(888) 544-6775
expert@peaktrust.com

SPATs: A Flexible Asset Protection Alternative to DAPTs

by Abigail E. O'Connor, JD, Mitchell M. Gans, JD, and Jonathan G. Blattmachr, JD, LLM

Originally published in Estate Planning magazine, February 2019

Many estate planning attorneys and their clients currently are wrestling with ways to best use the temporary increase in the federal applicable estate tax exclusion. For super high net worth clients, a gift of $5.5 million (or $11 million for a married couple) may be nothing more than a blip off of the portfolio, and the move takes very little thought. For clients in the high net worth range ($5 million to $20 million), but not super high net worth (over $20 million), the decision typically is more difficult. Estate tax savings has to be weighed against the potential need for the assets later during lifetime. What are the options for these clients?

A similar question arises in the context of asset-protection planning: how to achieve creditor protection without fully relinquishing access to the assets. In both contexts – asset-protection and estate tax planning – self-settled trusts often are used. A self-settled trust, also called a "domestic asset protection trust" (DAPT) when created in America, is an irrevocable trust created by an individual in which that individual is designated as a beneficiary. Given the possibility that the creditor protection aspects of DAPTs may be disregarded under the laws of many states,[1] however, the question becomes whether there is another option.

> *"While self-settled trusts may be excellent options for estate planning and creditor protection, the number of jurisdictions in which they can be used are limited."*

This article proposes the use of an irrevocable trust created for beneficiaries other than the grantor, in which one or more individuals (who are not the grantor and are not necessarily a beneficiary) have a lifetime special power of appointment, held in a nonfiduciary capacity, that may be used to direct assets back to or for the benefit of the grantor. The grantor would have no entitlement to benefits or even eligibility to receive benefits in the discretion of the trustee or another fiduciary; but only by the exercise of a special power of appointment held by someone in a nonfiduciary capacity-essentially a non-self-settled trust from which the grantor may benefit. In other words, the grantor would have no more right to benefit from the assets than if they were owned by someone else individually. To be sure, the concept of allowing the grantor to benefit from the trust assets through the exercise of a special power of appointment is not new. But questions about the structure of such an arrangement and its effectiveness need to be considered.

The discussion that follows begins with a brief explanation of how assets in a trust created by one person for the benefit of a beneficiary (other than the grantor) can be protected from creditors of the beneficiary. It also considers the creditor-protection issue in the context of a self-settled trust. Next it explores the use of the special power of appointment trust (SPAT). Following that, conclusions are set forth.

1 Note, also, that, regardless of what state law is involved, under U.S. Bankruptcy Code section 548(e), assets transferred to a self-settled trust or similar device may be avoided in a bankruptcy proceeding if the transfer was made within ten years of the filing of the bankruptcy proceeding and made with an actual intent to hinder, delay, or defraud a creditor.

Spendthrift Trusts

One of the primary purposes of creating trusts is to protect property held for the beneficiaries – often spouses or descendants – from their potential creditors. This protection both assures financial stability for the beneficiaries and preserves assets that may be the legacy of a family, such as family business. Spendthrift trusts can be created for finite periods, or in some states, can continue indefinitely, or at least until the assets are depleted.

An irrevocable trust is called a "spendthrift trust" if it contains a provision (or state law essentially provides one) that says the interest of a beneficiary cannot be alienated or involuntarily transferred. In such a case, the creditor of the beneficiary typically cannot reach the assets except to the extent the assets are distributed to and are in the hands of the beneficiary. There are some exceptions to spendthrift protection in some states, such as where a beneficiary cannot or refuses to pay court-ordered child support.[2] But if the beneficiary finds himself or herself in some type of financial trouble, such as a loss of employment or business failure, the assets in trust are safe from that beneficiary's creditors.[3] Generally, these spendthrift trusts work well and are respected by the courts, again with few, if any, exceptions.[4]

One important qualification is that spendthrift protection is generally available only in the case of a third-party trust. A grandparent creates a trust for children and grandchildren. A husband creates a trust for a wife. A child creates a trust for a parent. All of these are universally acceptable as providing protection of the trust assets against claims against the trust beneficiaries. When a person creates an irrevocable trust and names himself or herself as a beneficiary, however, even if there are other beneficiaries, the trust becomes a self-settled trust.

