ESTATE PLANNING COUNCIL OF DELAWARE, INC.

BDIT or BDOT:
That is the question.
Beneficiary Grantor Trusts

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III. BDITs - Beneficiary Defective Inheritor's Trusts

IV. BDOTs – Beneficiary Deemed Owner Trusts

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VI. Application, Planning, Examples

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Grantor Trusts - Overview

- **Grantor trusts**, also known as defective grantor trusts and intentionally defective grantor trusts, are trusts that are treated as owned by the **grantor** for income tax purposes.
    - All of the income and deductions of a grantor trust are attributed and taxed to the grantor, instead of to the trust. *IRC section 671.*
    - A trust may be a grantor trust in whole or in part.

- Who is a Grantor?
    - A **"grantor"** is any person to the extent such person either creates a trust, or directly or indirectly makes a gratuitous transfer of property to a trust.
        - Special rules for partnerships and corporations
- Grantors who are Not Owners – A nominal creator of a trust is also considered the grantor of that trust, but not treated as the owner if such person does not make any gratuitous transfers to the trust.

Grantor Trusts - Overview

- To be a grantor trust: trust *must contain certain provisions*, set forth in the Internal Revenue Code.
- Many provisions triggering grantor trust status would also cause the trust property to be included in the grantor's taxable estate (which is counter to most estate tax planning).
- Important that the trust, while treated as owned by the grantor for income tax purposes, not be treated as includable in grantor's estate for estate tax purposes.

IRC Code Section	Description
IRC 673	Reversionary Interests
IRC 674	Powers to Control Beneficial Enjoyment
IRC 675	Certain Administrative Powers
IRC 676	Power to Revoke
IRC 677	Income for the Benefit of the Grantor
IRC 678	Persons other than the Grantor Treated as Owner
IRC 679	Foreign Trusts with U.S. Beneficiaries

Non-Grantor Owners of a Trust - Overview

IRC Code Section 678	Description
IRC 678(a)	A person other than the grantor shall be treated as the owner of any portion of a trust with respect to which:
(1)	such person has a power exercisable solely by himself to vest the corpus or the income therefrom in himself
OR	
(2)	such person has previously partially released or otherwise modified such a power and after the release or modification retains such control as would, within the principles of §§671-677 of the Code, inclusive, subject a grantor of a trust to treatment as the owner thereof

"Income" as stated in the Regulations under subpart E refers to **income as determined for tax purposes** and not income for trust accounting purposes.

- Trust accounting income is referred to as "ordinary income" in subpart E.
- Trust accounting income is referred to as "income" elsewhere in subchapter J.

Non-Grantor Owners of a Trust - Overview

IRC Code Section 678	Exceptions
IRC 678(b)	If Grantor is owner - IRC 678(a) doesn't apply if the Grantor of the trust or a transferor (to whom section 679 applies) is otherwise treated as the owner under the provisions of Sections 671-677, and 679.
IRC 678(c)	Obligations of support – IRC 678(a) doesn't apply if a trustee can apply income of the trust to the support/ maintenance of a person whom the holder of the power is obligated to support/maintain except to the extent that such income is so applied.

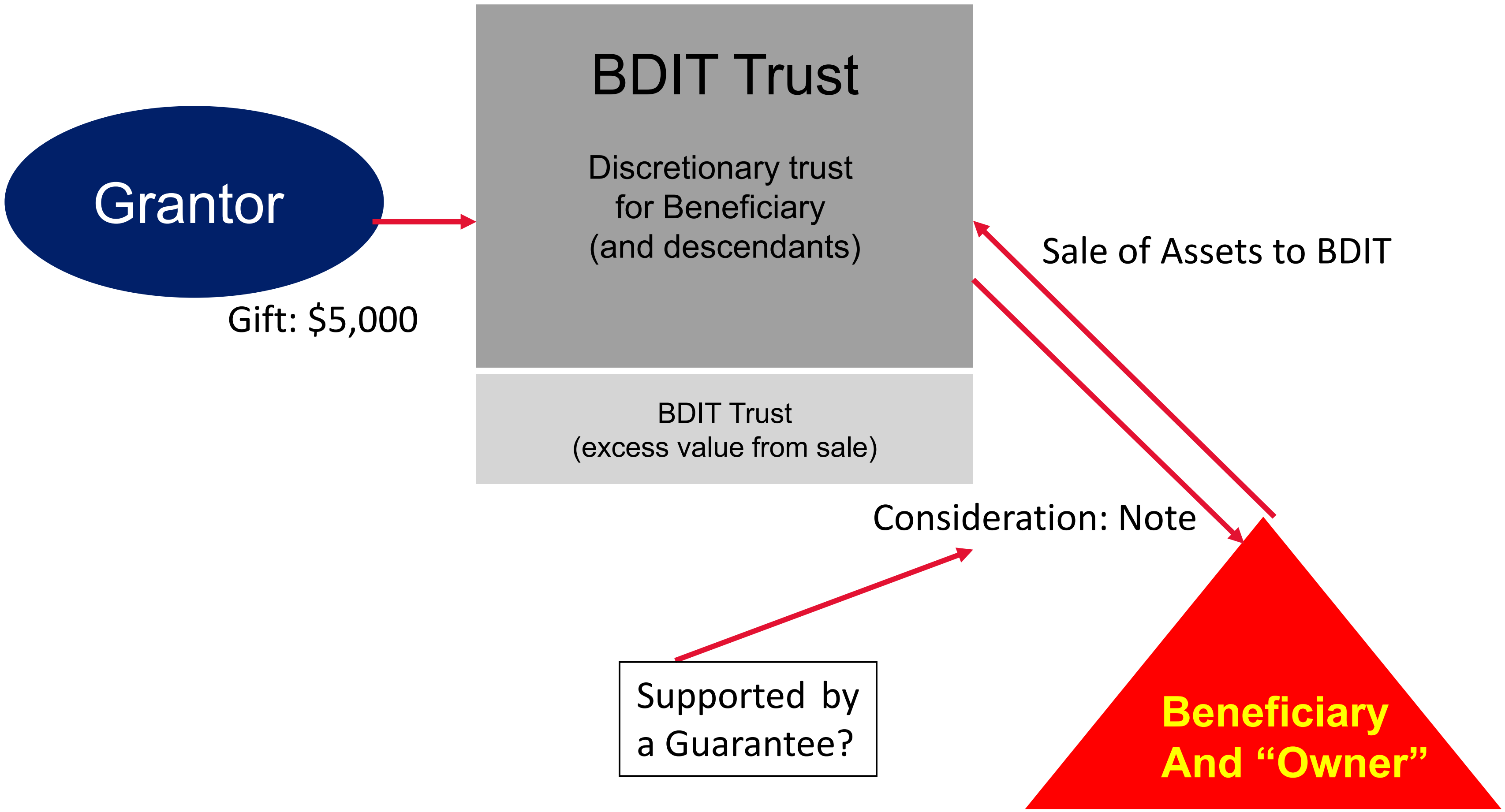
Is there an exception for an IRC 678 power based on an ascertainable standard?

