NING Trusts Provide Tax and Asset Protection Benefits

A recent series of private letter rulings cast a favorable light on a form of trust referred to as a Nevada incomplete gift non-grantor (NING) trust. For the practitioner's viewpoint on the implications of these rulings and more details on the NING trust, we contacted attorney Steven J. Oshins. Mr. Oshins is a member of the Law Offices of Oshins & Associates, LLC, in Las Vegas, Nevada (www.oshins.com), a nationally recognized firm specializing in estate planning and asset protection. Mr. Oshins wrote the Nevada law allowing restricted entities and has previously worked with the legislature to amend Nevada law to allow 365-year dynasty trusts and to make the charging order the exclusive remedy of a judgment creditor of an LLC or LP.

CCH: Since 2001 we have seen a number of favorable private letter rulings (e.g., IRS Letter Rulings 200148028, 200247013, 200502014, 200612002, 200637025, 200647001, 200715005, 200729025, and 200731019) dealing with what has commonly become known as a Delaware incomplete gift non-grantor (DING) trust. Could you provide our readers with some background on the primary benefits of this type of trust?

Mr. Oshins: The benefits include asset protection coupled with the elimination of state income taxes because the trust is established in a state with no income tax. Such benefits are particularly well suited to taxpayers in a high income tax state having large unrealized capital gains or a regular stream of ordinary income from an investment portfolio. Although these persons are seeking tax and asset protection benefits, they do not wish to give up the economic benefits of the underlying assets.

CCH: It seems that the major impediments to achieving these goals would be avoiding grantor trust status while at the same time not giving up so much control as to make a completed gift.

Mr. Oshins: Correct, and prior to 1997, this was not possible because, under Reg. §1.677(a), grantor trust status exists if the grantor's creditors can reach the trust assets under applicable law. At that time, all states provided that creditors could reach the assets of a self-settled trust for the payment of claims against the grantor.

CCH: So, what changed?

Mr. Oshins: Beginning with Alaska, followed by Delaware and Nevada, states began adopting statutes that allowed self-settled trusts that are protected from the claims of creditors. These domestic asset protection trusts (DAPTs) have since been adopted in a number of other jurisdictions [see the chart at http://www.oshins.com/images/DAPT_Rankings.pdf and at page 153]. Although many of the private letter rulings you mentioned involved Alaska, the term "DING trust" seems to have stuck in the popular mind since 1997 when Delaware's Qualified Dispositions in Trust Act (12 Del. C. §§ 3570 – 3576) was enacted.

CCH: Were there any significant common characteristics of the trusts in the private letter rulings mentioned previously?

Mr. Oshins: In order to make the transfers incomplete for gift tax purposes without creating grantor trust status, the parties gave the grantor a special testamentary power of appointment as described in Reg. §25.2511-2(b) and (c), and created a distribution committee that was charged with approving any distribution to the grantor. Members of the distribution committee were deemed to be adverse parties under Code Sec. 672(a) and, thus, the trust could not be a grantor trust.

CCH: Despite the favorable private letters rulings mentioned earlier, the IRS reaction to these trusts was not always positive. For example, there was IR 2007-127 and CCA 201208026. Please elaborate on the ramifications of these IRS pronouncements.

Mr. Oshins: In IR 2007-127 the IRS said generally that it was re-examining the question of whether the distribution committee members did or did not have general powers of appointment. In 2012, CCA 201208026 was issued. That ruling was particularly troubling in that it concluded that the retention of a testamentary power of appointment makes a transfer in trust incomplete with respect to the remainder interest, but not with respect to the lead interest. Effectively, this meant that, in order to maintain wholly grantor trust status, a settlor would have to retain an additional power.

CCH: Wasn't there also a potential legislative impediment as well?

Mr. Oshins: Yes, Code Sec. 2511(c), which was enacted as part of the Economic Growth and Tax Relief Reconciliation Act of 2011 (P.L. 107-16), would have treated a transfer to a non-grantor trust as a completed gift. That provision was originally to become effective beginning in 2010, in conjunction with the repeal of the federal estate tax. However, it was repealed by the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (P.L. 111-312), and this repeal was made permanent by the Taxpayer Relief Act of 2012 (P.L. 112-240).

CCH: More recently the IRS has privately ruled (IRS Letter Rulings 201310002, 201310003, 201310004, 201310005, and 201310006) on a variation of this theme—a Nevada incomplete gift non-grantor (NING) trust. What did the IRS conclude in these rulings?

Mr. Oshins: Generally, these more recent rulings eased the fears of many planners with respect to the concerns raised by IR 2007-127 and CCA 201208026. The parties in the 2013 letter rulings addressed the power of appointment issue by providing the trust settlor with a lifetime special power of appointment for health, education, maintenance and support in a non-fiduciary capacity. The IRS concluded that the transfers were incomplete for gift tax purposes and that the trusts were not grantor trusts for income tax purposes. In addition, the IRS ruled that the members of the distribution committee did not possess a general power of appointment.

