Steve Leimberg's Asset Protection Planning Email Newsletter - Archive Message #207

Date: 11-Sep-12
From: Steve Leimberg's Asset Protection Planning Newsletter
Subject: **Gassman, Share, Crotty & Hohnadell: Planning After IRS Memo 201208026: How Foreign Can Creditor Protection Trust Laws Get?**

"The asset protection and international trust law community was taken by surprise by the publication of IRS CCA 201208026, which somehow concluded that a taxpayer made a taxable gift to an irrevocable trust, despite retaining a power to appoint the trust assets upon death. This ruling seems to conflict with the language of the Treasury Regulations that define complete and incomplete gifts for federal gift tax purposes, along with a number of Private Letter Rulings issued over the past seven years.

It is important to note that a Chief Counsel Advice Memorandum (CCA) is not "the law" and simply reflects the opinion of the IRS attorney that prepared it. One well known authority in this area indicated that "this ruling is plainly wrong, and it is unfortunate that taxpayers will have to wait until the IRS corrects this deviation from accuracy or until this issue is determined by a court decision." We can only hope that the IRS does the right thing and revokes this opinion in the near future. The authors highly recommend that this occur or, at a minimum, the IRS limit its application to trust arrangements entered into after its publication."

Now, **Alan Gassman**, **Leslie Share**, **Ken Crotty**, and **Kacie Hohnadell** provide members with their commentary on a controversial Chief Counsel Advice Memorandum.

Alan S. Gassman, J.D., LL.M. practices law in Clearwater, Florida. Each year he publishes numerous articles in publications such as BNA Tax & Accounting, Estate Planning, Trusts and Estates, The Journal of Asset Protection, and Steve Leimberg's Asset Protection Planning Newsletters. Mr. Gassman is a fellow of the American Bar Foundation, a member of the Executive Council of the Tax Section of the Florida Bar, and has been quoted on many occasions in publications such as The Wall Street Journal, Forbes Magazine, Medical Economics, Modern Healthcare, and Florida Trend magazine. He is an author, along with Kenneth Crotty and Christopher Denicolo, of the BNA Tax & Accounting book Estate Tax Planning in 2011 and 2012. He is the senior partner at **Gassman Law Associates, P.A.** in Clearwater, Florida, which he founded in 1987. His email address is agassman@gassmanpa.com

Leslie A. Share, J.D., LL.M., is a shareholder in the Coral Gables, Florida law firm of **Packman, Neuwahl & Rosenberg**, where he practices in the areas of domestic and international tax, estate and business planning, and wealth preservation. Mr. Share has been quoted in numerous publications, has served as an adjunct professor at the University of Miami School of Law, and has written or co-authored articles for Estate Planning, the Asset Protection Journal, Entertainment Law & Finance, the University of Florida Law Review and an American Bar Association book entitled Foreign Investment in U.S. Real Estate-A Comprehensive Guide. Mr. Share received his B.A. from Northwestern University, his J.D., with honors, from the University of Florida, and his Master of Laws in Taxation from New York University. His e-mail address is las@pnrlaw.com.

Kenneth J. Crotty, J.D., LL.M., is a partner at the Clearwater, Florida law firm of **Gassman Law Associates, P.A.** , where he practices in the areas of estate tax and trust planning, taxation, physician representation, and corporate and business law. Mr. Crotty has co-authored several handbooks that have been published in BNA Tax & Accounting, Estate Planning, Steve Leimberg's Estate Planning and Asset Protection Planning Newsletters and Estate Planning magazine. He, Alan Gassman and Christopher Denicolo are the co-authors of the BNA book Estate Tax Planning in 2011 & 2012. His email address is ken@gassmanpa.com.

Kacie A. Hohnadell, B.A., J.D. candidate, is a third-year law student at Stetson University College of Law and is considering pursuing an LL.M. in taxation upon graduation. Kacie is also the Executive Editor of Stetson Law Review and is actively involved in Stetson's chapter of the Student Animal Legal Defense Fund. In 2010, she received her B.A. from the University of Central Florida in Advertising and Public Relations with a minor in Marketing, and moved to St. Petersburg shortly after graduation to pursue her Juris Doctor. Her email address is Kacie@gassmanpa.com.

