capital markets over the next 30 years. **Data don't represent past performance and aren't a promise of actual future results or a range of future results.**

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however, this amount will be reduced by half on Jan. 1, 2026—leaving a forecasted federal exclusion amount of $6.9 million (the residual amount). An individual can only preserve the portion of the current federal exclusion amount that exceeds the residual amount (the excess amount) by using such exclusion prior to its expiration. Importantly, an individual must apply the residual amount first to any taxable gift, leaving only those individuals who made aggregate taxable gifts of more than the residual amount prior to 2026 with the benefit of some or all of the excess amount. Treasury Regulations Section 20.2010-1(c).

2. Note, however, that the common law relation-back doctrine may cause inclusion of such property in the original grantor's taxable estate if the property is directed to a trust for such grantor's benefit. This doctrine developed alongside the legal concept of a power of appointment (POA) and provides that the donee of a power—that is, the person granted the authority to direct the distribution of trust assets—functions as the agent of the POA's creator, rather than the holder of a property interest. Thus, if one spouse creates a spousal lifetime access trust (SLAT) for the benefit of the other spouse, and the beneficiary spouse then exercises a POA to appoint the SLAT assets back to a trust for the benefit of the original grantor spouse, federal gift and estate tax law may treat the original grantor spouse as the *creator and beneficiary* of the new trust—triggering potential estate inclusion. Although commentators and case law have moved towards recognizing a general POA—that is, a power that can be exercised for the benefit of one or more of the powerholder, the powerholder's estate and creditors of the powerholder or the powerholder's estate—as a property interest, the relation-back doctrine may still apply to a limited POA that doesn't include such parties as potential appointees. *See In re Wylie's Estate,* 342 So. 2d 996, at pp. 998-999 (Fla. Dist. Ct. App. 1977) (discussing the history of the relation-back doctrine before holding that a testamentary POA doesn't constitute a property interest) and *Restatement (Third) of Property*, Section 17.4(f) (Am. Law Inst. 2011).
3. Twenty-one states currently provide varying levels of creditor protection to trusts that include the grantor as a beneficiary (a domestic asset protection trust), thereby avoiding estate inclusion due to a creditor's consumption of trust assets in satisfaction of the grantor's legal obligations. David G. Shaftel, *Thirteenth ACTEC Comparison of the Domestic Asset Protection Trust Statutes*, *www.actec.org/assets/1/6/Shaftel-Comparison-of-the-Domestic-Asset-Protection-Trust-Statutes.pdf?hssc=1* and Eric R. Kaplan, "Arkansas Becomes the 21st State to Adopt Domestic Asset Protection Trust Laws," International Wealth & Asset Planning Blog, *www.gmlaw.com/news/arkansas-becomes-the-21st-state-to-adopt-domestic-asset-protection-trust-laws.*
4. *United States v. Byrum*, 408 U.S. 125, at pp. 145-146 (1972) (noting that the provisions of Internal Revenue Code Section 2036(a)(1) "deal with situations in which the owner of property divested himself of title but retained an income interest or . . . the lifetime use of the property" and that the term "enjoyment" refers to a "substantial present economic benefit rather than technical vesting of title or estates.") Note also that "use, possession, right to the income, or other enjoyment of the transferred property" includes application of such property to discharge a transferor's legal obligation. Treas. Regs. Section 20.2036-1(b)(2).
5. A decedent must retain such power for life or a period that can't be ascertained without reference to the decedent's date of death or a period that doesn't in fact end prior to the decedent's death. IRC Section 2036(a).
6. The grantor of a trust may serve as trustee while avoiding Section 2036(a)(2) inclusion if the grantor can make distributions only under an ascertainable standard, such as distributions necessary to support the beneficiary's health, education, maintenance and support. *See Jennings v. Smith*, 161 F.2d 74 (2d Cir. 1947). Consider, however, that any requirement to use a SLAT's assets to satisfy the grantor's support obligations owed towards the grantor's spouse—no matter the identity of the trustee—may trigger estate inclusion under Section 2036(a)(1).
7. The grantor must also be restricted from removing and replacing this individual or entity with the grantor or an individual or entity related or subordinate to the grantor. Treas. Regs. Section 20.2036-1(b)(3) and Revenue Ruling 95-58.
8. *See e.g.,* Private Letter Ruling 200944002 (Oct. 30, 2009) ("the trustee's discretionary authority to distribute income and/or principal to Grantor, does not, by itself, cause the Trust corpus to be includible in Grantor's gross estate under Section 2036") and Rev. Rul. 2004-64 ("Section 2036 generally does not apply when trust property may be used to satisfy the decedent's legal obligation only in the discretion of the trustee, whether or not the discretion is exercised by the trustee").
9. *Byrum*, *supra* note 4, at p. 136.
10. *Ibid.,* at pp. 136-144 (citing decedent's fiduciary duty to minority shareholders of an operating company as a meaningful restriction on decedent's ability to influence the company's dividend policy). *See also Estate of Levine v. Commissioner,* 158 T.C. No. 2 (2022) (in which decedent's attorney-in-fact served as sole member of investment committee for directed trust that could unwind split-dollar life insurance transaction to benefit decedent, fiduciary duties to trust's beneficiaries—that didn't include decedent—prevented application of Section 2036(a)(2)). *But cf. Estate of Strangi v. Comm'r*, 85 T.C.M. 1331 (2003) and *Estate of Powell v. Comm'r*, 148 T.C. 392 (2017) (fiduciary duties owed almost exclusively to decedent as part of intrafamily investment vehicle when manager or general partner also served as decedent's attorney-in-fact proved illusory and didn't negate estate inclusion).
11. *Estate of Goodwyn v. Comm'r*, 32 T.C.M. 740 (1973) ("It would indeed be an unusual situation for a grantor to appoint trustees, whether corporate or otherwise, in the expectation that such trustees would,