Non-Grantor Owners of a Trust – **Beneficiary Defective Inheritor's Trust** (BDIT) Overview

BDIT	Terms of Trust
678(a)(1)	Beneficiary has the power to withdraw all contributions to the trust (which is generally why funding is limited to $5,000)
	Withdrawal power will lapse (within the $5,000 and 5% limitation), if not exercised within a specified period
	BDIT Trust does not otherwise qualify as a traditional grantor trust.
	A BDIT typically has a Crummey power of withdrawal to confer IRC 678(a) status for a limited period
678(a)(2)	After the withdrawal power lapses, the trust has other terms which satisfy the Release of Power requirement

A BDIT trust is typically funded by a parent or someone other than the beneficiary with only $5,000

Non-Grantor Owners of a Trust – Beneficiary Defective Inheritor's Trust (BDIT) Overview



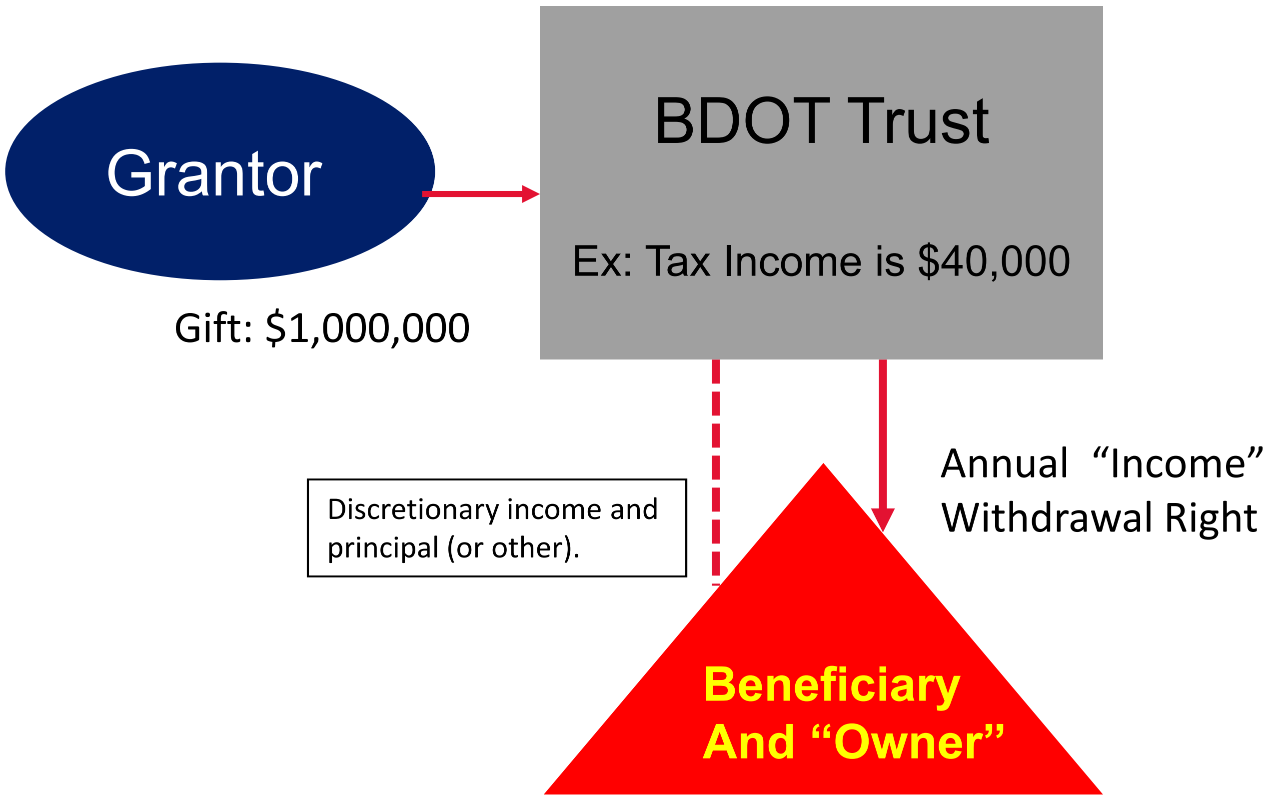
Non-Grantor Owners of a Trust – **Beneficiary Deemed Owner Trust** (BDOT) Overview