Here is their commentary:

EXECUTIVE SUMMARY:

The asset protection and international trust law community was taken by surprise by the publication of IRS CCA 201208026 on February 24, 2012, which somehow concluded that a taxpayer made a taxable gift to an irrevocable trust, despite retaining a power to appoint the trust assets upon death. This ruling seems to conflict with the language of the Treasury Regulations that define complete and incomplete gifts for federal gift tax purposes, along with a number of Private Letter Rulings issued over the past seven years.

It is important to note that a Chief Counsel Advice Memorandum (CCA) is not "the law" and simply reflects the opinion of the IRS attorney that prepared it. Chief Counsel Advice is defined as: (1) written advice or instructions under whatever name, prepared by the Chief Counsel's office and issued to the field or service center personnel or to regional or district counsel attorneys (2) that conveys any legal interpretation of a revenue position, or Chief Counsel position concerning a revenue matter or any legal interpretation of any law relating to the assessment or collection of any liability under a revenue provision.[1] CCAs may not be cited as precedent, but such memoranda often show how the IRS may consider a particular tax issue in the event of a taxpayer examination.

FACTS:

In the new ruling, a husband and wife as joint Grantors transferred property to an irrevocable trust, with their adult child as the sole trustee. The trust's beneficiaries were the Grantors' lineal descendants and their spouses along with a charitable organization (but neither of the Grantors were beneficiaries), with the trustee having sole discretion over income and principal distributions. The issues reviewed in the ruling were: (1) whether the Grantors made completed gifts upon transferring property to the trust; and (2) whether § 2503(b) annual exclusions were allowable for the withdrawal rights provided to the trust beneficiaries.

The new ruling distinguished the arguably clear language of the Treasury Regulations and the prior IRS rulings regarding incomplete gifts by stating that: "[t]he relinquishment or termination of a power to change the beneficiaries of transferred property, occurring otherwise than by the death of the donor (the statute being confined to transfers by living donors), is regarded as the event that completes the gift and causes the tax to apply." The ruling cites a number of cases, including Chandler v. Kelsey, 205 U.S. 466 (1907), a New York inheritance tax case that predated the federal gift tax, as arguably tenuous support for this new position that a Grantor-retained testamentary power of appointment is insufficient to render a gift incomplete when the Grantor has no right to control the disposition of any of the assets during the Grantor's lifetime.

The Grantors' "bail out" position that the Crummey powers held by the trust's beneficiaries effectively negated any completed gifts to the trust was also deemed insufficient. The ruling indicated that certain trust language made it relatively difficult to make such rights legally compulsory; therefore, the IRS found that these rights were "unenforceable and illusory" and thus did not to cause the transfers to the trust to be treated as gifts of present interests eligible for the § 2503(b) annual exclusion.

Finally, to add insult to injury, the IRS held that under § 2702(a)(2)[2] and Treasury Regulation § 25.2702-2(a)(4),[3] the value of the Grantor's retained testamentary power interest was considered to be zero, thus making the amount of the gift the full value of the transfer to the trust. Significantly, under § 2702(a)(3)(A)(i), these Chapter 14 special valuation rules never would have come into play if the transfer had instead been treated as an incomplete gift. The IRS recognized that the application of these rules was not a legal slam-dunk, as it indicated that "our belief in this regard carries certain hazards to the extent further study is required."

COMMENT:

The new IRS ruling paraphrases Treasury Regulation § 25.2511-2(c), which the vast majority of asset-protection trust drafters have reasonably relied upon to make gifts incomplete with the intention of avoiding the imposition of the gift tax upon transfers to such trusts regardless of their amount:

> A gift is also incomplete if and to the extent that a reserved power gives the donor the power to name new beneficiaries or to change the interests of the beneficiaries as between themselves unless the power is a fiduciary power limited by a fixed or ascertainable standard.