CCH: Could you provide more details on the specific rulings by the IRS?

Mr. Oshins: With respect to the gift tax issue, the IRS actually looked at three separate powers retained by the grantor. As to the first, referred to as the grantor's "consent power," the IRS concluded that the distribution committee members did not have interests that were adverse to the grantor for purposes of Reg. §§25.2511-2(e) or 25.2514-3(b)(2). This conclusion meant that the grantor was deemed to possess and retain the power to distribute income and principal to any beneficiary himself, thus causing the transfer of property to be wholly incomplete for federal gift tax purposes.

Similarly, as to the second power retained by the grantor—his "sole power"—the IRS said that pursuant to Reg. §25.2511-2(c) a gift is incomplete to the extent that a reserved power gives the donor the power to name new beneficiaries or to change the interests of the beneficiaries. Under the facts of the private letter rulings, the grantor's "sole power" gave him the power to change the interests of the beneficiaries, so retention of this power again caused the transfer of property to the trust to be wholly incomplete for gift tax purposes.

In addition, the IRS ruled that per Reg. §25.2511-2(b), the retention of a testamentary power to appoint the remainder of a trust is considered tantamount to retaining dominion and control over the remainder. Accordingly, the retention of this particular power caused the transfer of property to the trust to be incomplete for federal gift tax purposes with respect to the remainder in the trust.

Finally, the IRS looked at the distribution committee's "unanimous member power" over income and principal concluding that it was not a condition precedent to the grantor's powers. Citing two long-standing Tax Court decisions (*J. Goldstein*, 37 TC 897, CCH Dec. 25,348, and *H. Goelet Est.*, 51 TC 352, CCH Dec. 29,264), the IRS stated that because the grantor retained dominion and control over the income and principal of the

trust until the distribution committee members exercised their unanimous member power, this power did not cause the transfer of property to be complete for federal gift tax purposes.

CCH: And, what about the grantor trust and power of appointment issues?

Mr. Oshins: If I may quote from the rulings:

> … we conclude an examination of Trust reveals none of the circumstances that would cause Grantor to be treated as the owner of any portion of Trust under §§673, 674, 676, or 677. Because none of the other Distribution Committee members has a power exercisable solely by himself to vest Trust income or corpus in himself, none shall be treated as the owner of any portion of the Trust under §678(a).
>
> We further conclude that an examination of Trust reveals none of the circumstances that would cause administrative controls to be considered exercisable primarily for the benefit of Grantor under §675. Thus, the circumstances attendant on the operation of Trust will determine whether Grantor will be treated as the owner of any portion of Trust under §675. This is a question of fact, the determination of which must be deferred until the federal income tax returns of the parties involved have been examined by the office with responsibility for such examination.

Although the rulings do not specifically say this in their conclusions as to the grantor trust issue, it appears that the IRS reasoned that the members of the distribution committee were adverse parties under the definition found in Code Sec. 672(a).

With respect to the power of appointment issue, the IRS noted that the powers held by the distribution committee members under the grantor's consent power were powers that were exercisable only in conjunction with the grantor. Thus, under Code Sec. 2514(c)(3)(A), the distribution committee members did not possess general powers of appointment as a result of having this power. In addition, the powers held by the committee members under the unanimous member powers were not general powers of appointment. Citing the example in Reg. §25.2514-3(b)(2), the IRS concluded that the distribution committee members had substantial adverse interests in the property subject to this power. Accordingly, any distribution made from the trust to a beneficiary, other than the grantor, pursuant to the exercise of these powers, the grantor's consent power or the unanimous member powers, were not gifts by the distribution committee members, but would be gifts by the grantor.

CCH: But, what was the Nevada connection?

Mr. Oshins: Specifically, as of the date the private letter ruling was issued, Nevada was the only DAPT jurisdiction of the DAPT jurisdictions that seem to get the most publicity — Nevada, Alaska, South Dakota and Delaware — with a statute that allows the settlor to retain a lifetime power of appointment that (1) satisfies the gift tax regulations (Reg. §25.2511-2(b) and ((c)), and (2) does not subject the trust assets to the claims of creditors. Since the private letter ruling was issued, Alaska modified this aspect of its laws in order to match Nevada's advantage over the other jurisdictions.

CCH: And, what about the future?

Mr. Oshins: Obviously, other jurisdictions could choose to amend their laws in the future. Also, there may be other ways to achieve an incomplete transfer with respect to both the remainder and lead interests without ending up with grantor trust status, such as relying on the consent power to avoid a taxable gift over the lead interest. However, the actual trust that was approved by the recent private letter ruling would not have worked had it been domiciled in one of these other jurisdictions. So, for those seeking the best result now, I believe Nevada provides it.