Background on Sell-Settled Trusts

As mentioned above, a self-settled trust is one created for the benefit of the grantor. In some cases, it will be an irrevocable trust created by a person (the grantor), for that same person (as at least one beneficiary), with the hope and, perhaps, expectation that the assets of which generally will be protected from the grantor's creditors. A person-the grantor-creates the trust with another individual or corporation as the trustee. The grantor also is a beneficiary, generally with other family members. For example, a parent creates an irrevocable trust in which the parent, his or her spouse, and his or her children all are beneficiaries.

Under the common law, spendthrift protection was not available with respect to the creditors of the grantor-beneficiary in the case of a self-settled trust. In 1997, Alaska enacted ground-breaking legislation that extended spendthrift protection to self-settled trusts.[5] Today, approximately 18 states have enacted similar legislation. These states often are referred to as "DAPT states" or "DAPT jurisdictions."

Although the requirements in each of the DAPT states differ slightly, there are some general rules of thumb:

- The grantor's interest must be discretionary, meaning that he or she can have no right to income or principal.
- The trustee decides whether and, if so, when to distribute income and principal back to the grantor.
- The trust instrument should have the same spendthrift language discussed above.
- Almost universally, in order to be effective, the transfer to the trust cannot be a fraudulent conveyance, and the grantor cannot be insolvent when creating the trust; in addition, the transfer cannot render the grantor insolvent.[6]
- The grantor must not have a prearranged agreement with the trustee that he or she will receive distributions (no "wink-and-nod" agreement).[7]

The most obvious benefit of a self-settled trust is that the trust assets may be protected from the grantor's creditors in the event

2 See discussion in Roman, "Protecting Your Clients' Assets From Their Future Ex-Sons and Daughters-in-Law: The Impact of Evolving Laws on Alimony Awards," 39 ACTEC J. 157 (Spring/Fall 2013).

3 The U.S. has made itself a "super" creditor in some respects. See the discussion under "Stronger Asset Protection for Trust Beneficiaries" contained in Blattmachr, Chapman, Gans, and Shaftel, "New Alaska Law Will Enhance Nationwide Estate Planning-Part 1," 40 ETPL 3 (September 2013).

4 In New York, as a general rule, 90% of a distribution from a spendthrift trust is exempt from creditors. NY CPLR section 5205. Under an exception, creditors may be permitted greater access if it is shown that the distribution is not needed for the reasonable requirements of the beneficiary and his or her dependents. *Id.*

5 AS 34.40.110.

6 See Shaftel, ed., *Eleventh Annual ACTEC Comparison of the Domestic Asset Protection Trust Statutes Updated Through August 2017.*

7 See e.g., AS 34.40.110(i) (stating that "[a]n agreement or understanding, express or implied, between the settlor and the trustee that attempts to grant or permit the retention of greater rights or authority than is stated in the trust instrument is void").

the grantor runs into creditor issues. When structured properly, they work quite well.[8]

There are, however, some qualifications. As noted above, Bankruptcy Code section 548(e) imposes a ten-year lookback period if the trust was created to hinder, delay, or defraud a creditor. This makes it necessary to create the trust well in advance of any financial distress. In addition, as a matter of state law and bankruptcy law, fraudulent transfers to self-settled trusts generally will not be protected.[9] Further, states cannot assert exclusive jurisdiction over fraudulent transfer actions,[10] so creating a trust in one jurisdiction and funding it from assets located in another jurisdiction may expose the grantor to actions in the latter jurisdiction. Self-settled trusts can be "sticky" areas in divorce, as often both the grantor and the grantor's spouse are beneficiaries.[11]

Where a self-settled trust is entitled to spendthrift protection, it offers estate-planning advantages: The trust's assets can possibly be excluded from the grantor's gross estate even though the grantor has retained some access to the trust's assets. This makes a self-settled trust an attractive estate planning tool. Where, however, distributions to the grantor or other factors suggest that there was an implied understanding at the outset that the grantor would enjoy access to the trust's assets, the trust will not achieve its estate planning objective. In the case of such an understanding, the trust assets are included in the grantor's gross estate at the value on date of death.[12]

A gift to a self-settled trust effectively is an irrevocable gift with a built-in escape hatch. Although the grantor should not receive assets from the trust on a regular basis, the possibility of a future distribution eases the concern of "I don't want to give it away because I may need it." In essence, the property owner may give away the assets and thereby fix their value for estate tax purposes, but may later obtain access to them (of course, trustee discretion permitting).