In addition, many knowledgeable professionals believe that the following language from Treasury Regulation § 25.2511-2(b) further clarifies what was thought to be the IRS position in this area:

> As to any property, or part thereof or interest therein, of which the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit or for the benefit of another, the gift is complete. But if upon a transfer of property (whether in trust or otherwise) the donor reserves any power over its disposition, the gift may be wholly incomplete, or may be partially complete and partially incomplete, depending upon all the facts in the particular case. Accordingly, in every case of a transfer of property subject to a reserved power, the terms of the power must be examined and its scope determined. **For example, if a donor transfers property to**

> **another in trust to pay the income to the donor or accumulate it in the discretion of the trustee, and the donor retains a testamentary power to appoint the remainder among his descendants, no portion of the transfer is a completed gift.** (emphasis added)

At the very least, in those asset protection trusts where the Grantor remains a potential discretionary income (or principal) beneficiary, it would appear at first glance that a retained testamentary special power of appointment would fall within the Service's regulatory definition of a completed gift.

This position was echoed in a number of Private Letter Rulings. For example, in Private Letter Ruling 200502014, the Grantor retained a testamentary special power of appointment over the trust principal and any accumulated accrued and undistributed income. In this ruling, the IRS cited Sanford's Estate v. Commissioner, 308 U.S. 39 (1939), for its holding that a donor's gift was incomplete for purposes of the gift tax when the donor reserves the right to determine the donees who ultimately receive the trust assets. In Sanford's Estate, the court ruled that the Grantor's gift was complete once the Grantor relinquished his right to change the trust beneficiaries. In accordance with this decision, the ruling concluded that under its facts: (1) the Grantor retained the ability to change the beneficiaries to the trust though the testamentary special power of appointment; (2) the Grantor thereby continued to possess dominion and control over the transferred property; and (3) as a result, the Grantor's contribution of property to the trust was not a completed gift for U.S. gift tax purposes.

Private Letter Ruling 200715005 similarly confirmed that the Treasury Regulations supported this type of incomplete gift planning, with "A" being the trust's Grantor:

> In this case, A retains a limited testamentary power to appoint the Trust corpus and accumulated income to any persons (other than A, A's creditors, A's estate or the creditors of A's estate). In view of this retained power, A's transfer of property to Trust will not be a completed gift subject to Federal gift tax. See, §25.2511-2(b)…

The new IRS ruling could conceivably be distinguishable from these previous Private Letter Rulings because the grantors in those situations retained some control over the distribution of the trust assets in addition to retaining testamentary powers of appointment, such as by effectively retaining the power to veto distributions to other beneficiaries and by preventing the trustee of the trust from transferring trust assets to individuals other than the grantor.

Although the new IRS ruling in effect takes a contrary position to the analysis of the Treasury Regulations and other existing tax law found in prior rulings, its conclusions on the complete/incomplete gift issue could conceivably be upheld by a trial court, and may then need to be appealed. For this reason, a number of respected asset protection professionals have indicated that they will no longer completely rely upon testamentary power of appointment to render a gift incomplete, and instead will use alternative incomplete gift tools such as a retained Grantor lifetime power of appointment or distribution veto power, notwithstanding the related issues that could potentially arise from an asset protection standpoint.[4]

Practitioners who have relied solely upon testamentary powers of appointment for this type of planning clearly did the right thing and should not have to worry about it. It is expected by many that the IRS will either revoke this CCA or will limit its applicability to trust arrangements entered into after its publication. Again, a CCA is not binding authority and cannot be cited in court, but often shows the viewpoint of the IRS regarding a particular issue.In the authors' opinion, it should not be considered to be even remotely negligent to have followed the advice provided by the leading practitioners and published authors in the estate and gift tax field (as well as the prior rulings and the above regulation), which included the following:

In **LISI** Estate Planning Newsletter #931, **Steve Akers** wrote:

> The most conservative planning is to contribute the limited partnership interests to an irrevocable trust (with a third party trustee) that is an incomplete gift (i.e., have the client retain a testamentary power of
>
> appointment over the trust).