CCH: Are there other considerations that should be analyzed?

Mr. Oshins: As with any tax strategy, the benefits should be weighed against the costs, such as the costs of establishing and maintaining such a trust, including the cost of obtaining a private letter rul-

ing if one is desired. There is no legal requirement that a private letter ruling be obtained, but it provides certainty for the client.

CCH: Do you have any closing thoughts for our readers on this subject?

Mr. Oshins: With the applicable exclusion amount as large as it is currently ($5,250,000 in 2013), planners may want to consider the possibilities offered by such trusts even for clients with more modest levels of wealth. Whereas, in the past, the object may have been to avoid paying gift taxes or using up the lifetime exclusion amount by having gifts treated as incomplete, taxpayers today may be more interested in keeping gifts incomplete for the purpose of obtaining a basis step-up at death.

4th Annual Domestic Asset Protection Trust State Rankings Chart (updated)

Rank	State	State Income Tax (65% weight)	Statute of Limitations (Future Creditor) (5% weight)	Statute of Limitations (Preexisting Creditor) (5% weight)	Spouse/ Child Support Exception Creditors (5% weight)	Preexisting Torts Exception Creditors/Other Exception Creditors (5% weight)	Ease of Use – Is a new Affidavit of Solvency required for every new transfer? (5% weight)	Reputation/ Fraudulent Transfer Standard//Other Adjustments (10% weight)	Total Score
1	Nevada	No	2 Yrs.	2 Yrs. or 0.5 Yr. Discovery	No	No	No Affidavit Required	Significant	99
2	South Dakota	No	2 Yrs.	2 Yrs. or 0.5 Yr. Discovery	Divorcing Spouse; Alimony; Child Support (only if indebted at time of transfer)	No	No Affidavit Required	Significant	97
3 (tie)	Ohio	No (except residents)	1.5 Yrs.	1.5 Yrs. or 0.5 Yr. Discovery	Divorcing Spouse; Alimony; Child Support	No	Affidavit Required	Medium	87
3 (tie)	Tennessee	No (except dividends/ interest on residents)	2 Yrs.	2 Yrs. or 0.5 Yr. Discovery	Divorcing Spouse; Alimony; Child Support	No	Affidavit Required	High	87
5	Alaska	No	4 Yrs.	4 Yrs. or 1 Yr. Discovery	Divorcing Spouse	No	Affidavit Required	Significant	81
6	Delaware	No (except residents)	4 Yrs.	4 Yrs. or 1 Yr. Discovery	Divorcing Spouse; Alimony; Child Support	Preexisting Torts	No Affidavit Required	Significant	80
7	Wyoming	No	4 Yrs.	4 Yrs. or 1 Yr. Discovery	Child Support	Property listed on app. to obtain credit – but only as to that lender	Affidavit Required	High	78
8	Rhode Island	No	4 Yrs.	4 Yrs. or 1 Yr. Discovery	Divorcing Souse; Alimony; Child Support	Preexisting Torts	No Affidavit Required	Medium	75
9	New Hampshire	No (except dividends/ interest on residents)	4 Yrs.	4 Yrs. or 1 Yr. Discovery	Divorcing Spouse; Alimony; Child Support	Preexisting Torts	No Affidavit Required	High/ Limited clear and convincing evidence standard	73
10	Utah	Very questionable/ limited ability to avoid	2 Yrs.	2 Yrs. or 1 Yr. Discovery (also 120-day mailing/publication option)	No	No	Affidavit Required	Low/Missing clear and convincing evidence standard	70*
11	Missouri	No (except Missouri source income)	4 Yrs.	4 Yrs. or 1 Yr. Discovery	Alimony; Child Support	State/U.S. to extent state/federal law provides	No Affidavit Required	Low	68
12	Hawaii	No (except residents)	2 Yrs.	2 Yrs. Pers. Injury; 6 Yrs. Contract	Divorcing Spouse; Alimony; Child Support	Preexisting Torts, Certain Lenders, Hawaii Tax	No Affidavit Required	Low/Limited clear and convincing evidence standard	67
13	Virginia	Yes	None	5 Yrs.	Child Support	Creditor who has provided services to protect trust; U.S., city, etc.	No Affidavit Required	Low	53
14	Oklahoma	Yes	4 Yrs.	4 Yrs. or 1 Yr. Discovery	Child Support	Protection limited to $1,000,000	No Affidavit Required	Low	48
15	Colorado	Yes	Not clear if protection from any creditor	Not clear if protection from any creditor	Not clear if protection from any creditor	Not clear if protection from any creditor	No Affidavit Required	Low	0

4th Annual Domestic Asset Protection Trust State Rankings Chart created in April 2013/updated in July 2013. Original State Rankings Chart created in April 2010.

*Utah's law is great for Utah residents, but is ranked low because of its state income tax uncertainty for non-residents.