
Folks:

Take-Away: Asset protection trusts (APTs) and *incomplete grantor* trusts (IGTs) for gift tax purposes have a bewildering history when it comes to the IRS. What are informally called DINGs (or ING), which are sophisticated wealth accumulation and asset protection trusts, seem to confuse the IRS. Nor is the IRS quite sure how to deal with these trusts when it comes to the imposition of transfer taxes. Until the IRS provides clear guidance, it would be best to ‘go slow’ if an individual is considering the adoption of *incomplete non-grantor trust*, or ING.

Background: Michigan authorizes the use of an asset protection trust. Michigan calls it’s APT a *qualified dispositions in trust*. [MCL 700.1041.] Many may not know, but an asset protection trust, or APT, can be structured, and most are, as a *grantor* trust for federal income tax reporting purposes. That is because the trustee of the APT may distribute income to, or accumulate that income for, the settlor/grantor of the trust without the approval of an adverse party. [IRC 677(a)(1).]

However, in some states which permit asset protection trusts, it may be possible for the settlor to create a non-*grantor* APT for federal income tax reporting purposes, fund that trust with contributions that are not considered taxable gifts by its grantor for federal gift tax reporting purposes, and yet the grantor can retain the right to receive discretionary distributions of trust income or trust principal.

This type of non-*grantor* trust can be of great benefit to those individuals who reside in states with high personal income tax rates because the individual is able to create a non-*grantor* irrevocable trust while at the same time avoid the high state fiduciary income tax rates on the trust’s accumulated income, both in the asset protection trust state and the

individual's state where he/she resides. These trusts, for asset protection and income tax minimization purposes are often called DINGs, which stands for *Delaware Incomplete Non-Grantor Trust*, or an ING.

ING: An ING is an irrevocable non-*grantor* trust that is typically created in an APT state that does not tax income and capital gains that are accumulated in the irrevocable trust. However, that individual cannot create a non-*grantor* APT to avoid state income tax on *source* income from the individual's own state of residence.

Example: A Michigan resident creates an asset protection trust in Delaware, uses a Delaware trustee, and authorizes the Delaware trustee to accumulate income, all of which is sourced in New York, not Michigan. The accumulated income in the Delaware trust will avoid any income tax either in Delaware or Michigan. However, federal income tax on the accumulated income in the Delaware trust would not be avoided.

APT States: States with these favorable trust income tax rules include Delaware, Alaska, New Hampshire, and Nevada. The key point to remember is that is an ING is not normally used to avoid the trust's federal income tax liability, just state income tax liability. The ING trust must be formed in an APT state because the trust will be treated as if the grantor's creditors can access the trust's assets, i.e., a self-settled trust, which is why the APT is used to protect against any creditor claims. [Regulation 1.677(a)-1(d).] [In contrast, at common law, a trust will be treated as a *grantor* trust if the grantor's creditors can reach the assets of a self-settled irrevocable trust. MCL 700.7505, codifies this common law in Michigan.]

Incomplete Transfers: Individuals usually want their transfers to the APT to be an *incomplete* gift for federal gift tax reporting purposes. Otherwise, the transferor will consume his/her available federal gift tax exemption when the APT is funded. That federal gift tax exemption will be wasted if APT assets are later distributed back to the transferor as a discretionary

trust beneficiary. Additionally, the cost of a completed gift might discourage the transferor from transferring assets to the APT that have a value greater than the transferor's remaining applicable exemption amount; most donors detest paying any federal gift taxes. Consequently, the goal is to structure the APT as a being funded with *incomplete* transfers by its grantor so that no gift tax is incurred when the APT receives the assets.

Incomplete Gifts: A gift is *incomplete* by its transferor if and to the extent that the transferor reserves the power to name new trust beneficiaries or the power to change the interests of those beneficiaries. [Regulation 25.2511-2(c).] A gift is also *incomplete* if the transferor retains a testamentary power of appointment over the gifted property interest. [Regulation 25.2511-2(b).] Consequently, for most ING trusts, the grantor will make *incomplete* gifts to the trust by retaining the power either to name new beneficiaries to the trust, or to change the interests of the initial trust beneficiaries, or by reserving a testamentary limited power of appointment over the trust's assets. The presence of these retained powers or reserved rights prevents the gift from being complete for gift tax purposes.

