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Return of the DING Trusts

With William D. Lipkind, Steven J. Oshins, and Jonathan G. Blattmachr

By Robert L. Moshman, Esq.

Spring, summer, autumn, winter—the passing seasons left behind a little-known technique. Delaware incomplete non-grantor (DING) trusts provided state-of-the-art asset protection, along with a unique talent for avoiding state income taxes.

Yet women and men (both little and small) cared for DING trusts not at all[1]—at least not without a more robust IRS approval. But, in 2013, through a happy confluence of events, the DING has returned in time for spring. Shall we DING? Dare we DING?

Presented With Our Compliments

To get to the heart of this fascinating concept, we are delighted to have the assistance of William D. Lipkind, who just obtained a key PLR to reawaken DINGs; Steven J. Oshins, an expert on domestic asset protection trust (DAPT) jurisdiction variations; and Jonathan G. Blattmachr, the preeminent master of creative estate planning techniques.

Domesticating Asset Protection

In the late 1990s, Alaska, Delaware, and Nevada took the lead in enacting legislation that permitted self-settled trusts and could protect grantors from creditors.

Instead of having to look to offshore havens, such as the Cayman Islands, grantors finally had domestic options for asset protection and strategic tax planning.

"When I drafted the first DAPT statute (for Alaska) and participated in the drafting of the second (for Delaware)," explains Jonathan Blattmachr, "my motive was to allow more efficient estate tax planning. One of the major reasons, in my experience, why individuals will not do estate tax planning is because they usually lose all potential benefit from the property used in the plan. By creating a self-settled trust in a DAPT jurisdiction, the taxpayer can make a completed transfer for estate and gift tax purposes but remain a discretionary beneficiary of the trust used in the arrangement. That, I think, continues to be the major advantage of DAPT legislation."

DAPT jurisdictions also benefited.

"Professors Sitkoff and Schanzenbach demonstrated in their seminal article," notes Blattmachr, "that 'progressive' trust laws bring considerable financial businesses to the states that have them." [2]

Within a short time, more domestic jurisdictions began competing to attract trust assets. "Several other state laws also affect the choosing of a trust jurisdiction," notes Blattmachr, "such as the repeal of the rule against perpetuities. Other factors include ease of trust administration, the ability to limit trustee liability, and state premium taxes. States will continue to compete for this business. Being able to create a DING is only one factor and probably an irrelevant one for most taxpayers."

There are currently 14 DAPT jurisdictions, and attorney Steven J. Oshins maintains a watchful eye over their respective rules with an annual chart and ranking system.[3]

Dawn of the DING

Delaware incomplete non-grantor (DING) trusts arose soon after the 1997 enactment of Delaware's Qualified Disposition in Trust Act.

By 2001, the IRS had issued *Private Letter Ruling 200148028,* the first of nine PLRs that provided a green light to DING variations from 2001 through mid-2007. Most of these PLRs involved Alaska self-settled trusts, yet the "DING" label has become somewhat generic for incomplete non-grantor trusts set up elsewhere. It has been noted that individuals from high state income tax states set up DING trusts.[4]

In 2007, the IRS issued IR-2007-127, a news release in which it said it was rethinking its position on certain concepts, some of which involved DINGs. This vague dissing of DINGs and the Service's silence in not issuing PLRs about DINGs for nearly six years had a chilling effect.

Let's DING Anew!

Attorney William D. Lipkind recently broke the spell by finally eliciting a response from the IRS on March 8, 2013, regarding a DING trust he designed.[5]

Private Letter Ruling 201310002, much like PLRs of the past, treats incomplete non-grantor trusts favorably.

Moreover, timing of this PLR coordinates well with a rising stock market, bountiful Federal estate tax exclusions in the wake of ATRA, and the advent of domestic asset protection tax havens that have no state income tax and permit self-settled trusts.

However, without additional clarifications, care must be taken on specific DING trust designs and which DAPT jurisdictions are selected.