where given a choice, act contrary to the wishes and intent of the grantor. Notwithstanding that [the trustees in this case] permitted the decedent full discretion in the management of these trusts, as a matter of law the trustees were responsible and answerable for the decedent's acts on their behalf").

12. Notably, the Internal Revenue Service has been careful to preserve exceptions for a pre-existing arrangement from past rulings, including PLR 200944002 (Oct. 30, 2009) and Rev. Rul. 2004-64, which otherwise "blessed" granting the trustee the fully discretionary ability to distribute trust property to the trust's grantor.
13. Treas. Regs. Section 20.2036-1(c)(1)(i) ("An interest or right is treated as having been retained or reserved if at the time of the transfer there was an understanding, express or implied, that the interest or right would later be conferred").
14. *Strangi*, *supra* note 10, at p. 7.
15. *Ibid*.
16. *Ibid*., at p. 8.
17. *See, e.g., Estate of Wells v. Comm'r*, 42 T.C.M. 1305, 4 (1981) and *Estate of Hendry v. Comm'r*, 62 T.C. 861, 872 (1974).
18. *Strangi*, *supra* note 10, at p. 10 ("Circumstances that have been found probative of an implicitly retained interest under section 2036(a)(1) include transfer of the majority of the decedent's assets, continued occupation of transferred property, commingling of personal and entity assets, disproportionate distributions, use of entity funds for personal expenses, and testamentary characteristics of the arrangement").
19. *Ibid*.
20. *Ibid.,* at p. 3.
21. *Ibid.,* at p. 10. In addition to the transfer of a majority of his assets, the Tax Court cited: (1) the decedent's continued use of the residence transferred to the partnership without timely rent payments, (2) partnership distributions in response to the decedent's spending needs or those of his estate, and (3) similarities between the partnership's creation and funding and the implementation of an estate plan in reaching its holding. *Ibid.,* at pp. 10-12.
22. *Ibid.,* at p. 10.
23. Liquidity from a potential sale of Amir's business interest wasn't factored into this cash flow analysis due to uncertainty of the business' future value and marketability.
24. IRC Section 677. It may be possible to convert the trust to a non-grantor trust while keeping the grantor's spouse as a trust beneficiary through use of an adverse party to control distributions to such spouse. However, commentators have noted both uncertainty regarding the level of adversity needed and myriad provisions that would require adverse party review to avoid such status, making this strategy highly complicated. Edwin P. Morrow, "Ed Morrow and Using Spousal Lifetime Access Non-Grantor Trusts (SLANTs) After the 2017 Tax Reform," *Steve Leimberg's Income Tax Planning Email Newsletter #139* (April 13, 2018) (*see* discussion of IRC Section 676).
25. IRC Section 1(e).
26. Given the Tax Court's view of illiquid assets in *Strangi*, consider whether assets held in trust for a grantor's benefit—for example, a SLAT from which distributions can also carry a negative tax impact like estate inclusion—fare any better as an external reserve for the grantor's spending needs.
27. *Estate of Maxwell v. Comm'r,* 3 F.3d. 591 (2d Cir. 1993).
28. The decedent also simultaneously forgave $20,000 of the original purchase price as annual exclusion gifts to her son and his wife. *Ibid.,* at p. 592.
29. *Ibid.*
30. The court also noted: (1) that the decedent forgave the mortgage's principal balance through a combination of gifts and a testamentary bequest, and (2) the decedent's age and poor health in reaching this conclusion. *Ibid.*
31. *Ibid.,* at pp. 594-595.
32. *Estate of McCabe v. U.S.,* 475 F.2d 1142, at pp. 1144, 1147 (Ct. Cl. 1973).
33. *Ibid.,* at pp. 1146-1147.
34. *Ibid.*
35. *Ibid.,* at pp. 1147. *See also Estate of Moore v. Comm'r*, 119 T.C.M. 1251 (2020) (finding that de facto control through compliant trustees evidenced lack of meaningful change in relationship to assets leading to Section 2036(a)(1) inclusion: "Moore's children typically did things because Moore asked them to and giving them nominal 'power' was no different from Moore's keeping that power.")
36. *Ibid.,* at p. 1146.
37. *Ibid.,* at p. 1148.
38. *Gutchess v. Comm'r,* 46 T.C. 554 (1966).
39. *Ibid.,* at p. 557.
40. *Hendry*, *supra* note 17, at p. 876.
41. *U.S. v. Grace's Estate*, 395 U.S. 316, at p. 324 (1969).
42. *Estate of Levy v. Comm'r*, 46 T.C.M. 910 (1983).
43. *Ibid.* (doctrine didn't apply when husband and wife created trusts on the same date pursuant to joint consultations with the same attorneys, with the same type of assets and for the same non-spouse beneficiary, but only wife held a special POA over the trust created by husband, under which she could have transferred sufficient company interests to block a merger, consolidation, amendment to the governing documents, etc., in conjunction with her outside company interests). *See also* PLR 9643013 (Oct. 25, 1996) (doctrine wouldn't apply when husband and wife each create a trust but only husband receives a beneficial interest) and PLR 200426008 (June 25, 2004) (doctrine wouldn't apply when husband names wife as beneficiary of trust and

