Steve Leimberg's Estate Planning Email Newsletter - Archive Message #1824
Date: 22-Jun-11
From: Steve Leimberg's Estate Planning Newsletter
Subject: **The BDIT: A Powerful Wealth Planning Strategy When Properly Designed and Implemented**

Now, **Dick Oshins, Larry Brody and Katarinna McBride** provide **LISI** members with an analysis and clarification of the functionality of the BDIT (Beneficiary Defective Inheritor's Trust), as well as an explanation as to why attempts to modify the BDIT steps can actually deteriorate the purity of this largely codified but creative strategy.

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The authors would like to extend their thanks to **Professor Jerome ("Jerry") M. Hesch** for his scholarly review and comments, as well as **Susan P. Rounds**, JD, CPA, LLM for her revisions.

Now, here is their commentary:

EXECUTIVE SUMMARY:

If our clients were able to express to us what they would want to accomplish during the estate planning process, assuming that it was obtainable, it would consist of a combination, with varying emphasis, of the following:

- Control - Including the managerial control, of their wealth until death;
- Beneficial enjoyment - The use and enjoyment of the property for any purpose until death;
- Power to amend - The ability to change who has the right to use or receive the assets if there is a change in family dynamics, the law or for any other reason;
- Creditor protection - Including protection from divorcing or dissident spouses, for them and their descendants; and
- Tax Savings – For them and their descendants.

The Beneficiary Defective Inheritor's Trust ("BDIT") is a trust funded solely by a third party for the benefit of a client (often an affluent individual) which will enable the client, as the beneficiary of the BDIT, to accomplish the goals outlined above, provided that it is structured properly. Think of the BDIT as the third party's Dynasty Trust created for the beneficiary and his or her descendants.

FACTS:

THE "PIPE DREAM TRUST" – WHAT DOES NOT WORK[1]

The perceived obstacle our clients, and we as their advisors, face is that clients cannot create an estate planning vehicle for themselves and accomplish all of these goals. If clients create this for themselves, it has been referred to as the "Pipe Dream Trust." Not only would the Client be subject to income and transfer taxes as if the trust had not been created, the trust would be a "self-settled" trust and potentially expose the trust assets to the Client's creditors. Even though an individual cannot create such a trust for him or herself, any other person can create a trust for someone else, even for the client's spouse, and accomplish the desired benefits for the trust beneficiaries. This is a typical trust with a spendthrift clause.

Why can a third party create a trust for someone else that accomplishes the desired goals, while an individual cannot establish a trust for his or her own benefit with the same result? Property transferred during life may be pulled back into the estate at death under the "string provisions" of IRC §§2036-2038. For example, in the context of FLPs, the IRS has been successful in taxing transfers under §2036 when the decedent has transferred assets during lifetime and has retained an interest, either express or implied, in the transferred property. (Note – if the transferor had received assets of equivalent value in exchange, the transfer would be protected from inclusion under the "adequate and full consideration" exception to §2036.)

The string provisions are only applicable to transfers during lifetime where the transferor (i) makes a transfer, (ii) retains an interest in the transferred property, and (iii) the transfer was for less than "adequate and full consideration." If *any* of these three conditions does not exist, §§2036-2038 will not apply and the property will not be pulled back into the estate.

Why is this important here? If someone other than the decedent made the transfer, the string provisions would not be triggered, and as long as other estate tax inclusion provisions were not violated, the property would not be brought back into the estate. In addition, if the client makes a transfer to an otherwise safe trust set up by someone else and receives something of equal value in exchange, the assets transferred will not be exposed to the estate tax. If this is done properly in a state with an unlimited perpetuity period, the assets can be protected from all estate, gift and GST taxes, forever, as long as they remain in trust.

Finessing the "Pipe Dream"

The BDIT can enable the client to reasonably accomplish the goals set forth in the

introductory paragraph without running afoul of the nefarious string provisions. This article will discuss the BDIT and how to avoid, or finesse the various traps which would otherwise expose the estate owner to taxes or creditors, and still leave the estate owner with reasonable control and the beneficial enjoyment of the property.