Taxation of DINGs

The DING trust is a highly useful asset protection trust, but what makes it unique is the fact that it combines an incomplete gift for transfer tax purposes with a non-grantor trust for income tax purposes. We asked Mr. Lipkind about the net result of DING transfers.

"The transfer of the assets is to the trust," explains Lipkind. Nonetheless, the transfer is "incomplete for Federal gift tax purposes. Therefore, no gift tax applies to the transfer."

Nor is gift tax triggered by distributions from the trust to the grantor. A transfer of assets from the trust to beneficiaries would be treated as a completed gift from the grantor. A gift from the trust should not be treated as a gift from the members of the distribution committee of the trust.

Whatever assets remain in the DING upon the death of the grantor are included in the grantor's estate for transfer tax purposes.

Income Taxation: Having a non-grantor trust is responsible for a key income tax advantage of the DING, i.e., that a grantor's investment income, which would otherwise be subject to state income tax, is instead part of a DING trust that is set up in a state that has no state income tax.

Normally, an incomplete gift to a domestic asset protection trust would result in a grantor trust. "That is the result because the non-adverse trustee would have the power to make distributions to the grantor," says Lipkind. Avoiding grantor trust status requires having "adverse parties" on the

distribution committee within the meaning of IRC§ 672 (a) and avoiding the retention of grantor powers in IRC §§674 – 677.

When DINGs Go Wrong

Even if the trust is located in a state that does not impose a state income tax (e.g., Nevada or Alaska), the state in which the beneficiaries, trustees, or grantor reside may attempt to impose the tax. Even a DING that is properly set up could lose its state tax benefits if states become jealous of tax revenues escaping and take corrective action, such as expanding the scope of grantor trusts to include a DING.

More PLRs are needed to clarify what DING scenarios are possible and what DAPT jurisdictions can be utilized. The concept of incomplete gifts was impacted by the Office of Chief Counsel Memorandum *CCA 201208026* (Sept. 28, 2011).[6]

Many experts are critical of this CCA, but it points to grantors having to retain lifetime rights or powers of appointment for a transfer to a DING to be incomplete for gift tax purposes. *PLR 201310002* implies that an incomplete gift is established if the grantor retains a lifetime power of appointment. While Blattmachr notes that this PLR did not turn on this point at all, Lipkind notes that the IRS did not want him to take the lifetime power of appointment out of his proposed fact pattern.

Currently, only Nevada's statute explicitly permits the grantor to retain a lifetime power of appointment without subjecting the trust to creditor claims. On the other hand, Blattmachr notes that the common law applicable to all states would allow the same retained power without exposing trust assets to creditors. However, Lipkind notes that Delaware's statute would disqualify the trust if the grantor retained a lifetime power of appointment.

Discussion with William D. Lipkind

Q: What are the best circumstances for using a DING?

A: By domesticating a DING in a non-tax jurisdiction (such as Nevada), and causing the trust (not the grantor) to be taxed on the trust income, one eliminates taxable income being attributed to the grantor for both his or her Federal and domicile state income tax purposes on the assets transferred to the trust and the income not currently distributed therefrom back to the grantor. This should be of extraordinary interest in high state tax jurisdictions, such as New York, New Jersey, and California, and of no interest in non-tax jurisdictions like Florida.

Q: What is the role of a DING's asset protection?

A: For the DING to work, the grantor's creditors must not have access. Accordingly, although the grantor is not making a transfer to hinder, delay, or defraud creditors (which, of course, would be a fraudulent conveyance), he or she does, as it were, achieve asset protection because his or her motivation was to achieve income tax planning—obtaining a PLR would go far, it seems, in demonstrating that motivation.

Q: The new PLR answered some questions but not others. Were you satisfied with the result?