While self-settled trusts may be excellent options for estate planning and creditor protection, the number of jurisdictions in which they can be used are limited. A person who wants to avail himself or herself of the benefits of a self-settled trust needs to create the trust in a DAPT state. Otherwise, in non-DAPT states where the common law prevails, spendthrift protection cannot be applied to a grantor's interest in his or her own irrevocable trust; the grantor's creditors can reach the maximum amount that can be distributed by the trustee to or for the grantor's benefit.[13] Some non-DAPT states simply rely on the common law; other non-DAPT states, such as New York, go further and have language expressly supporting the common law.[14]

Some clients have reservations about using self-settled trusts. Geography is one factor. Because most states are non-DAPT states and do not support the notion of self-settled trusts, creating one usually means that the grantor has to locate the trust in another state – a DAPT state. Each state has its own rules for determining what is a sufficient nexus to have a trust in that jurisdiction, such as designating a trustee with a place of business or residence in that state. Another factor is that some clients are concerned that, despite the existence of the self-settled trust in the DAPT state, their home states still may find a way to reach the assets.[15] Lastly, these trusts may seem to some just a little too "edgy." Although these trusts have been used as effective estate planning tools for years, they still are beyond the comfort zone for some. For all of these clients, there may be an alternative, which is the primary subject of this article.

What is a SPAT?

A SPAT is an alternative approach for clients who have reservations about using DAPTs. Under a SPAT, the grantor creates an irrevocable spendthrift trust for others and does not designate himself or herself as a beneficiary. The grantor gives one or more individuals who are not necessarily a beneficiary of the trust a special lifetime power of appointment. The power is held in a nonfiduciary capacity, and it permits the holder of the power to appoint trust assets to a class of individuals that includes the grantor (such as the descendants of grantor's mother). This special power provides an escape hatch: The powerholder can appoint the assets back to or for the benefit of the grantor.

The SPAT is not a self-settled trust. Because the grantor is not a beneficiary, the self-settled trust rule in common law jurisdictions under which the grantor's creditors can reach the trust's assets-is not applicable. Accordingly, there should be no need to use a DAPT state. Nonetheless, to the extent that there is concern that creditors could argue that a SPAT should be treated as if it were a self-settled trust (see below for discussion of this point), it would make sense to locate the trust in a DAPT state.

---

8 But see discussion in Blattmachr and Blattmachr, "Avoiding the Adverse Effects of Huber," 152 Trusts & Estates 7 (July 2013).

9 See generally Shaftel, *supra* note 6.

10 See Toni 1 Trust v. Wacker, 413 P.3d 1199 (Alaska 2018)).

11 See, e.g., Riechers v. Riechers. 267 A.D.2d 445 (N.Y 2nd Dept. 1999).

12 See. e.g., Ltr. Rul. 200944002 (not precedent under Section 6110(k)); also see Paxton. 86 TC 785; also for a full discussion, see Portfolio 810-3rd: Asset Protection Planning, Detailed Analysis, BNA Tax Management Portfolios.

13 Restatement (Third) of Trusts § 60. Comment *f;* Restatement {Third} of Trusts § 58. Paragraph 2; UTC § 505(2).

14 New York EPTL 7-3.1(a) ("A disposition in trust for the use of the creator is void as against the existing or subsequent creditors of the creator.").

15 Cf. In Re Huber, 201 B.R. 685 (Bkrptcy DC WA 2013)

Where a grantor resides in a common law state and creates a trust in a DAPT state, there is a risk that courts in the grantor's home state might conclude that spendthrift protection in the case of a self-settled trust offends its strong public policy, and as a result, refuse to respect the DAPT state's legislation.[16] The likelihood that a court in a common law state would find the DAPT legislation in violation of its strong public policy could well be diminished if the grantor uses a SPAT instead of a DAPT.

Options for Structuring the Trust

The trust should be irrevocable and designed for the grantor's tax and nontax goals, as with any trust. The usual considerations regarding selecting beneficiaries, trustees, and dispositive provisions play pretty much the same as for any irrevocable trust. With that said, there are some specific provisions to include or exclude depending on several attributes of the trust.

Should the trust be a grantor trust or a nongrantor trust? If the primary goal is estate tax minimization, then creating a grantor trust provides the opportunity for additional tax-free gifting. If grantor trust status is not optimal, such as if the grantor's cash flow would make the payment of tax burdensome, or if the grantor lives in a high-tax state and plans to settle the trust in a jurisdiction with no or a low state income tax, then grantor trust status should be avoided.