Skilled estate planners are aware of the fundamental fact of estate planning: Assets placed into a trust by someone else have substantial advantages relative to assets that are received outright by gift or bequest. A perpetual trust will extend these enhanced benefits for multiple generations, subject only to the applicable rule against perpetuities, if any.

COMMENT:

Solely because assets are transferred to a trust by someone other than the trust beneficiary, and as long as they are retained in trust, those assets are well positioned to be sheltered from the estate, gift, and GST tax, as well as from the beneficiary's present and potential creditors. This is true even though the beneficiary is given the use and enjoyment of the trust assets, in addition to substantial control of the trust. Forum shopping for a favorable trust jurisdiction is encouraged when designing BDITs.[ii]

There are four general components which enable the BDIT to accomplish the desired benefits.

- **Third Party Funding**: The trust funding cannot be attributable to the beneficiary. The trust must be funded solely by someone other than the beneficiary, and the beneficiary cannot reimburse the donor either directly or indirectly.

- **No Gift by Beneficiary**: The beneficiary must never make a gratuitous transfer to the trust.

- **Valuation Dat**e: The value of the transfer is measured at the time of the transfer and subsequent growth is irrelevant. This is true for both the original gift to the trust, as well for as any assets sold to the trust.

- **Grantor Trust**: The BDIT will be designed and funded so that it will be treated as a Grantor Trust under §678 of the Code as to the beneficiary, but intentionally not as to the creator.

Steps of the BDIT

Although the BDIT can be used in many ways to accomplish estate and business planning objectives, this article focuses primarily on transferring the client's existing assets into the trust through an installment note sale to the BDIT. To ease the discussion, we will refer to the donor as "Parent" and to the beneficiary as "Client or Beneficiary." This transaction is similar in many respects to the installment note sale to an IDGT transaction. The following steps should be observed:

1. ***Set up a BDIT*****:** A BDIT is set up as a fully discretionary GST trust, (wholly exempt from the GST tax, by allocation of the creator's GST exemption), set up in a state which has a "self-settled trust" statute and the Beneficiary is given a broad Special Power of Appointment ("SPA"). The BDIT will have a formula clause which shifts unintended gifted assets to a non-exempt BDIT and/or permits a qualified severance allowing the trustee to divide the trust into separate trusts.

2. ***BDIT Design*****:** The BDIT is designed as a Beneficiary Controlled Trust ("BCT"). The Client is given as much control over the trust as possible without exposing the trust to taxes or creditors. That control is substantial. The Client controls (i) the management of the trust, (ii) the selection of the parties who are permitted to use the trust assets (including the Client), and (iii) the identity of the Independent Trustee subject to the restrictions of IRC §672 (c) and Rev. Rul. 95-58. The Client can alter both the dispositive scheme and the trusteeship structure through a special power of appointment without exposing the trust assets to estate tax or creditors. The BCT trust is designed as discussed in the various articles cited in footnote ii.

   Planning Note: *Some advisors have suggested using a single trustee with a "health, education, support and maintenance" distribution standard. We strongly recommend the use of a discretionary trust with an Independent Trustee designed in the manner discussed in the articles listed in footnote* ii. *The use of such a trust will provide the client and future beneficiaries with the maximum tax and creditor protection.* [iii] *The Client will be the Investment Trustee. The use of an Independent Trustee in a preferable state will enable the Client to benefit from that state's laws. Some clients will prefer the BDIT arrangement where there are two separate Independent Trustees, one who is a trusted friend as the Distribution Trustee and the other who will be sufficiently connected to the state of choice such that the BDIT can be governed under that state's laws.*

3. ***Gift of $5,000***: Parent (or some other third party) gives $5,000 to the BDIT, subject to a power of withdrawal in the Client which lapses in 30 days. The $5,000 is not invested during the 30 day period; thus, the entire contribution lapses 30 days from the date of gift. As a result of the power of withdrawal, the Client will be treated as the owner of the trust income. Because the Client is treated as the Grantor for income tax purposes, (i) he or she can transact with the trust income tax free [iv] and (ii) by paying the income tax on the trust income, the client's estate will be depleted for both transfer tax purposes and creditor purposes. $5,000 of Parent's GST tax exemption is allocated to the BDIT so that the trust is 100% GST exempt.