A: Very satisfied. We obtained what we wanted, getting more than the immediately preceding rulings, and knowing that there were certain issues not addressed. As to the issues not addressed, we didn't raise them, and the IRS didn't raise them. The client was aware of those issues and concurred in our approach.

Q: Won't the state income tax savings be offset by higher Federal income tax on trusts and administrative costs?

A: Considering the existence of the alternative minimum tax, and the cap on itemized deductions, the savings of the state income tax should substantially exceed the Federal cost of losing the income tax deduction on the state income taxes. The ongoing administrative cost of a DING should be no greater than the ongoing administrative cost of any trust—that is a function of whether the trust is a directed trust and the fees charged by the trustee. Moreover, a trust is not subject to Section 68 of the Internal Revenue Code. That Section, which was reenacted as of the beginning of this year, disallows a portion of a taxpayer's itemized deductions. Of course, being a non-grantor trust, the trust will now need its own separate income tax return. The other expense in creating the DING is the expense of seeking a PLR.

Q: What other tax strategies could apply to distributions of income from a DING?

A: If the trust permits distributions of its gross income to charity, the trust can obtain an income tax deduction under Section 642(c) for its gross income paid to charity, which, in many cases, is treated more favorably than a charitable donation by an individual. However, no DING PLR has been issued in which the authority to distribute to charity was contained in the trust. Another benefit of a DING may be the chance for income shifting. If distributions are made to a family member who is in a low income tax bracket, even Federal income taxes could be reduced.

Q: What tax savings might be generated by a DING?

A: We have seen the DING become useful both in the context of a transfer of a substantial portfolio and the transfer of a substantial single asset. For example, a $20 million portfolio that is generating ordinary income and capital gains at merely a 3% annual level generates $600,000 per year of taxable income. If the state (and local) income tax is 10%, then the savings is $60,000 per year (reduced by administration expenses).

Q: Would other clients need to get their own PLRs?

A: There is a risk factor if there is no PLR. If there is no PLR, then the risk factor is enhanced if the fact pattern of *PLR 201310002* is not followed. I cannot emphasize too strongly Ruling #4 of *PLR 201310002*, i.e., that the beneficiary members of the Distribution Committee do not have general powers of appointment upon distributions either to the grantor or anyone else. Other than #4, I don't think the IRS has much incentive to care about this strategy because it is getting its full tax (actually a greater tax because there is no deduction for

state income taxes) and the assets are in the estate of the grantor. In every case, the client needs to sit with his various advisors and project out the state income tax consequences versus the cost of establishment, maintenance, and whether to obtain either a PLR or a Tax Opinion.

William D. Lipkind, JD, LLM, is a founding member of Lampf, Lipkind Prupis & Petigrow, PC, in West Orange, New Jersey. He has practiced law for more than 45 years and has been admitted to the U.S. Tax Court since 1971.

Discussion with Steven J. Oshins

Q: Is there a market for incomplete non-grantor trusts?

A: There is definitely a market for them. With the recent increase in Federal income taxes, there is a bigger emphasis on income tax reduction, including the reduction of state income taxes. The new Private Letter Ruling draws attention to this.

Q: What are the key selling points that would make a NING attractive?

A: It's a great opportunity to not only reduce state income taxes, but also to utilize the leading domestic asset protection trust jurisdiction. Because Nevada has a short two-year statute of limitations before the assets are protected, as well as no statutory exception for creditors and no bad features, it's an easy sale to a prospective client.

Q: How should *CCA 201208026* be handled?

A: When *CCA 201208026* came out last year, the estate planning community was in shock. I hope the Service reverses its position, but there is no telling if or when the Service will do so. Until then, we will enjoy the added advantage we have in Nevada, which specifically allows the settlor to retain an inter vivos power of appointment pursuant to its domestic asset protection trust statutes and thus gives us a way around this bad Ruling.

