



A Presentation For The  
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# IRS Circular 230

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# DING Trusts Did Not Exist Before 2001

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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.

# DING Trusts

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- 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).
- All PLRs after PLR 200502014 addressed the transfer tax consequences to the Distribution Committee.

## Importance of Creditors Rights

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A DING Trust must be created in a state that allows self-settled asset protection trusts.

A DING Trust 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).

# Asset Protection Trusts In A Nutshell

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- An asset protection trust is essentially a trust where the trust instrument contains a spendthrift provision that is enforceable with respect to the settlor's beneficial interests in the trust.
- A Delaware asset protection trust is a trust that complies with the requirements of the Delaware Qualified Dispositions in Trust Act, 12 Del. C. §§ 3570-76.

# Requirements of Trust Instrument

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Generally, the trust instrument of a Delaware asset protection trust must satisfy the following conditions:

- Appoints a qualified trustee or qualified trustees;
- Incorporates Delaware law to govern the validity, construction and administration of the Trust;
- Must be irrevocable;
- Must contain a provision that provides that the interest of the transferor or other beneficiary in the trust property or the income therefrom may not be transferred, assigned, pledged or mortgaged, whether voluntarily or involuntarily, before the qualified trustee or qualified trustees actually distribute the property or income therefrom to the beneficiary and such provision shall be deemed to be a restriction on the transfer of the transferor's beneficial interest that is enforceable under applicable nonbankruptcy law within the meaning of Sec. 541(c)(2) of the Bankruptcy Code;
- May not provide the transferor with any interest in the trust estate other than those retained interests specifically enumerated in 12 Del. C. § 3570; and
- Must meet trust validity requirements under Delaware law.

# Nexus of Trust To Delaware

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The trustee must perform one or more of the following functions within the State of Delaware:

- Maintain or arrange for custody in Delaware of some or all of the trust property;
- Maintain records for the trust on an exclusive or nonexclusive basis;
- Prepare or arrange for the preparation of fiduciary income tax returns; or
- Otherwise materially participate in the administration of the trust.
- The Trusts may have non-Delaware co-trustees, investment advisers, trust protectors, distribution advisers and other advisers located outside Delaware.
- **BEWARE: Situs and Choice of Law Rules!**

## 4 Types of Delaware Asset Protection Trusts

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It is possible to create an asset protection trust with any one of the following four income and gift tax results:

1. A completed gift and a grantor trust.
2. A completed gift and a non-grantor trust.
3. An incomplete gift and a grantor trust.
4. An incomplete gift and a non-grantor trust.

# Treatment as a Completed Gift or Incomplete Gift

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- In cases where the settlor wishes to avoid making a completed gift, but wishes to obtain the asset protection benefits of the statute, the settlor may:
  - (i) retain the power to veto all distributions to beneficiaries; and/or
  - (ii) retain a testamentary limited power of appointment.
- Alternatively, the settlor may make a qualified disposition to a trust that may be treated as a completed gift so long as the grantor has not otherwise retained sufficient dominion and control over the assets of the trust to prevent treatment as a completed gift.

# Incomplete Gift Treatment of DING Trusts

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- The testamentary limited power of appointment causes contributions to be incomplete gifts.
  - As we will discuss later, this is being challenged by comments provided to the IRS from the New York State and City Bar Associations.
- Any other retained rights would likely effect the nongrantor trust treatment.

# Federal Income Tax

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- In general, Delaware asset protection trusts are taxed as grantor trusts because the trustee, as a nonadverse party, has the power to dispose of the beneficial enjoyment of corpus and income and to distribute the trust income to the settlor.
- However, it is also possible to design an asset protection trust to avoid treatment as a grantor trust by providing beneficiaries who have interests in the trust that are substantially adverse to the settlor's interest with a power to block distributions to the settlor.

# Distribution Committee

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- A Distribution Committee comprised of beneficiaries who have a substantially adverse interest with respect to the settlor is the key to nongrantor trust treatment.
- The size of the Distribution Committee matters.
- Perhaps it matters if the Distribution Committee members are takers in default.

# Overview of DING Trust Requirements

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- **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).
- **No Spousal Attribution.**
  - (i) Spouse may be a discretionary distributee during the lifetime of the settlor
  - (ii) No QTIP trust
  - (iii) Grantor could exercise LPOA in favor of spouse or QTIP
- **LPOA.** Need a testamentary limited power of appointment to avoid completed gift, but this will not cause the trust to be a grantor trust.

# IR 2007-127

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- 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.
- Recent PLRs have addressed, in part, the gift tax consequences applicable to the Distribution Committee under Sections 2511 and 2514 of the Internal Revenue Code (the “Code”). It has come to the IRS’s attention 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. Sec. 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

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- Before the Office of Chief Counsel takes any action with respect to the PLRs, 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.

# DINGS After IR2007-127

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- Do they still work?
- The only key distinction between the DING structure in the PLR's and Rev. Rul. 76-503 and Rev. Rul. 77-158 is that with a DING, the settlor's gift to the trust is incomplete.
- The IRS now refuses to rule.

# Alternative Approaches to Drafting

## NO GENERAL POWERS FOR DISTRIBUTION COMMITTEE

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- Use of a shrinking Distribution Committee of three members falls squarely within Treasury Regulation §25.2514-3(b)(2) and should address all of the concerns that the IRS raised in IR 2007-127.
- But a shrinking Distribution Committee raises other issues if one or more members dies.
  - Exit Strategy?
  - Possible addition of new members (not automatic)?

# Other Considerations

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- Although not raised as an issue by the IRS, the New York State and City Bar Associations commented that the DING trusts described in the PLR's were grantor trusts pursuant to Code Section 674(a) because, in their view, the settlor could approach a Distribution Committee member about making a distribution to such member, and the Distribution Committee member would immediately join in the distribution and therefore not be adverse.
  - In my view, this is a misreading of Section 674(a). The Distribution Committee possesses the power with the consent of the settlor, and the New York Bar comment presumes that is the same as the settlor possessing the power to make a distribution to the Distribution Committee member, which the member would automatically accept. The power is NOT possessed by the settlor.
- They also argued that a testamentary limited power of appointment retained by the settlor is not alone enough to cause incomplete gift treatment, even though the PLR's clearly so ruled, and there is no authority for that argument. They argue that the incomplete gift ruling requires one to look at the settlor's power to consent to distribution decisions made by one Distribution Committee member and if that member is adverse then there is a completed gift but if the member is not adverse then it is a grantor trust.
- Unlike the other comments submitted to the IRS, they also argued that persons can possess taxable general powers of appointment over assets that were never the subject of a completed gift and are includable in the settlor's estate.

# Drafting Around The New York Bar Association's Concerns

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- You could eliminate Settlor's power to consent to distribution decisions with one Distribution Committee member. That power was only added to the ruling requests to provide the settlors with a little more power. This approach presumes that the testamentary limited power alone is enough for incomplete gift treatment. The IRS clearly ruled that the testamentary limited power alone is enough to cause incomplete gift treatment and the settlor's power to consent to distributions was neither argued in the ruling requests nor addressed in the analysis in the rulings.
- Alternatively, simply provide that any member of the Distribution Committee can make a distribution with the consent of the settlor; provided, however, that no such distribution may be made to the Distribution Committee member initiating the distribution.

# Timing of IRS Pronouncement?

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- Maybe 2009?
- Will older DING trusts created before July 7, 2007 be grandfathered?
- Will the IRS address the additional considerations raised by the New York Bars or limit its pronouncement to the issues it raised in IR 2007-127?