4. ***Defined Value Sale ("DVS") to BDIT for a Note***: The Client will sell assets to the trust in return for a note, interest-only at the AFR, with a balloon payment at the end of the term, which is generally nine years. The sale will be structured as a DVS. [v]

5. ***Quality Appraisal***: The sales price will be determined by a quality appraisal. We recommend that the Independent Trustee (or Special Trustee) which is a trust company (or other independent institution with appropriate fiduciary responsibility) represent the BDIT in the sale or purchase of hard-to-value assets to or from the BDIT. The trust company is represented by separate counsel. The trust company and its counsel discuss the transaction with the appraiser.

   Planning Note: There is little incentive to obtain an aggressive appraisal. As a general rule, the estate depletion as a result of grantor trust status will, over time, "tax burn" the Client's estate. Because the Client is a beneficiary and in substantial control of the trust, the BDIT does not have the economic risks of alternative defective trust wealth shifting arrangements. [vi]

6. ***Legitimate Guaranty***: In order to give the sale economic substance, the note is guaranteed by a person or entity who or which has the financial wherewithal to guaranty the sale if the guaranty is called. The amount guaranteed in these transactions is normally double the amount which we would use if we did a note sale to an IDGT. We discuss the economic viability with the appraiser during the planning process. The Guarantor is paid a guaranty fee in order to avoid a potential gift from the guaranty. The appraiser reviews the financial statement of the guarantor and determines the appropriate guaranty fee. [vii] The guarantor is represented by separate counsel. The guaranty is a very real guaranty and will

expose the guarantor to liability if it is called. It should be reflected on the balance sheet of the guarantor as a contingent liability.

Planning Note: *A concern has been raised that the funding of a BDIT with only $5,000 would lack "economic substance" and might result in the transaction being recast as something other than a legitimate sale. Surely, a legitimate guaranty as outlined above will support the same transaction as the more traditional note sale to a trust with seed money. In addition, the use of guarantees is more synonymous with transactions as they are structured in the real world, as opposed to a sale to an entity which only has assets worth 10% of the property it is acquiring.*

7. ***File a Gift Tax Return***: "A timely filed gift tax return as a non-gift completed transfer under Treas. Reg. §301.6501(c)-(f)(4)"[viii] should be filed. This will start the statute of limitations period running. If the Service does not audit it within three years, the statute will have run. If the Service comes in and successfully adjusts the valuation, the Client will adjust the allocation of the asset sold to reflect the change by shifting the gift portion into a non-exempt trust. Because of the special power of appointment, there will not be a gift tax owed.[ix] With respect to the BDIT, there will be certainty going forward and because there has not been a gratuitous transfer to the BDIT, the trust will be outside the transfer tax system similar to any other Dynasty Trust.

   Planning Note: *By using a DVS (see Step #4) there will not be a gratuitous transfer to the BDIT. By filing a timely gift tax return, the statute of limitations will run on the sale, or upon adjustment of the valuation the allocation to a non-exempt trust will be made in accordance with the formula. Thus, the Client will have achieved certainty going forward that there has not been a gratuitous transfer to the BDIT, and that the trust is outside the estate tax system. The trust will be treated as a Dynasty Trust, a trust we all are comfortable with. That protection is not, and cannot be obtained by the alternative techniques suggested below.*

Results:

As a result of the compliance with these steps:

- The trust can be protected from all estate, gift and GST taxes forever – It's Parent's Dynasty Trust and the Beneficiary/Client has never made a gratuitous transfer to the BDIT. The use of a DVS and the filing of the

gift tax return assure that result.

- Protected from creditors forever - The Beneficiary/Client has received back assets of equal value to any assets sold to the trust.

- The Beneficiary/Client may "use" the trust assets for any purpose.[x]

- The Beneficiary/Client is in control of the trust, except for distributions.