BDOT	Terms of Trust
678(a)(1)	Income Withdrawal Power -- Beneficiary has the power to withdraw (exercisable solely by her/himself) all of the trust's tax income, including capital gains and other income allocable to principal
Laspe	If beneficiary fails to withdraw the tax income in any year, Withdrawal Power would lapse (at year end or other date). If lapse amount is within the $5,000 or 5% safe harbor, the lapse should not be considered a gift by beneficiary to BDOT Trust

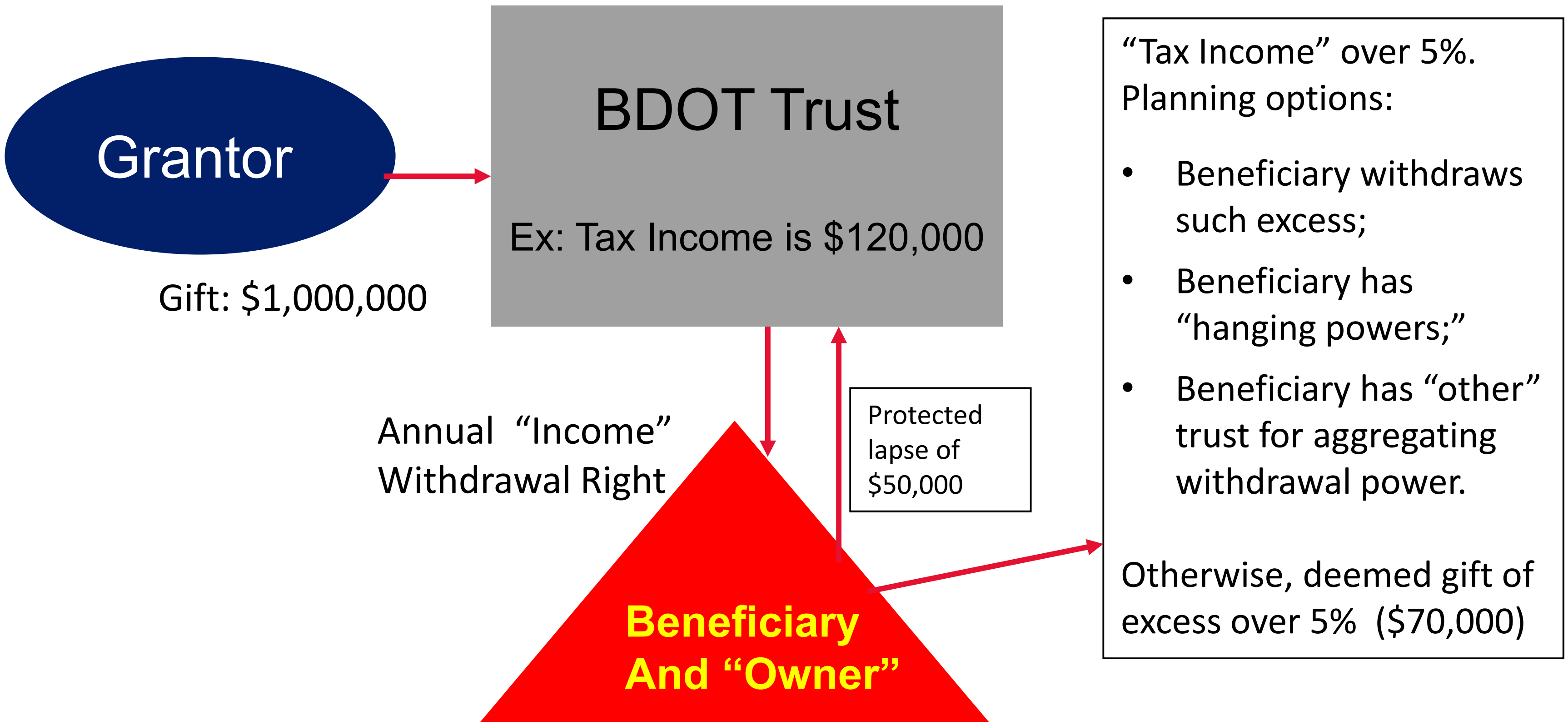
A BDOT trust is not limited to initial funding of $5,000

Generally advisable that the Income Withdrawal Power be exercisable year-round: avoids argument that trust is a BDOT only during a limited period of time.

