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DING TRUSTS

**A Presentation For
Atlanta Estate Planning Council**

November 5, 2013

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IRS Circular 230

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What Is a DING Trust?

- It is a Delaware Incomplete gift Non-Grantor Trust.
- Contributions to the trust are not subject to gift tax.
- The trust is taxed as a nongrantor trust for income tax purposes (i.e. a separate taxpayer).

What Are The DING Trust Planning Opportunities?

For settlors who live in states where it is possible to set up a self-settled nongrantor trust that is not subject to income tax in their state of residence, it is possible to create a DING trust so that future income on the assets in that trust are not subject to state income tax.

Basic Structure of a DING Trust

- **Creditor Rights** – it must be an asset protection trust because a trust is a grantor trust if the settlor's creditors can attach the trust's assets under Treasury Regulation Section 1.677(a)-1(d).
- **Distribution Committee** - distributions from a nongrantor trust can only be made to the settlor with the consent of an adverse person.
- **Testamentary Limited Power of Appointment** – this is a retained power necessary to cause incomplete gift treatment.
- **Grantor Consent Power** – this is a retained power necessary to cause incomplete gift treatment (PLR 201310002 stated this is sufficient to make the gift “wholly incomplete”).
- **Grantor Sole Power** – this is a retained power that helps cause incomplete gift treatment (In PLR 201310002, the Nevada trust also granted the settlor a lifetime inter vivos limited power, but the settlor of a Delaware asset protection trust cannot possess this power).

Grantor Trust Treatment And the Testamentary LPOA

- The settlor's testamentary power of appointment cannot be exercisable over income that is not accumulated only with the consent of an adverse person. See Treas. Reg § 1.674(b)(3).
- Therefore ALL distributions, to the settlor and the Distribution Committee members, must be made only with the consent of the Distribution Committee.

Distribution Committee

- A Distribution Committee comprised of beneficiaries who have a substantially adverse interest with respect to the settlor is the key to nongrantor trust treatment.
- Size of the Distribution Committee matters. Ideally 3.
- Distribution Committee members must be eligible for distributions and should be takers in default.
- The Distribution Committee members should be legitimate beneficiaries who could possibly get distributions – not the milkman.

Can a DING Trust Work for a Georgia Resident?

- The Georgia income tax statutes at first glance appear to tax a resident or non-resident trust with respect to funds or property managed “for the benefit of a resident of [Georgia]”. This could potentially cause a problem because a DING trust is a self-settled trust, and the other beneficiaries besides the settlor are likely to be the settlor’s descendants and some of them are likely to be Georgia residents. See OCGA 48-7-22(a)(1).
- However, OCGA 48-7-22(b) states that the net income is taxed in the same manner and on the same basis as in the case of an individual. That means that a non-resident trust should only be taxed on Georgia source income (which does not include income from marketable securities).
- So what does it mean to be a Georgia resident or non-resident trust? The answer to that question is not entirely clear under Georgia law. There is no statutory definition. But it appears that the most important factors are the domicile of the trustee and the place of administration, and the residency of the settlor is not important. If that is true, then it should be relatively easy to create a non-resident DING trust for Georgia tax law purposes that has only a Delaware trustee that administers the trust in Delaware.
- Thus, Georgia should not tax a DING trust if it has no Georgia source income or property located within Georgia.
- CAUTION: I am not a Georgia attorney and it is my understanding that there are some gray areas in this area of the law.

DING Trusts: A Brief History

- DING trusts did not exist before 2001.
- It is difficult to draft a trust instrument where the settlor gives up enough rights to make the trust a nongrantor trust but retains enough rights to make transfers to the trust incomplete gifts.

The PLRs

- First PLR issued on August 27, 2001.
- The IRS has ruled on a number of occasions: PLR 200148028 (Aug. 27, 2001); PLR 200247013 (Aug. 14, 2002); PLR 200502014 (Sept. 17, 2004); PLR 200612002 (Nov. 23, 2005); PLR 200637025 (June 5, 2006); PLR 200647001 (Aug. 7, 2006); PLR 200715005 (Jan. 3, 2007); PLR 200731019 (May 1, 2007); PLR 2007729025 (April 10, 2007); and PLR 201310002 (Nov. 7, 2012).
- All PLRs after PLR 200502014 addressed the transfer tax consequences to the Distribution Committee.

IR 2007-127

- The IRS announced on July 9, 2007 in IR 2007-127 that it is reconsidering a series of private letter rulings (PLRs) that address DING Trusts.
- PLRs have addressed the gift tax consequences applicable to the Distribution Committee under Sections 2511 and 2514 of the Internal Revenue Code. IRS suggested that the conclusions in the PLRs regarding the application of Section 2514 to the Distribution Committee members may not be consistent with Rev. Rul. 76-503, 1976-2 C.B. 275, and Rev. Rul. 77-158, 1977-1 C.B. 285.
- Do Distribution Committee members possess general powers of appointment?
- The IRS acknowledged that it received comments that the facts in the PLRs are distinguishable from the Revenue Rulings because in the PLRs, the settlor's gift to the trust is incomplete. However, the IRS referenced Treas. Reg. § 25.2514-1(e), Ex. (1) and Rev. Rul. 67-370, 1967-2 C.B. 324 as possibly suggesting a contrary view.