- The Beneficiary/Client's wealth is depleted, but moved into the trust transfer tax and income tax free.

COMPARISON WITH ALTERNATIVE RECOMMENDATIONS

Over the past year there have been a number of articles written on the BDIT which have raised some concerns and have suggested alternative solutions that attempt to achieve the same results as the BDIT/note sale. The following compares the recommended solutions to the BDIT. We will assume that the BDIT is structured as set forth previously and compare it to the alternatives using the objections set forth in the LISI article dated Dec. 14, 2010.[xi]

Two of the recommended "alternatives" to the BDIT pursuant to that article are the Private Annuity Sale and the Beneficiary Grantor Trust:

1. ***The Private Annuity Sale (hereinafter "PAS")*****:** [xii] The client makes a sale to an IDGT in exchange for a Private Annuity for life. The client is provided with upside growth using "options to repurchase, 'waterfall' provisions and appropriate management fees and provisions in LLC and FLP documents keying into contingent and extraordinary growth." The authors conclude that this transaction "mimics" or "surpasses" the economic advantages of the BDIT.

Comments:

1. The PAS transaction, as advocated, is a high risk plan. The PAS transaction is intended to achieve the benefits of the BDIT, however, it does not result in the Client obtaining any of the five components detailed in the Executive Summary Section – (i) control, (ii) use and enjoyment of "all" of the property, (iii) the ability to alter the beneficial enjoyment over the property, (iv) creditor protection, and (v) similar estate tax benefits (if any are achieved). The Client

has only the right to receive the annuity when paid and that right is exposed to potential creditors. The Client is taxed on all of the trust income and thus is economically exposed if the income tax depletes the Client's estate too much. Furthermore, a PAS to a grantor trust must meet the IRS exhaustion test, while an installment sale does not have the same requirement.

The retention of the rights, which are designed to "mimic" the BDIT, exposes the transaction to being treated as a transfer with a retained interest, thus causing exposure to possible estate inclusion. For example, if the compensation is even $1.00 too high, the Client will fail the "full and adequate" consideration exception to the string provisions. The Client cannot effectively enter into a "Defined Value **Compensation**" agreement or file a gift tax return on the compensation, so the statute of limitations cannot run and certainty cannot be achieved. The annuity will be paid until death; therefore, unlike a term note where the estate tax inclusion risk ceases[xiii] when the note is paid, the PAS transaction is always exposed because the annuity term is determined with reference to death. The more the transaction attempts to "mimic" the BDIT, the greater the exposure the PAS transaction has to being treated as a transfer with a retained interest.

In almost all BDIT transactions, the Client will transfer his or her entire ownership interest to the BDIT. There is no reason to retain any interest because the Client is a beneficiary of the BDIT which is designed as a BCT. The Client can receive distributions from the trust as a beneficiary in the discretion of the independent trustee whose identity is determined by the Client. This eliminates the economic necessity of having to retain the risky compensation and option arrangements which continuously expose the transaction to §2036 risks.

2. ***The Beneficiary Grantor Trust/Opportunity Shifting (hereinafter "BGT")*:**[xiv] The Client has a business which is expanding. The Client's parent makes a gift of $5,000 into a trust subject to a lapsing power of withdrawal. The Client sets up an LLC which makes a deal with the business to build a building and lease it to the business (presumably on the land that the LLC acquired). Based upon the strength of the lease, the Client obtains the financing to accomplish this result.

Comments:

The structure of the BGT/Opportunity Shifting transaction creates a far greater risk than if the transaction had been structured as an installment note sale to a BDIT. This is counter-intuitive to the visceral reaction of most planners, but it is the obvious

result. As a general rule, "Opportunity Shifting" is considered to be a safer transaction than the use of a sale to the trust. This conclusion is based upon the presumption that the client is not transferring anything to the trust which would expose the transaction to being treated as a transaction with a retained interest and putting the fair value exception into issue.

