

# Intentionally Defective Grantor Trusts

October 8, 2015



**This course qualifies for 1 Hour of Continuing Education Credit for both CFP® and CTFA designations.**

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- Visit the ITM|TwentyFirst Website at [www.itm-twentyfirst.com](http://www.itm-twentyfirst.com)
  - And the new ITM|TwentyFirst Blog
- Please Note: A Handbook with Outline and CE Form has been provided for this session. If you have not received one, email us at [lwessels@itm21st.com](mailto:lwessels@itm21st.com)



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# Future Webinars

- Michael Brohawn, CFP, CLU Tuesday, October 27th at 2PM EST
- 1 Hour CE credit for CFP and CTFA (Financial)
- A Close Look at the Current Universal Life Cost Increase
- While it seems the cost of life insurance should be going down since we are living longer, three carriers have announced their costs are going up. In some instances the premium needed to carry a policy to maturity has more than doubled in just the last few months. Find out why this is and whether other carriers may follow suit. A case study will be reviewed that will look inside a policy affected, analyze all options and to show the steps needed to develop prudent policy management decisions. If you are a TOLI Trustee or just an advisor on life insurance, this is an important session for you.
- Register at the ITM|21<sup>st</sup> Website at [www.itm-twentyfirst.com/Education](http://www.itm-twentyfirst.com/Education)



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**Today's Webinar**

- October 8, 2015
- Today's Speaker: Randy Pople, CFP®, AEP®
- Pople Financial Consulting, Inc.
- [www.poplefinancial.com](http://www.poplefinancial.com)



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**Intentionally Defective Grantor Trusts (IDGT)**

- Intentionally – Yes
- Defective – Yes and No

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**What is an IDGT?**

- An Irrevocable Trust
- Grantor's Transfer to the Trust is Complete for Transfer Tax Purposes
- Grantor's Transfer to the Trust is Incomplete (Defective) for Income Tax Purposes

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## How Can This Be?

- An Inconsistency Between the Definition of a Completed Gift for Income Tax Purposes vs Transfer Tax Purposes



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## Grantor Trust Rules (IRC Sec. 671-679)

- (IRC Sec. 673) Reversionary Interest
- (IRC Sec. 674) Power to Control Beneficial Enjoyment
- (IRC Sec. 676) Power to Revoke
- (IRC Sec. 677) Income for Benefit of Grantor
- (IRC Sec. 675) Administrative Powers



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## Estate Tax Rules

- Section 2031 – Definition of the Gross Estate
- Section 2036 – Transfer with a Retained Life Estate
- Section 2037 – Retained Interest/Reversionary Interest
- Section 2038 – Revocable Transfers
- Section 2039 – Annuities
- Section 2040 – Joint Interests
- Section 2041 – Power of Appointment
- Section 2042 – Proceeds of Life Insurance
- Section 2043 – Transfers for Insufficient Consideration



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## The Odd Duck

- The Power to Reacquire Assets
- IRC 675(4) provides that a trust is a grantor trust for income tax purposes if any person holds a power "in a nonfiduciary capacity to reacquire the trust corpus by substituting other property of an equivalent value."
- No companion in the estate tax law

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## What Does This Mean?

- It is possible for a single trust document to contain language causing a transfer to be complete for estate/gift tax purposes but incomplete or defective for income tax purposes because of the inclusion of the power contained in IRC Section 675(4).
- The Grantor has not retained any powers that would cause estate tax inclusion.
- The future growth of the assets is removed from the Grantor's estate.

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## What Else?

- Even though the Grantor is not entitled to any trust distributions he or she is taxed on all the trust income.

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## Who Would do Such a Strange Thing?

RICH PEOPLE

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## The Benefits of an IDGT

- Basic Benefit – the payment of the income tax is a tax free gift to the trust.
- Sale to an IDGT

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## The Issues

- Even though the IDGT is a separate legal entity, because it is a grantor trust it is not a separate taxable entity.
- No gain will be recognized on the sale.
- Income paid by the trust to the grantor will not be recognized for tax purposes.
- Since the trust is a grantor trust it can hold Sub S Corporation stock.

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## The Sale

- Grantor establishes an IDGT
- Grantor funds the IDGT with a minimum of 10% of the value of the assets being sold.
- Grantor enters into a bona fide arms length sales agreement.
- Ideally the assets being sold are income producing with expectation of significant appreciation.
- Grantor takes a note for the sale.
- The note can be interest only for a term with a balloon payment.
- Trust funds in excess of required interest payments can be used to purchase life insurance on the grantor.



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## At the Grantor's Death

- Only the value of the installment note will be in the grantor's estate.
- The trust assets and appreciation pass estate tax free to the heirs.



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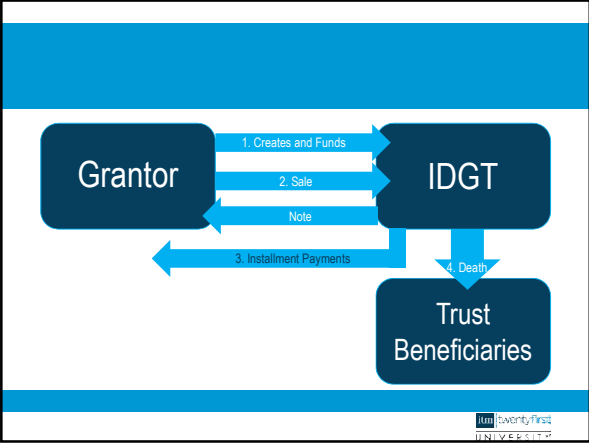
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Questions

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Thank You

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Phone: | Email: \_\_\_\_\_



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