Non-Grantor Owners of a Trust –
Beneficiary Deemed Owner Trust (BDOT) Overview



Non-Grantor Owners of a Trust – Beneficiary Deemed Owner Trust (BDOT) Overview



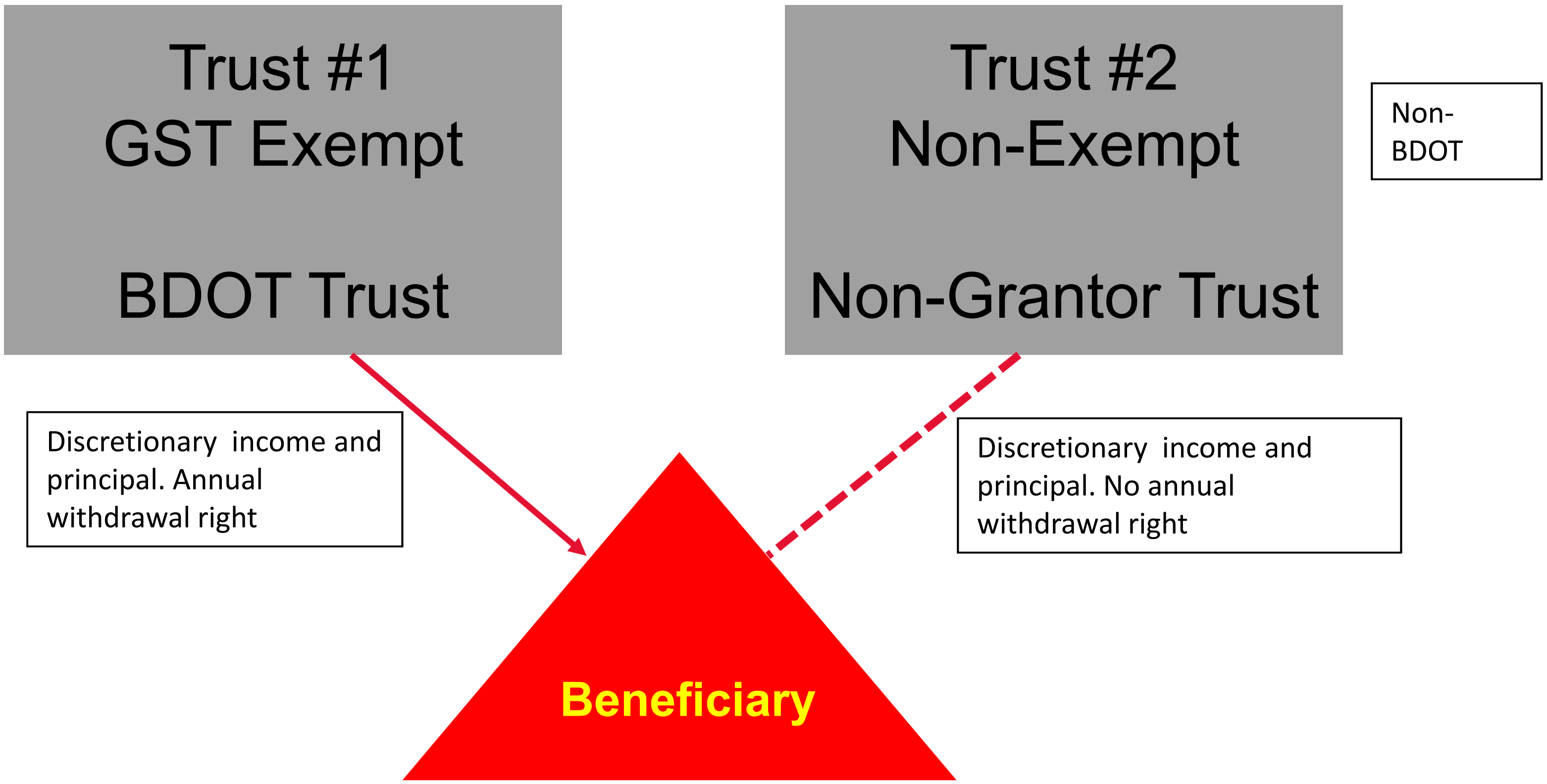
Benefits / Detriments of Grantor Trusts – Income Tax Considerations

Attribute	Description
Compressed Tax Brackets	Trusts subject to highly compressed tax brackets - top marginal tax rate at approximately $13,500 (joint filers reach top bracket at about $650,000)
Net Investment Income Surtax	Trusts subject to net investment income surtax at about $13,500 (joint filers threshold is $250,000)
Capital Gains	Top capital gain and dividend tax rate hit trusts at nearly $14,000, (joint filers hit the top rate at about $517,000)
Previously Proposed BBB Surcharges	Proposed surcharge of 5% on trust income over $200,000 and an additional 3% surcharge on income over $500,000. (Individuals' thresholds proposed at $10 million and $25 million respectively)

Benefits / Detriments of Grantor Trusts – Income Tax Considerations (continued)

Attribute	Description
Principal Residence Exclusion	exclusion up to $250,000 in gain on sale of a principal residence available to individuals, but not trusts
Business Property	election to expense (up to $1,080,000, for 2022) depreciable business property in the year of purchase available to individuals, not trusts
State Income Taxes	beneficiary located in a state with no income tax; trust in a state with income tax (opposite could be true)
Qualified Small Business Stock	not having the trust taxable to the beneficiary, could give "additional" $10 million exclusion to the trust
Miscellaneous Expenses	some tax deductions available to trusts, but not individuals (e.g., tax prep. and trustee fees). Expenses not deductible by a beneficiary treated as owner of trust
Charitable Deductions	unique rules for trusts
Other	potential qualified business income deduction (IRC §199A), eligibility to hold S-corp. stock and $25,000 offset for rental real estate. State source income considerations