> *"If the primary goal is estate tax minimization, then creating a grantor trust provides the opportunity for additional tax-free gifting."*

If grantor trust status is not desired, then special care in the drafting is necessary to avoid inadvertently triggering the grantor trust rules.[17] A power of appointment that can revest trust assets in the grantor that is exercisable by a non-adverse party, without the approval or consent of an adverse party, results in the grantor being treated as the owner of those trust assets for income tax purposes.[18] In addition, the grantor is treated as the owner (for income tax purposes) of any part of the income of the trust that can be distributed back to the grantor without the approval or consent of an adverse party or accumulated for future distribution to the grantor.[19] Consequently, if grantor trust status is not desired, the powerholder needs to be an adverse party, or the consent of an adverse party needs to be necessary before distributions are made to or for the grantor.[20]

Alternatively, if there are multiple powerholders, then at least one of them, whose consent is required to exercise the power, must be an adverse party. If the grantor retained a reversionary interest in the trust, then the trust would be a grantor trust;[21] however, a special powerholder's ability to appoint assets to the transferor, with the consent of an adverse party, does not appear to be a reversionary interest.[22]

If grantor trust status is desired, then the grantor has numerous options. He or she can appoint a non-adverse party as the special powerholder, as discussed above, who can exercise the power without the consent of an adverse party. The grantor also can retain the ability to substitute assets of equivalent value property,[23] or include a variety of provisions that are addressed in the grantor trust rules.[24] Creating grantor trust status is easy. Avoiding it takes much more thought, as explained above.

Should the gift to the trust be complete or incomplete? For the grantor who wants to fix the value of their assets for transfer tax purposes, that grantor will need to make sure that the assets conveyed to the trust will not be included in his or her gross estate-which requires a completed gift. If the purpose of the trust, on the other hand, is solely to achieve creditor protection, then the grantor may not want to complete the gift. A gift is complete when the grantor has parted with dominion and control and, therefore, has no ability to change its disposition.[25]

Traditional irrevocable trusts created for a grantor's descendants or spouse, with no ability to receive the assets back, either via a trustee's discretionary distribution (such as for a DAPT) or through the exercise of a special power of appointment (such as for a SPAT), generally are completed gifts.

16 See In Re Huber, *supra* note 15.
17 See Akers, Blattmachr, and Boyle, "Creating Intentional Grantor Trusts," 44 Real Property, Trust and Estate Law J. 207 (Summer 2009).
18 Reg. 1.676(a)-1.
19 Sections 677(a)(1) and (2).
20 Section 672(a). Section 672 provides a definition of adverse party.
21 Section 673.
22 See Blattmachr and Lipkind, "Fundamentals of DING Type Trusts: No Gift Not a Grantor Trust," 26 Probate Practice Reporter 1 (April 2014).
23 Section 675(4)(C).
24 Sections 671 through 679.
25 Reg. 25.2511-2(b); see also Zeydel, "When Is a Gift to a Trust Complete: Did CCA 201208026 Get it Right?," 117 J. Tax'n 142 (September 2012).

If the grantor wishes the transfer to be an incomplete gift, then he or she should retain a special lifetime power of appointment and/or a power to veto distributions proposed by the trustee and a testamentary power of appointment. The gift is incomplete, because the grantor retains the power to change the ultimate disposition of the assets.[26] If the grantor changes his or her mind after the trust is created, he or she can relinquish the power and complete the gift.[27]

Structuring the Power of Appointment – By Whom and To Whom?

There are various ways to structure the power of appointment. The two most significant aspects of the power are the identity of the powerholder and the class of permissible appointees. Each aspect is discussed in turn.

There are two choices for the identity of the powerholder: a beneficiary or a nonbeneficiary. As explained above, if the grantor wants to avoid grantor trust status, at least one powerholder needs to be an adverse party (or must be able to exercise the power only with the consent of one), which means someone with a "significant beneficial interest" whose interest would be adversely affected by the exercise of the power. If the grantor does not care about triggering grantor trust status, or intentionally desires grantor trust status, then the powerholder need not be adverse and need not require the consent of an adverse party to exercise the power. There are some concerns about appointing a beneficiary as a powerholder (other than the grantor trust issue). An exercise of the power by the beneficiary-powerholder could be treated as a taxable gift by the powerholder, which may be viewed as an adverse consequence. In Estate of Regester,[28] the U.S. Tax Court held that a beneficiary with a mandatory income interest and discretionary principal interest in a trust, who also had a special lifetime power of appointment, made a gift of her income interest when she exercised her power in favor of a trust for her grandchildren. The court focused on the powerholder's mandatory income interest, not her discretionary interest in the principal. One interpretation is that the powerholder makes a gift only if the powerholder has a mandatory right to the income or principal of the trust; a more conservative interpretation is that there definitely is a gift with a mandatory interest, but a gift still may be the result even with a discretionary interest.