Steven J. Oshins, Esq., AEP (Distinguished), is a member of the Law Offices of Oshins & Associates, LLC, in Las Vegas, Nevada. Mr. Oshins has been recognized as one of the nation's top estate planners and is a prolific author and was previously interviewed for this publication in "Asset Protection Jurisdictions Compared" (May 2012); "Nevada-izing Assets" (March 2009), and "Dynastic Trusts Today" (May 2006).

Discussion with Jonathan G. Blattmachr

Q. Will DAPT jurisdictions tweak their statutes to make DING trusts possible?

A. This depends on several factors. For example, it may be that a taxpayer will be able to receive a favorable DING PLR with respect to a trust governed by the law of another state, such as Alaska or Delaware, the only states under which all prior PLRs were issued. If someone seeks a ruling with respect to a trust governed by the law of a state (e.g., Wyoming, Alaska, or Delaware) and the IRS refuses to rule because the law of that state is not parallel to that of Nevada, certainly those states will consider changing their laws.

Q: How critical is the issue of grantors retaining a lifetime power of appointment?

A: When the IRS raised an issue in 2007 about DINGs and stopped issuing rulings, it was not with respect to the incomplete gift or non-grantor trust status questions; it was only as to whether members of the Distribution Committee held a general (estate and gift taxable) power of appointment. It does not seem that the resolution of that issue turned on state law at all. So, we will have to see.

Q. Is the DING a big enough parade for the IRS to rain on?

A. The DING rulings appear to be sound and with 10 PLRs on point, it is impossible to believe anything fraudulent is occurring. Most important, in most cases, Federal taxes by using a DING will not likely decline—if anything, they will increase.

Jonathan G. Blattmachr, JD, AEP (Distinguished), was a partner at Milbank Tweed Hadley and McCoy, LLP, in New York for 33 years until 2010; Editor of the Chase Review; *and a member of the Bar in Alaska, California, and New York. He is currently a principal at Eagle River Advisers and ILS Management, LLC. Mr. Blattmachr has trailblazed innovative estate planning techniques for a generation of professionals and is a leading voice in modern estate planning.*

TECHNICAL REFERENCES

1. Paraphrased from the untitled and unpunctuated poem by E.E. Cummings (1940) that begins, "anyone lived in a pretty how town with up so floating many bells down."

2. Sitkoff, Robert H. & Max Schanzenbach. "Jurisdictional Competition for Trust Funds: An Empirical Analysis of Perpetuities and Taxes," 115 Yale Law Journal 356 (2005).

3. There are 14 DAPT locations. In ranking order (based on the excellent Third Annual State Rankings Chart developed in April 2012 by Steven J. Oshins), they are Nevada, South Dakota, Alaska, Delaware, Tennessee, Rhode Island, New Hampshire, Hawaii, Wyoming, Missouri, Utah, Virginia, Oklahoma, and Colorado. Note: The last three on the list impose state income taxes and would therefore not support the income tax savings component of DING trusts. The DAPT Chart can be found at http://www.oshins.com/images/DAPT_Rankings.pdf.

4. Use of Delaware Incomplete Gift Non-Grantor Trusts in Light of IR-2007-127, by Michael M. Gordon, Esq. This article notes that DINGs were set up by grantors from high state income tax jurisdictions, such as Kentucky, Massachusetts, Michigan, Missouri, New Jersey, and New York. However, it isn't clear how many DINGs were launched, which DAPT jurisdictions those grantors utilized (though it was presumably Delaware or Alaska based on the only PLRs issued), whether PLR fact patterns were emulated, or if these trusts were ultimately successful.

5. See LISI Estate Planning Newsletter #2076 (March 12, 2013), in which attorney William D. Lipkind explains PLR 201310002.

6. See Zaritsky, Gans & Blattmachr on Chief Counsel Advisory 201208026, LISI Estate Planning Newsletter #1936 (March 6, 2012); and Zeydel, When is a Gift to a Trust Complete—Did CCA 201208026 Get it Right?, Journal of Taxation (Sept. 2012).

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