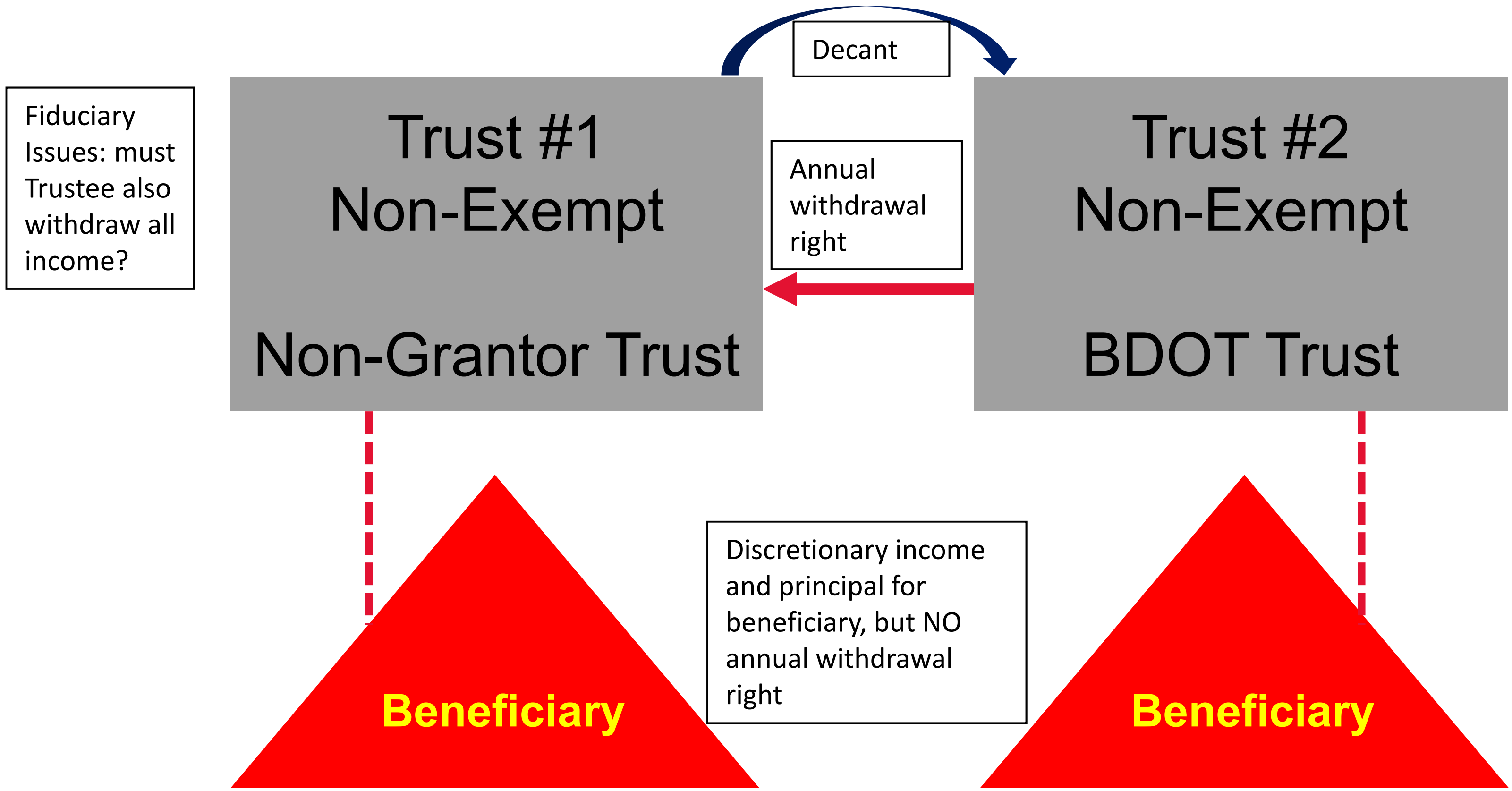
BDOT – Application and Planning



Trust 1 provides Beneficiary with an annual Withdrawal Right over Trust #1 tax income. Beneficiary pays Trust #1's income taxes, allowing Trust #1 (GST Exempt to grow in a tax efficient manner)