IRS Requested Comments

- The Office of the Associate Chief Counsel, Passthroughs & Special Industries has requested comments regarding whether the Distribution Committee members possess general powers of appointment under Code Section 2514.
- Comments were received by the IRS from the Delaware Bankers Association and Delaware Bar Association, the American Bar Association, New York Bar Association Tax Section, New York City Bar Association and others.

I.R.C. Section 2511(c)

- In 2010, there was an outright freeze on DING Trusts when Code Section 2511(c) became effective for one year.
- 2511(c) provided: “Notwithstanding any other provision of this section and except as provided in regulations, a transfer in trust shall be treated as a transfer of property by gift, unless the trust is treated as wholly owned by the donor or the donor’s spouse under subpart E of part I of subchapter J of chapter 1.”
- This law went away on January 1, 2011 and, thereafter, clients again began to form DING trusts.

CCA 201208026

- On February 24, 2012, the IRS issued Chief Counsel Advisory 201208026, in which it ruled that a transfer to a trust was a completed gift for federal tax purposes even though the donor retained a testamentary limited power of appointment over the entire trust.
- Immediately raised questions about whether the PLRs were correct in concluding that transfers to a DING trust are incomplete gifts for federal tax purposes merely due to the retention by the settlor of a testamentary limited power of appointment.
- It now appeared that some settlor control over a trust's current interests might be necessary to achieve incomplete gift treatment.

PLR 201310002

- On March 8, 2013, the IRS released PLR 201310002, a new DING trust ruling which demonstrates that the IRS is once again prepared to recognize the basic DING trust structure with some slight variations.
- This PLR involved a Nevada trust.

PLR 201310002

Distribution Powers

- During the settlor's lifetime, the trustee would distribute such amounts of net income and principal to the settlor and his issue as directed by the Distribution Committee and/or settlor, as follows:
 - pursuant to the direction of a majority of the Distribution Committee members, with the written consent of the settlor (the "Settlor's Consent Power");
 - pursuant to the direction of all of the Distribution Committee members other than the settlor (the "Unanimous Member Power"); and
 - such amounts of the principal (including the whole thereof) as the settlor deemed advisable to provide for the health, maintenance, support and education of the settlor's issue (the "Settlor's Sole Power").

PLR 201310002

Shrinking Committee

- Although not explicitly stated in the PLR itself, under the facts of this ruling, there was no automatic replacement if a member of the Distribution Committee ceased to serve.
- In addition, the Distribution Committee would cease to serve if there were ever fewer than two members of the Distribution Committee.

PLR 201310002

Settlor Consent Power

- With respect to the Settlor's Consent Power, the IRS noted that under Treas. Reg. § 25.2511-2(e), a donor is considered as himself having a power if it is exercisable by him in conjunction with any person not having a substantial adverse interest in the disposition of the transferred property or the income therefrom.
- The Distribution Committee members are not takers in default for purposes of Treas. Reg. § 25.2514-3(b)(2). They are "merely coholders of the power." Also, under Treas. Reg. § 25.2514-3(b)(2), a coholder of a power is only considered as having an adverse interest where he may possess the power after the possessor's death and may exercise it at that time in favor of himself, his estate, his creditors, or the creditors of his estate. In this case, the Distribution Committee ceases to exist upon the settlor's death. Accordingly, the Distribution Committee members do not have interests adverse to the settlor under Treas. Reg. § 25.2514-3(b)(2) and for purposes of Treas. Reg. § 25.2511-2(e).
- Therefore, the settlor is considered as possessing the power to distribute income and principal to any beneficiary himself because he retained the Settlor's Consent Power. **The ruling states that: "The retention of this power causes the transfer of property to the trust to be wholly incomplete for federal gift tax purposes."**
- In Delaware, the settlor can't actually be the member of the Distribution Committee of an APT, but he or she can functionally have the exact same consent power.

PLR 201310002

Adverse Interests?

- The IRS appears to apply two separate tests for adversity under the income tax laws and the gift tax laws. Under Section 674 of the Code, a trust will be considered a grantor trust if the beneficial enjoyment of the trust property is subject to a power of disposition exercisable by the settlor or a nonadverse party, or both, without the approval or consent of any adverse party. Still, the IRS expressly concluded that the Distribution Committee members do not have interests adverse to the settlor under Treas. Reg. § 25.2514-3(b)(2) and for purposes of Treas. Reg. § 25.2511-2(e).