> *"It may be wise to provide that the powerholder needs the consent of some nonadverse party such as a partner in the law firm that has represented the grantor."*

The class of permissible appointees must consist of individuals or entities in addition to the grantor. There would be nothing to stop the powerholder from exercising the power to direct the assets away from the grantor. On the other hand, the powerholder could be given the power only to appoint the property to or for the grantor, although this might be used as evidence that there was an understanding with the grantor and powerholder that the latter had agreed to benefit the former.

The appointment of multiple powerholders may solve the concerns raised above. If grantor trust status is not desired, then one should be an adverse party (a beneficiary with a "substantial beneficial interest"), and any exercise should be made either unanimously or by majority but with the adverse party's consent. If grantor trust is desired, then the powerholders do not have to be adverse parties (as noted above, there are other ways to make a trust a grantor trust). Having the power exercised by one or more persons who are not beneficiaries, however, without the need for the beneficiary's agreement, means that the power can be exercised without triggering a gift by the beneficiary. The "team" approach also gives the grantor a little more comfort that one rogue powerholder could not exercise the power in a manner that harms the grantor.

The class of permissible appointees can be defined in various ways. The ability to appoint to "any person or entity" generally would include the grantor. To narrow the choices and at least assure that assets remain in the family, the class can consist of the descendants of the grantor's parents or grandparents. If, in reality, the grantor is the only descendant, then the power might be viewed more as a distribution provision than a power. There likely are numerous more ways to create the class, but the drafter must be careful to include the grantor and probably others. As the power is a special power, the drafter also must be sure to exclude the powerholder, his or her creditors or estate, and creditors of his or her estate, from the list of permissible appointees, as being able to distribute to any of those means the powerholder will have a general power of appointment for estate and gift tax and, perhaps, state creditor rights purposes.[29]

26 Reg. 25.2511-2(b)

27 Reg. 25.2511-2(f).

28 83 TC 1 (1984).

29 See Sections 2041 and 2514; New York EPTL 10-7.2.

Advantages of a SPAT

The trust, as drafted, is not a self-settled trust. The grantor is not a beneficiary, only one of, perhaps, numerous potential appointees under a power of appointment held in a nonfiduciary capacity. A beneficiary is a person for whose benefit property is held in trust.[30] To be a beneficiary, the grantor must manifest an intention to give the person a beneficial interest; merely benefiting incidentally from the performance of the trust does not render a person a beneficiary.[31] The trust, therefore, is afforded the same treatment as any ordinary irrevocable trust, of which the grantor is not a beneficiary.

The trust provides asset protection both for the grantor and the beneficiaries. As long as the trust contains the spendthrift language, then the beneficiaries' creditors cannot reach the assets as long as they remain in the trust. Neither can the grantor's creditors reach the assets. The trust retains all of the protections of any ordinary spendthrift trust.

The transaction can be structured as a completed gift, so the grantor uses his or her applicable lifetime exclusion, or to the extent already used, pays gift tax on the value of the assets transferred. Again, from this standpoint, the trust and the transfer to the trust is no different than any other ordinary irrevocable trust. The assets should be excluded from the grantor's gross estate at death, as the grantor presumably will have retained no rights or powers under Section 2036 or 2038.[32] Of course, if the special power is exercised to distribute the assets outright to the grantor, then the assets will be included in his or her gross estate for federal estate tax purposes.

The trust can be structured as a grantor trust or nongrantor trust. If structured as a grantor trust, and the grantor wishes to turn off grantor trust status, then he or she can relinquish whatever powers render it a grantor trust. These options give the grantor significant flexibility.

One careful consideration is ensuring there always will be someone who holds the special power that can be exercised in the grantor's favor. Default powerholders might include siblings or cousins, for example, but allow the trustee to strip the power from any person who succeeds to the power. Also, it may be wise to provide that the powerholder needs the consent of some nonadverse party such as a partner in the law firm that has represented the grantor.