BDOT – Application and Planning

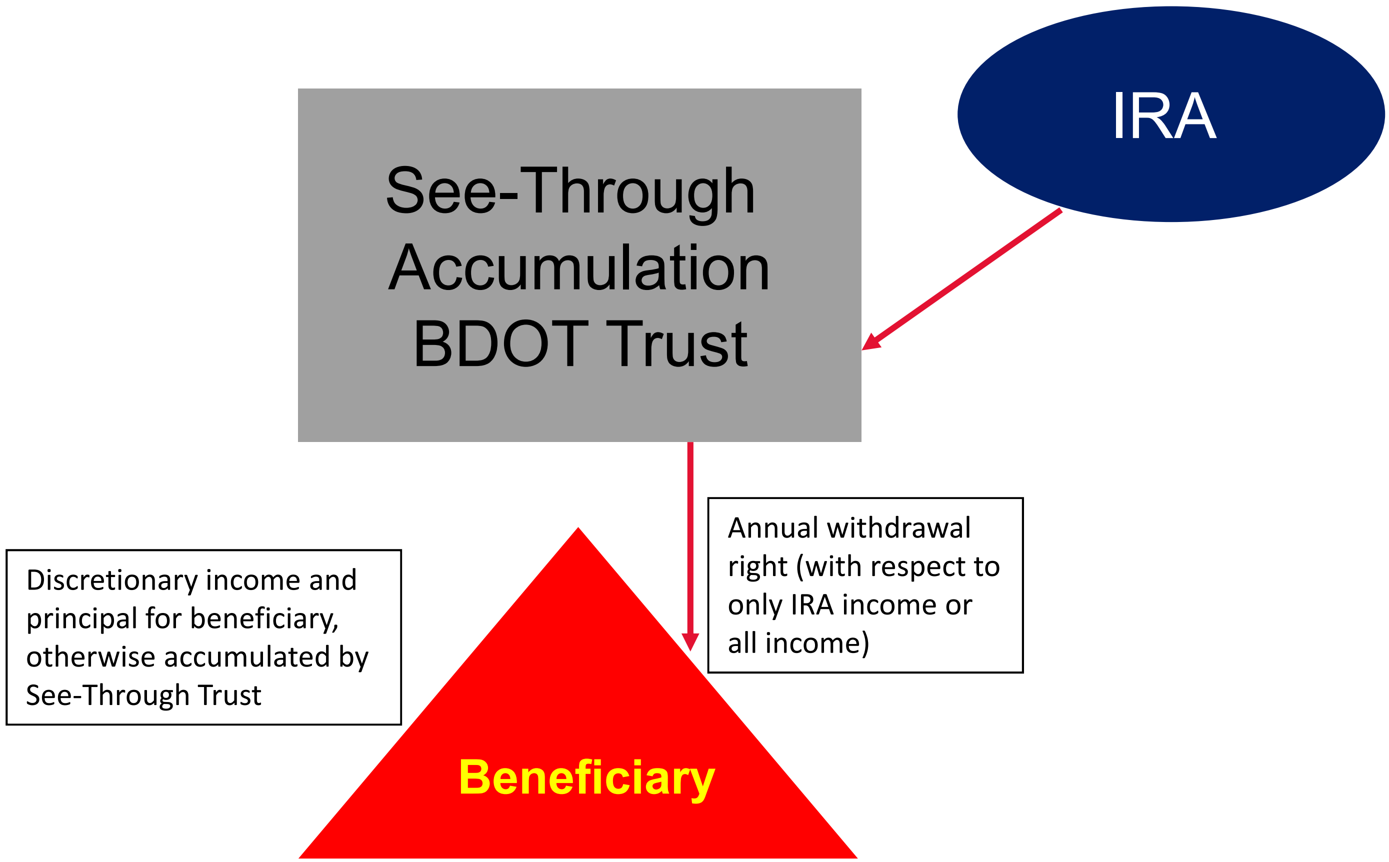
PLR 201633021



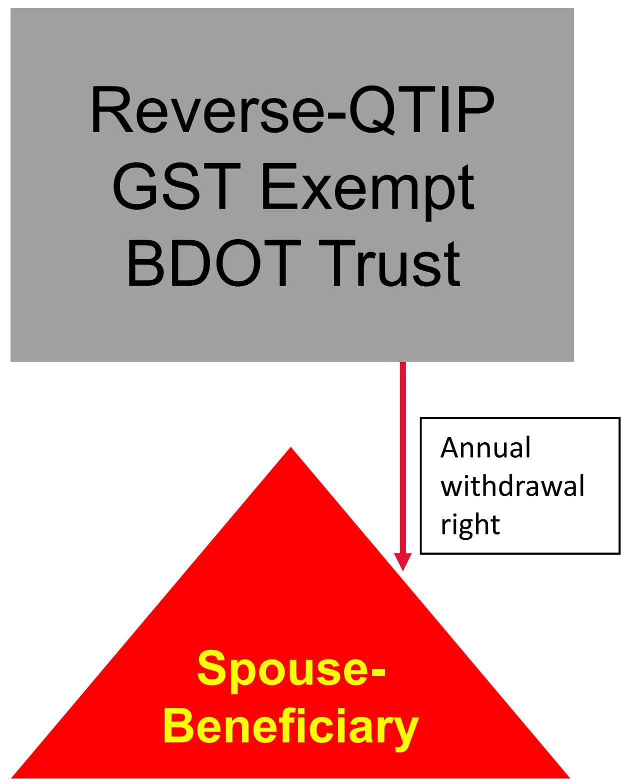
Trust 1 retains the power, solely exercisable by Trust 1, to withdraw the net income of Trust 2 by Trust 1; provided, however, that such power shall lapse on the last day of such calendar year. Income, according to Trust 1 includes (i) any dividends, interest, fees and other amounts characterized as income under §643(b) of the Code and (ii) any realized net long-term and short-term capital gains.

IRC section 6110(k)(3) provides that a PLR may not be used or cited as precedent.