grants her withdrawal and appointment powers over trust property, while wife creates trust that doesn't benefit husband—outside of a contingent marital deduction trust—until three years after wife's death and only subject to certain income limitations).

44. For a tongue-in-cheek article on how to foil a SLAT-based estate plan, *see* Martin M. Shenkman, "Spousal Lifetime Access Trusts (SLATs): Easy Ways to Destroy Your Trust Plan?" *Forbes, www.forbes.com/sites/martinshenkman/2021/12/11/spousal-lifetime-access-trusts-slats-easy-ways-to-destroy-your-trust-plan/?sh=125b18247305.*
45. *Wells*, *supra* note 17, at p. 1.
46. *Ibid.*
47. *Ibid.*, at p. 2.
48. *Ibid.*, at pp. 4-5.
49. *Ibid.* Interestingly, one has to wonder why Gizella retained an interest in the trust if she had no need to access its assets. Her estate could have avoided substantial legal fees had she created a gift trust solely for the benefit of others and relied on outside assets to support her world travels.
50. *Ibid.*, at p. 5.
51. *Ibid.*
52. *Ibid.*
53. Note, however, that there's no clear guidance on the level of confidence needed to show that a grantor won't need to access the trust's assets in the future. If a cash flow analysis demonstrates that there exists a 50% probability of the grantor retaining cash reserves necessary to support future spending, is this sufficient? Does the trustee's opinion as to the requisite level of confidence impact the analysis' efficacy, as any implied understanding would involve both the grantor and the trustee?
54. If only one member of a married couple creates an irrevocable trust, the couple should consider how the trust assets will be treated in the event of a divorce. *See* Jennifer B. Goode, "The Best Laid Plans: How Divorce Can Impact SLAT Planning and Why a Postnuptial Agreement May Be Your Best Option," 48 *Tax Mgmt. Est., Gifts & Tr. J.* No. 2 (March 9, 2023).
55. A common concern when comparing the use of rolling, short-term grantor retained annuity trusts (GRATs) to a gift or sale to trust is the ultimate generation-skipping transfer (GST) tax treatment of the GRAT remainder. Due to the grantor's retained interest in a GRAT, IRC Section 2642(f) prevents an effective allocation of the grantor's $12.92 million GST tax exemption to the GRAT at its creation. Treas. Regs. Section 26.2632-1(c)(1)(i). However, the GRAT's grantor can allocate such exemption to the trust's remainder at the end of the GRAT term. If the GRAT provides that such remainder continue in trust, this will potentially result in the creation of GST tax-exempt and non-exempt trust shares. Additionally, consider the impact of so-called "upstream planning" on the GST non-tax-exempt share. More specifically, consider whether the grantor could name an older family member as a beneficiary of the GST non-tax-exempt share and grant this beneficiary a general POA over such property to the extent of the lesser of the beneficiary's remaining federal exclusion amount and GST tax exemption. On this individual's death, the property subject to the general POA then will use the beneficiary's remaining exclusion and exemption to deliver a new GST tax-exempt share with a stepped-up basis for income tax purposes.