The following statement was made by **Ms. Carol Harrington** in the Question & Answer Session of the **2006 Heckerling Institute on Estate Planning**, which can be found in Chapter 11 at page 11-11 in the Institute book published in 2006 by Mathew Bender & Company, Inc.:

> Another thing we have talked about is to get rid of all the units, either by selling them or giving them all away. If you need the economic benefit, sell them to a grantor trust for a note and keep that income stream. If you are not willing to monetize it in that way and your client is worried about keeping the interest for life, you can put it into a trust that is irrevocable, but avoid a completed gift by retaining a testamentary nongeneral power of appointment. The client can keep the economic stream of payments, and with an independent trustee of that trust, would not be voting those limited units. So you could negate a control argument. I think that is a more difficult and complex analysis than most clients will find acceptable, but if a great deal of money is on the table, I think that eliminates the Section2036(a)(2) risk.
>
> Dennis, tell us what you are doing in your practice with new clients who have not created these partnerships already. Coming in to see you for estate planning advice, what are you telling them?
>
> **Mr. Dennis Belcher** condoned this method on page 11-12 by stating: If you believe that Section2036(a)(2) is a significant risk and there are enough dollars involved, you may want to use the technique that Carol described by which I convey my limited partnership interest to an irrevocable trust that is an incomplete gift.
>
> **Professor Jeffrey Pennell** from **Emory University** was the third member of the panel and had no comment on the above (which is unusual for the beloved Professor Pennell, who known not to be bashful about disagreeing with mainstream opinions or to side with the IRS on questionable situations.)

Howard Zaritsky's *Tax Planning for Family Wealth Transfers* Treatise

stated as follows on pages 3-21 in the Fourth edition:

> Donor has not made a completed taxable gift of either principal or income, because Donor's testamentary power of appointment and the indefinite nature of Beneficiary's income interest give Donor the potential power to decide who shall receive all parts of the trust."[1]

trust.

(A footnote to the above sentence is as follows: This power, however, would not have caused the Grantor to be taxed as the owner of the trust under the Grantor rules."See Internal Revenue Code Section 647(b)(2).)

Additionally, the treatise states, "A donor's reserved power to ... change the beneficiaries or their respective interests will always render the transfer incomplete for gift tax purposes."

Conclusion:

One well known authority in this area indicated that "this ruling is plainly wrong, and it is unfortunate that taxpayers will have to wait until the IRS corrects this deviation from accuracy or until this issue is determined by a court decision." We can only hope that the IRS does the right thing and revokes this opinion in the near future. The authors highly recommend that this occur or, at a minimum, the IRS limit its application to trust arrangements entered into after its publication.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

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CITES:

CCA 201208026; Private Letter Ruling 200502014; Private Letter Ruling 200715005; Treasury Regulation §25.2511-2(b); Treasury Regulation §25.2702-2(a)(4).

CITATIONS:

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[1] Michael I. Saltzman, *IRS Practice and Procedure*, ¶ *3.04 Other Statements of IRS Position and Practice* (Thomson/RIA 2012).

[2] Internal Revenue Code §§ 2702(a)(2)-(3) provide as follows:

(2) Valuation of retained interests.

(A) In general. The value of any retained interest which is not a qualified interest shall be treated as being zero.

(B) Valuation of qualified interest. The value of any retained interest which is a qualified interest shall be determined under section 7520.

(3) Exceptions.

(A) In general. This subsection shall not apply to any transfer-

(i) if such transfer is an incomplete gift,

(ii) if such transfer involves the transfer of an interest in trust all the property in which consists of a residence to be used as a personal residence by persons holding term interests in such trust, or

(iii) to the extent that regulations provide that such transfer is not inconsistent with the purposes of this section.

(B) Incomplete gift. For purposes of subparagraph (A), the term ' incomplete gift' means any transfer which would not be treated as a gift whether or not consideration was received for such transfer.

[3] Treasury Code Regulation § 25.2702-2(a)(4) provides as follows: "An interest in trust includes a power with respect to a trust if the existence of the power would cause any portion of a transfer to be treated as an incomplete gift under chapter 12."

[4] Howard Zaritsky, Mitchell Gans, and Jonathan Blattmachr discuss these alternative methods of creating an incomplete gift in Estate Planning Newsletter #1936 (Mar. 6, 2012) at http://www.leimbergservices.com. Jeffrey Pennell also describes these methods in Estate Planning Newsletter #1937 (Mar. 7, 2012) at http://www.leimbergservices.com.

0 Comments Posted re. *Gassman, Share, Crotty & Hohnadell: Planning After IRS Memo 201208026: How Foreign Can Creditor Protection Trust Laws Get?*

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