BDOT – Application and Planning

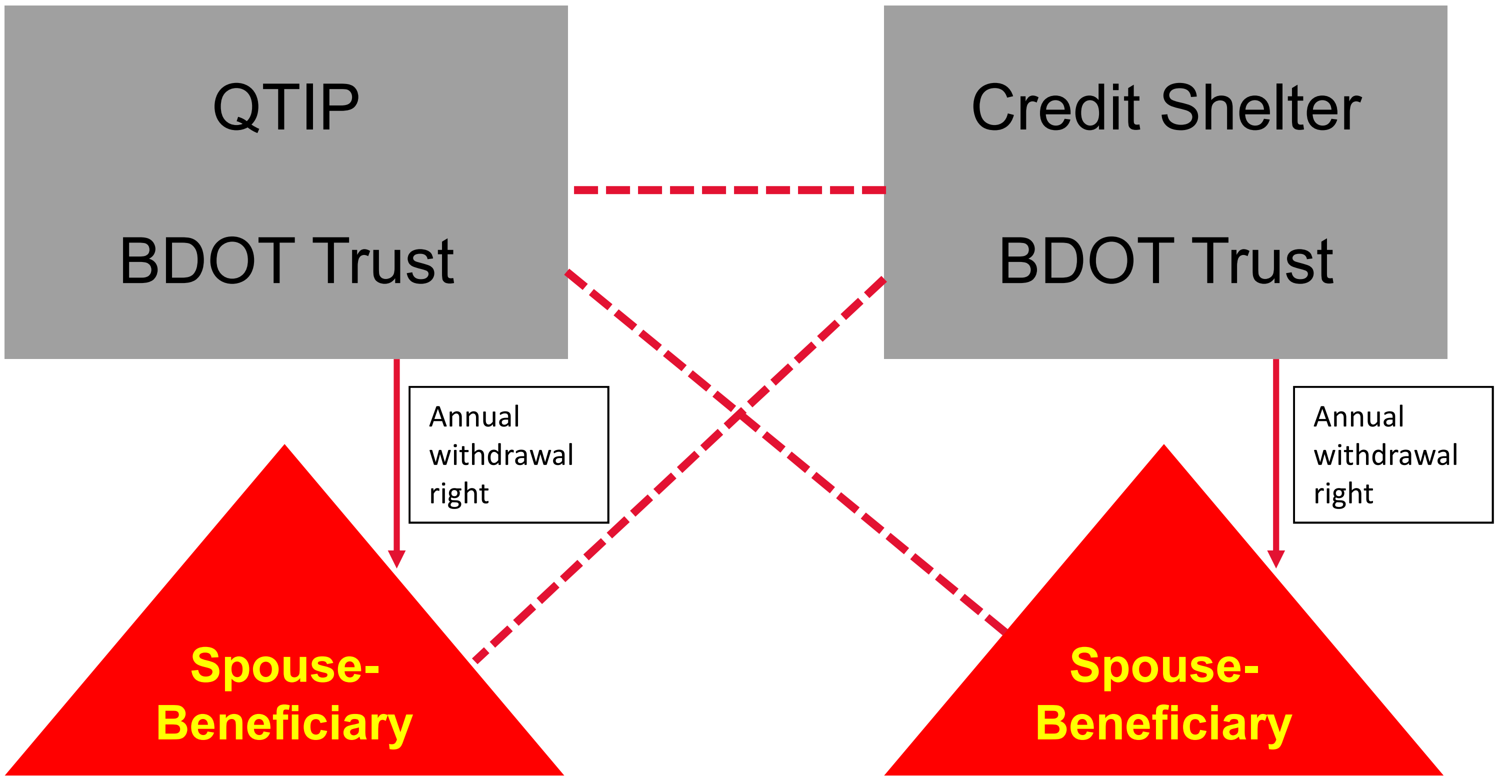


BDOT – Application and Planning



Beneficiary pays income tax on GST Exempt Trust, allowing more funds to stay in Trust and more tax efficient growth over surviving spouse's lifetime. However, QTIP is still includible in surviving spouse's estate.