Under the fact pattern suggested by the BGT proponents, the BGT enters into a lease with the Client's business. This, in and of itself, reverses the risk feature of the transaction. If the lease is greater than "market rate" (even by $1.00) the Client will have been deemed to have made a gift to the trust, thereby exposing all of the assets (other than the original $5,000) to estate tax inclusion and creditors of the Client because the Client will have made a gratuitous transfer to the trust. The BGT would have the estate tax inclusion risk forever.

Furthermore, it is difficult to accept the economics of the transaction as suggested. However, we will accept the facts as set forth. In any case, the ability to design a "fair market" lease is quite problematic. There is no guidance to design the lease, remembering that the trust funded with $5,000 must buy the land and build the building and the Client's business must wait until that has occurred in order to occupy the premises. The Client cannot establish a "Defined Value **Lease**" and cannot file a realistic gift tax return. Because the risk is exposure of the entire wealth shift into the trust, this transaction is far riskier than the BDIT and should never be attempted.

The risk could be easily avoided by changing the ordering of the planning and following the steps set out previously. If the Client were to buy the land himself and construct the building, he could then sell the office building to a BDIT using a DVS and file a gift tax return. The correct ordering of the steps would change the transaction from a high risk transaction into one which has the built-in safety features.

DISCUSSION OF PRIMARY ISSUES RAISED ABOUT THE BDIT:

Issue # 1 – Economic Substance/Thin Capitalization:

The economic substance issue deals with the economic legitimacy of the transaction. If the trust is too thinly capitalized, the Service may try to recast the sale as a gift. In addition, if there is insufficient economic substance, the value of the note could be reduced resulting in the seller not receiving assets equal in value to the asset transferred.[xv] The "rule of thumb" often used is that 10% will provide adequate "seed" funding. In support of an IDGT transaction having more economic substance, the authors suggest that the BDIT proponents "dismiss the 10% requirement". [xvi]

In order to easily compare a BDIT and an IDGT transaction, we will assume that the value of the asset that will be sold to the trust is $9 million. The IDGT alternative would involve funding the trust with 10%, or $1 million. In the BDIT transaction, the trust is capitalized with $5,000 and a legitimate guaranty of $2 million is made by a party (or another trust) which has the economic wherewithal to pay to the guaranty if called. Thus, the cushion is $2,005,000. In comparing the BDIT and IDGT transactions as recommended, it is difficult to conclude that the BDIT does not have more economic substance than an IDGT transaction. Given the alternatives, the owner of a $9 million asset should prefer selling the asset to the trust seeded with $5,000 with a legitimate guaranty of $2 million, over selling the asset to a trust capitalized with $1 million.

Other Perceived Issues – Step Transaction:

The authors that recommended the PAS with the retained features suggest that the separate steps (seeding the trust and the sale) would be aggregated and treated as a single transaction. They cite three cases where the courts applied the step transaction involving FLPs: Linton[xvii], Heckerman[xviii] and Pierre[xix]. In each case, the steps occurred in the same day. With the BDIT, we wait at least 30 days from funding until the lapse of the withdrawal right, and often the time gap is much greater. It should be noted that in the Linton appeal, the Ninth Circuit held that if the "ordering" of the steps were correct, then the step transaction would not apply.

Before examining the results of a successful "step transaction" argument by the Service, a level playing field should be established. We will assume that the same time gap between the funding of the trust and the sales transaction occurs for both the BDIT and PAS strategies. In such instance, the step transaction would be less likely to be applied to the BDIT than the PAS because the BDIT is set up by a third party who, in our experience, does not even know about the transaction. In the PAS transaction, the same person is seeding the trust and making the sale. Moreover, the various additional components, such as the compensation arrangement and the option, add to the exposure. In other words, the BDIT has less risk of a step transaction attach than a traditional PAS transaction and significantly less risk than a PAS transaction that includes the additional retained features

Assuming arguendo, that the IRS was successful with the "step transaction," position the BDIT would be protected by the "full and adequate consideration" exception. The PAS and the BGT would be fully exposed to the string provisions.