Non-grantor Trusts: For the APT to be an *incomplete* for gift tax reporting purposes and to be classified as a *non-grantor* trust for income tax purposes, the consent of an adverse party is necessary regarding discretionary distributions to the grantor from the trust. [IRC 677(a)(1).] This 'adverse party' requirement is often achieved by using a distribution committee that is comprised of adverse parties [defined in the Tax Code, at IRC 672], which then makes a discretionary distribution to either the grantor or to the grantor's spouse, or for the trustee to accumulate income in the trust which is then subject to the grantor's retained lifetime or testamentary limited power of appointment.

IRS and INGTs: Initially the IRS seemed to endorse the use of INGTs, and in particular DINGs, but then apparently the Service started to have

second thoughts.

Private Letter Rulings: In a series of private letter rulings from 2005 to 2007 the IRS concluded that a grantor could create an APT for federal income tax purposes, fund that trust with contributions that were not treated as taxable gifts for federal gift tax reporting purposes, and still have the grantor retain the right to receive discretionary distributions of trust income or principal. [PLR 200715005; PLR 200637025.] The IRS's initial conclusions in these PLRs were that: (i) a distribution from the APT to a beneficiary other than its grantor would be treated as a completed gift by the grantor to that 'other' beneficiary; (ii) the distribution committee members possessed substantial adverse interests to each other for purposes of IRC 2514, and therefore none of the distribution committee members possessed a general power of appointment over the APT's assets; and (iii) any distribution from the APT would not be subject to gift tax with respect to each of the distribution committee members, i.e., the committee members were not treated as having made a taxable gift when they authorized a distribution from the trust to a beneficiary.

IRS News Release 2007-127: Then, in 2007, the IRS issued a News Release that announced that it was reconsidering its prior private letter rulings with respect to the gift tax consequences of a *non-grantor, incomplete* gift to an APT with respect to the prior PLRs' initial conclusion that members of the distribution committee did not hold general powers of appointment over the APT's assets. The IRS suggested in this Release that distributions made by the APT distribution committee might be treated as gifts by the individual members of the distribution committee. This possible IRS interpretation created a strained 'Alice in Wonderland' view where: (i) a discretionary distribution from the APT by its distribution committee to the grantor-beneficiary would be viewed as a taxable transfer made to the grantor of property which the grantor is already treated for federal transfer tax purposes as owning, i.e., a taxable gift

to one's self; and (ii) a discretionary distribution made by the distribution committee to a non-grantor beneficiary, e.g., the grantor's child, would constitute a taxable gift of the *same* property to the *same* person by *both* the grantor and the distribution committee members. Talk about confusion!

More PLRs: Starting in 2012 the IRS again started to issue PLRs and a Chief Counsel Memorandum on the transfer tax consequences of using an APT-INGT.

2012: The IRS held that the grantor's retention of a testamentary power of appointment over the trust's assets, alone, did **not** render the grantor's gift to the APT *incomplete* for federal gift tax purposes., i.e., there would be a taxable gift by the grantor. [Chief Counsel Memo 201208026.]

2013: The IRS issued a couple of identical PLRs that involved distribution committee gift tax exposure, must like its earlier PLRs. [PLR 20131002.]

2014: The IRS issued more PLRs in which it concluded that the grantor's contribution of property to an irrevocable trust for the benefit of the grantor and his descendants was not a completed gift for gift tax purposes and that the distribution decisions by a distribution committee do not result in completed gifts being made by members of that committee, meaning the distribution committee members do not hold a general power of appointment over the APT's assets.

No Revenue Rulings: Then, in 2021, the IRS issued Revenue Procedure 2021-3 in which it provided a list of areas that it would not issue private letter rulings. Two so listed were: (i) whether the beneficiaries who are members of the distribution committee have general powers of appointment; or (ii) whether a transfer to a non-*grantor* trust is an *incomplete* gift for gift tax reporting purposes.

This non-issuance policy continues to 2024. [See Revenue Procedure 2023-3, Section 5 (.01)(15)(17).]

Conclusion: Grantors who are considering an INGT cannot expect any guidance from the IRS, and if they proceed, they do so at their risk. Since the IRS will not issue private letter rulings or other guidance with respect to the tax consequences of ING trusts, and it is unsure if distribution committee members are deemed to hold general powers of appointment over the INGT's assets, individuals should be very careful if they decide to proceed with such a trust in light of the risk that the ING turns out to be something that was not contemplated, e.g., a completed gift for gift tax reporting purposes, or classification as a *grantor* trust for income tax reporting purposes.