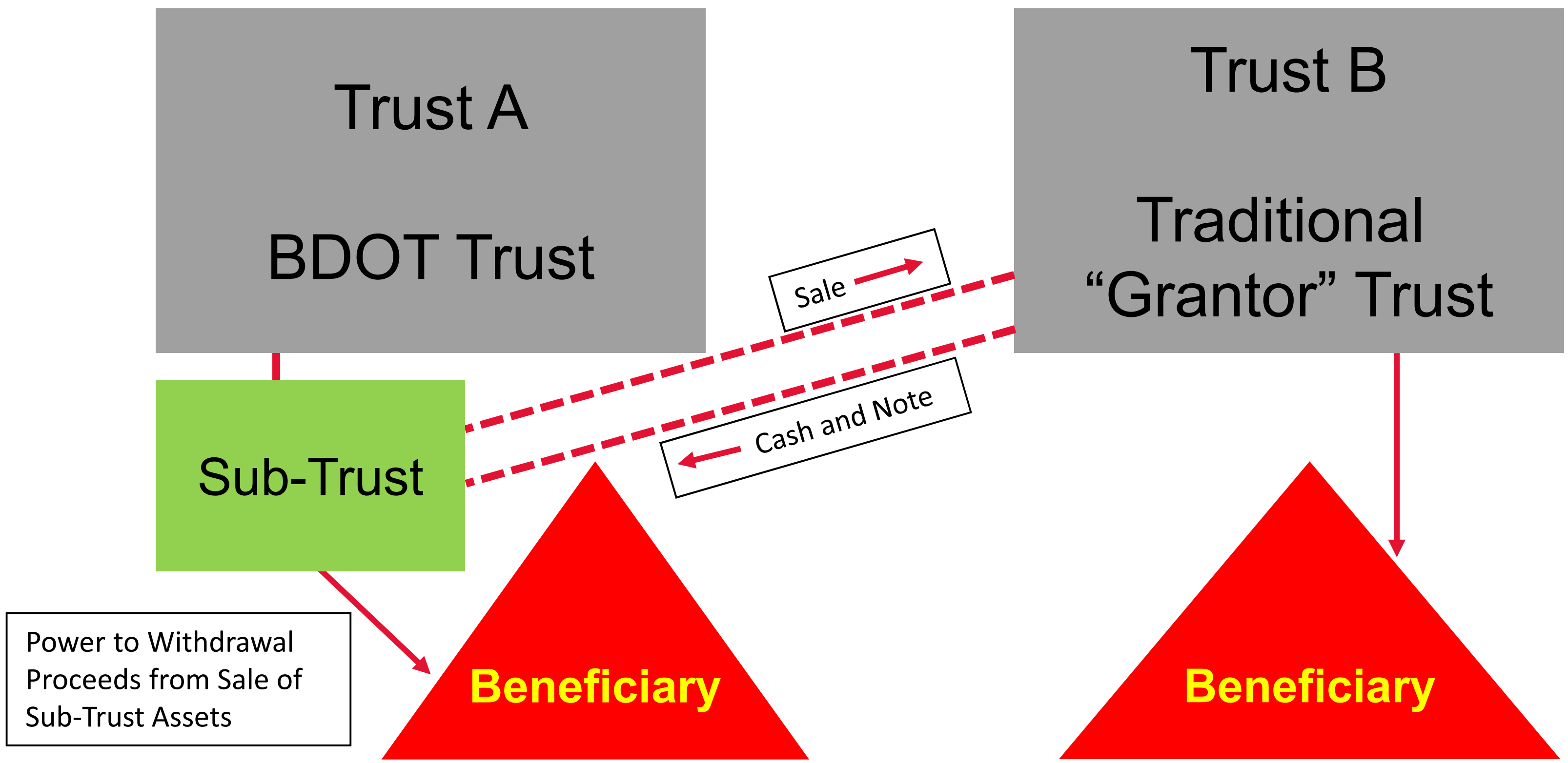
BDOT – Application and Planning



- Spouse pays income tax on QTIP Trust.
- Since the QTIP Trust is includable in the surviving spouse's estate, it appears this strategy would be of limited benefit. However, there could be a benefit if both the credit shelter trust and the QTIP trust were created as BDOTs.
- QTIP and CST could engage in estate freeze transactions with each other, without any income tax consequences.

BDOT – Application and Planning

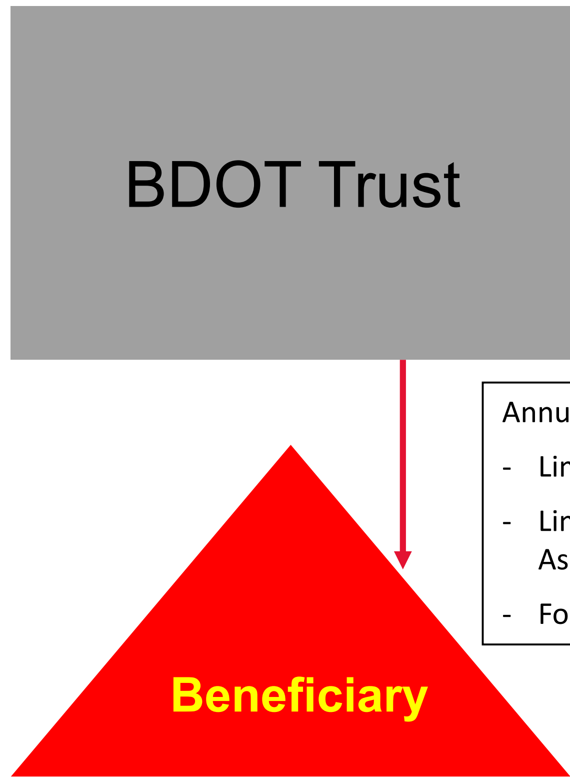
PLR 202022002



- Trust A's Sub-Trust permits Beneficiary to withdraw proceeds of sale of Sub-Trust assets
- Beneficiary is considered Owner of proceeds under IRC 678(a)(1)
- Beneficiary is considered Owner of Trust B under traditional grantor trust rules
- Trust A could sell appreciated assets to Trust B, without federal income tax consequences under non-recognition treatment pursuant to Rev. Rul. 85-13.

IRC section 6110(k)(3) provides that a PLR may not be used or cited as precedent.

BDOT – Application and Planning



Annual withdrawal right:

- Limited to Income from a Specific Asset
- Limited to Income from "high income" Assets
- Formula driven / defined amount

Caution: fiduciary and conflict of interest issues if power limited to specific (types) of assets and Beneficiary is also trustee or investment advisor?

Stranger Things!

- Withdrawal Powers over phantom income
- Adding withdrawal powers to existing trusts
- Application of Rev Rul 85-13 to BDOT Trusts

Q & A