In Pierre, a case which opens the door to an interesting and very reasonable position for the Service to attack sales to IDGTs, the IRS was successful in arguing step transaction. In Pierre, the taxpayer formed an LLC and made gifts of 9.5 percent of the LLC and a sale of 40.5 percent interests to two trusts, one for each child. The Tax Court held that the step transaction doctrine applied and aggregated the gift and sale transactions for valuation purposes, so that two 50% interests were valued, rather than the four minority interests.

Why is the step transaction a major concern in the context of a sale to an IDGT or a PAS? As previously mentioned, to have inclusion under §2036, three things must occur – (i) a transfer; (ii) with a retained interest; (iii) for less than full and adequate consideration. Assume that an IDGT is set up and funded with $1 million and the estate owner sells $9 million worth of an entity – which is quite typical.

If the Service successfully argues that the "seed" gift and the sale were part of a step transaction, the seller will have transferred $10 million to the trust and received only the $9 million note back. That would cause the transaction to fail §2036 and if the note was outstanding at death, there would be estate tax inclusion, including appreciation. Because the PAS transaction is designed so that the annuity is paid until death, if the Service were to prevail on the step transaction argument, there could be estate tax inclusion. In most instances, the amount included would also be valued as part of a control block, and the discount would be includable. The same result would occur if the BGT lease was a "favorable" lease. The gift portion would expose the BGT to §2036 inclusion. This result does not occur with the note sale to the BDIT since the third party would have transferred the "seed" money. Since the estate owner never transferred the "seed" money, the step transaction does not apply to aggregate the two transfers.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Richard A. Oshins
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CITATIONS:

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[i] As with any newly-developed planning technique (think about installment sales to grantor trusts some 15 years ago which some practitioners in the 1990's felt were risky) the BDIT is in a similar position. By analogy, before defined value clauses were upheld by the courts (most recently in Hendrix v. Comm'r., T.C. Memo 2011-133) similar concerns were voiced about defined value clauses. Recently, several articles have expressed concern about the BDIT. This newsletter will address how to structure a BDIT so as to eliminate or protect against these concerns. In addition, some of these critical articles made assumptions that can easily be overcome. For example, if a client desires asset protection, attorneys often recommend Nevada, South Dakota, Delaware or Alaska trusts. If an article evaluates the creditor protection concerns of a N.Y. trust, it is natural to be critical. Despite raising concerns with the strategy, several authors are now writing and lecturing on the virtues of the BDIT concept, albeit calling the BDIT by different names (such as the Beneficiary Grantor Trust "BGT"), and adding variances which they suggest enhance the strategy. As will be discussed, the perceived enhancements can actually add significant risks to the strategy and expose the transaction to IRS and creditor attack. The principal conceptual defects in the alternative advice come from a misunderstanding of IRC §2036. Steven B. Gorin, *Letter Ruling 201039010 – The Latest Beneficiary Grantor Trust Ruling*, Estate, Gifts and Trusts Journal 179 (May 12, 2011); See also Steven B. Gorin and Jeffery Galant, ACTEC 2011 Summer Meeting Presentation, Atlanta, Georgia; See also Steven B. Gorin, *A Balanced Solution*, Trusts & Estates (May 2011); See also Avi Kestenbaum, Jeffery Galant and Eli Akhavan, *The Beneficiary Defective Inheritor's Trust: Is It Really Defective,* LISI (December 14, 2010).

[ii] Richard A. Oshins and Jerry Kasner, *The Dynastic Trust Under the Relief Act of 2001*, Tax Notes (October 8, 2001) at 247; See also Frederick Keydel, *Trustee Selection, Succession, and Removal Ways to Blend Expertise with Family Control*, 23 U. Miami Inst. On Est. Plan., Ch. 4 (1989).

[iii] Steven J. Oshins and Mark Merric, *Effect of the UTC on the Asset Protection of Spendthrift Trusts,* Estate Planning (August, September and October 2004).

[iv] Rev. Rul. 85-13.