PLR 201310002

Settlor's Sole Power

- In addition, the IRS also concluded that the Settlor's Sole Power gives the settlor the power to change the interests of the beneficiaries and, accordingly, the retention of the Settlor's Sole Power causes the transfer of property to the trust to be wholly incomplete for federal gift tax purposes under Treas. Reg. § 25.2511-2(c).
- CAN'T do this in Delaware.

PLR 201310002

Testamentary Power of Appointment

- Just as in the previous PLRs, the settlor retained a testamentary limited power of appointment.
- The IRS concluded that under Treas. Reg. § 25.2511-2(b) the retention of a testamentary power to appoint the remainder of a trust is considered a retention of dominion and control over the remainder and the retention of the testamentary limited power of appointment causes the transfer of property to the trust to be incomplete with respect to the remainder of the trust for federal gift tax purposes.

PLR 201310002

Distribution Committee GPOA?

- Similar to the previous PLRs since 2005, the IRS concluded that the members of the Distribution Committee do not possess general powers of appointment.
- The IRS found that the powers held by the Distribution Committee members with the Settlor's Consent Power are exercisable only in conjunction with the creator, the settlor, and thus under Code Section 2514(c)(3)(A) the Distribution Committee members do not possess general powers of appointment by virtue of possessing this power.
- The IRS further held that the powers held by the Distribution Committee members under the Unanimous Member Powers are not general powers of appointment because, as in the example in Treas. Reg. § 25.2514-3(b)(2), the Distribution Committee members have substantial adverse interests in the property subject to this power, because the failure of any member of the Distribution Committee to serve will leave a vacancy and there is no automatic replacement (i.e. shrinking Distribution Committee).

PLR 201310002

Other Rulings

- Finally, the IRS concluded that
 - the trust's assets are includible in the settlor's taxable estate for federal estate tax purposes,
 - any distribution to the settlor from the trust is merely a return of the settlor's property with no transfer tax consequences,
 - any distribution to a person other than the settlor will be a taxable gift by the settlor, and
 - distributions by the members of the Distribution Committee are not taxable gifts made by the Distribution Committee members.

Delaware Implications

- In Delaware, the settlor can retain the Settlor's Consent Power but not the Settlor's Sole Power.
- Under Delaware law, it is permissible for a settlor of a Delaware asset protection trust to retain a lifetime power to consent to all distributions and also a testamentary limited power of appointment under Section 3570(11)b of Title 12 of the Delaware Code.
- PLR 201310002 states: "The retention of [the Settlor's Consent Power] causes the transfer of property to the trust to be wholly incomplete for federal gift tax purposes." Consequently, it seems reasonable to conclude that the Settlor's Consent Power alone sufficed to cause the transfers to the trust to be wholly incomplete for gift tax purposes (without the necessity of the settlor's inter vivos or testamentary limited powers of appointment).
- It is not permissible for the settlor to be an actual member of the Distribution Committee, although the structure in this PLR could be otherwise replicated in Delaware, absent the inter vivos limited power of appointment.

Overview of DING Trust Requirements

- **Creditor Protection.** Must be an asset protection trust - - a trust is a grantor trust if the settlor's creditors can attach the trust's assets under Treasury Regulation Section 1.677(a)-1(d).
- **No Reversion.** Eligibility to receive discretionary distributions doesn't seem to constitute a reversionary interest as the term is commonly understood under Code Section 673.
- **Substantially Adverse Parties.** The trust income and principal may be distributed or accumulated in the trust only with the consent of the members of a "distribution committee", each of whom is an adverse party within the meaning of IRC Section 672(a).
- **Size of Distribution Committee.** The Distribution Committee should be around 3 or 4 individuals, all of whom should be "real" beneficiaries.
- **Distribution Committee Action.** All distributions during the settlor's lifetime should be made:
 - pursuant to the direction of a majority of the Distribution Committee members, with the written consent of the settlor (the "Settlor's Consent Power"); or
 - pursuant to the direction of all of the Distribution Committee members other than the settlor (the "Unanimous Member Power").

Overview of DING Trust Requirements (Continued)

- **No Spousal Attribution.**
 - Spouse may be a discretionary distributee during the lifetime of the settlor (subject to Distribution Committee)
 - No QTIP trust
 - Settlor could exercise LPOA in favor of spouse or QTIP
- **Testamentary LPOA.** Need a testamentary limited power of appointment to avoid completed gift, but this will not cause the trust to be a grantor trust.
- **Settlor Consent Power.** After PLR 201310002, the settlor should have a power to consent to distributions.
- **Shrinking Distribution Committee.** The members of the Distribution Committee Should not be automatically replaced.

Pitfalls

- Large percentage of settlor's assets.
- Timing of funding and the tax event.
- Unwinding.