[v] Carlyn S. McCaffrey, *Formula Valuation – Shield Against Gift Tax Risks or Invitation to Audit*, 42 U. Miami Inst. On Est. Plan., Ch. 11 at §1101.2 [B] (2008); See also Carlyn S. McCaffrey, *Tax Turning the Estate Plan by Formula,* 33 U. Miami Inst. On Est. Plan., Ch. 4 (1998); See also Carlyn S. McCaffrey and Mildred E. Kalik, *Using Valuation Clauses to Avoid Gift Taxes*, 125 Trusts & Estates 47 (October 1986); See also John Porter, *A Formula for Avoiding Transfer Tax Litigation*, Williamette Law Review (Autumn 2010) at 86.

[vi] "Although valuation discounts receive most of the attention, over a long period of time the grantor's payment of the income taxes on the trust's taxable income will almost always have a far greater impact on the amount of wealth transferred without exposure to the gift, estate and generation skipping transfer taxes than valuation discounts…."
"Although the primary objective of most freeze techniques is to shift future appreciation in value to the trust without any gift taxes, a separate wealth shifting benefit arises by the grantor's payment of the grantor's trust's Federal and state income tax liabilities. If grantor trust status continues for a significant period of time, this wealth transfer feature can transfer far more wealth without transfer taxes than the use of low interest rates or valuation discounts." Jerome M. Hesch and David A. Handler, *Evaluating the Sometimes Surprising Impact of Grantor Trusts on Competing Strategies to Transfer Wealth*, 68 N.Y.U Tax. Inst. On Fed. Tax'n. (2009).

[vii] A. James Casner and Jeffrey N. Pennell, Estate Planning, Vol. One - Sixth Edition, Shifting Opportunities at §6.3.3.6; See also Milford Hatcher, *Planning for Existing FLPs,* U. of Miami Tax Inst., 2001, Ch. 3 at Section 302.2.

[viii] Carlyn S. McCaffrey, *Formula Valuation – Shield Against Gift Tax Risks or Invitation to Audit*, 42 U. Miami Inst. On Est. Plan., Ch. 11 at §1101.2 [B] (2008);

[ix] Treas. Reg. §301-6501(c)-(f)(4).

[x] Ron Aucutt, *Structuring Trust Arrangement for Flexibility*, 35 U. of Miami Inst. on Est. Plan., Ch. 9 (2003) at §902.3.

[xi] Avi Kestenbaum, Jeffery Galant and Eli Akhavan, *The Beneficiary Defective Inheritor's Trust: Is It Really Defective,* LISI (December 14, 2010).

[xii] *Id.*

[xiii] Except if there is an implied understanding that the transferred assets may be enjoyed by the Client, such as through excessive compensation.

[xiv] Steven B. Gorin, *Letter Ruling 201039010 – The Latest Beneficiary Grantor Trust Ruling*, Estate, Gifts and Trusts Journal 179 (May 12, 2011); See also Steven B. Gorin and Jeffery Galant, ACTEC 2011 Summer Meeting Presentation, Atlanta, Georgia; See also Steven B. Gorin, *A Balanced Solution*, Trusts & Estates (May 2011); See also Avi Kestenbaum, Jeffery Galant and Eli Akhavan, *The Beneficiary Defective Inheritor's Trust: Is It Really Defective,* LISI Estate Planning Newsletter #1730 (December 14, 2010).

[xv] David H. Handler and Deborah V. Dunn, *Drafting the Estate Plan,* Section 11.06(B)(2)(a) (Discussing seed money and economic substance/thin capitalization).

[xvi] The 10% is only a rule of thumb. Further discussion of that is beyond the scope of this article, except to point out that we discuss the issue with the appraiser and generally double what we would have used if the sale was to an IDGT. The amount of the guaranty and the guaranty fee generally varies depending upon the nature of the asset being transferred and other factors.

[xvii] *Linton v. U.S.,* 107 AFTR 2011-375 (9th Cir. 2011).

[xviii] *Heckerman v. U.S.,* U.S. Dist. Ct., W.D. Washington, Cause No. C08-0211-JCC (July 27, 2009).

[xix] *Pierre v. Comm'r,* 99, T.C.M. (CCH) 1436 (2010).

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