Potential Disadvantages of a SPAT Arrangement

The IRS could argue that there was an implied or express understanding at the time of the trust creation that the powerholder would exercise the power in favor of the grantor. This, of course, would have the negative consequence of triggering Section 2036, and therefore thwart any estate tax planning objective.[33]

The grantor's creditors might argue that the SPAT should be treated as if it were a self-settled trust. The grantor's defense would be that there is a significant distinction between the two: Whereas the trustee in the case of a DAPT is under a fiduciary duty, the powerholder in the case of a SPAT is not. For example, in *Iannotti v. Commissioner of New York State Dept. of Health*,[34] a trust protector had the power to amend the trust and thereby make the grantor a beneficiary. Based on this power, the court ruled that the grantor's creditors could reach the trust's assets. Note, however, that the trust protector was subject to a fiduciary duty.

If the special powerholder does indeed appoint the assets back to the grantor, and the transfer was a completed gift, then the grantor's exclusion would have been wasted and the assets would be back in his or her estate. In addition, if asset protection was the goal, then that purpose will have been thwarted because the assets would then be available to the grantor's creditors. It may be anticipated that the escape hatch would be used only if the grantor actually needed the assets that is, he or she would spend the money; alternatively, someone to whom the assets are distributed would acquire assets for the use of the grantor. The SPAT trust should really be viewed as a means of last resort for the grantor as is a DAPT. If the special powerholder appoints the assets to a trust for the grantor, instead of outright, then the resulting trust might be considered a self-settled trust, which is what the grantor presumably wanted to avoid in the first place. As a matter of common law, the special powerholder is not treated as owning the trust property and is not treated as the transferor but merely as the agent of the original transferor (i.e., the grantor of the original trust).[35] The law seems uncertain on whether the trust created by the exercise for the benefit of the grantor of the power over the trust which the grantor created is treated as self-settled for creditor purposes.

---

30 Restatement (Third) of Trusts § 3(4).

31 Restatement (Third) of Trusts§ 48. See, e.g., Fla. Statutes§ 736.0103(4) ("An interest as a permissible appointee of a power of appointment, held by a person in a capacity other than that of a trustee, is not a beneficial inter est.... ").

32 See Rev. Rul. 2004-64, 2004-2 CB 7.

33 See Ur. Rul. 9141027 (not precedent).

34 283 A.D.2d 645, 725 N.Y.S.2d 866 (2001).

35 See discussion in Self, 135 Ct. Cl. 371, 142 F. Supp. 929 (1956), also cited in Estate of Regester, 83 TC 1 (1984)

The special powerholder needs to beware of triggering the Delaware Tax Trap. If the holder exercises the power to create another power that may postpone vesting or suspend absolute ownership for a period not ascertainable without reference to the date that the trust was created, then the assets will be subject to estate tax in the powerholder's estate or cause the powerholder to be deemed to have made a gift.[36] The trust can avoid this result by limiting the exercise so that any creation of another power cannot trigger the Trap. Then again, some practitioners intentionally trigger the Trap to use the otherwise unused gift or estate exemption of the powerholder or to obtain a change in tax basis under Section 1014, in which case the trust should not include such limiting language, but the powerholder needs to be aware of the issue.[37]

Lastly, there always is a chance that the special powerholder could exercise the power in favor of someone else in a manner not really intended by the grantor. For example, if the power permits the appointment of any descendants of the grantor's grandparents, the powerholder may exercise the power in favor of the grantor's sibling or cousin, much to the grantor's dismay, although the power could be made exercisable only with the consent of a third party, such as the grantor's legal counsel, as mentioned above.

An Analogy to ING Trusts

For years, practitioners have assisted clients in the creation of incomplete nongrantor trusts, created in asset jurisdictions such as Alaska, Delaware, and Nevada.[38] The purpose of these "ING" trusts generally is to attempt to avoid state income tax on assets held in trust, which otherwise would be taxed to the grantor who lives in a locale with state income tax. There are several analogies that exist between ING trusts and SPATs.

One of the key ingredients to ING trusts is the existence of a "distribution committee," or "power of appointment committee," which is a group consisting of at least two individuals other than the grantor to whom the committee may direct the trustee to make distributions. In these trusts, the trustee has no discretion to distribute income or principal during the grantor's lifetime. Instead, distributions by the trustee are made only at the unanimous direction of the distribution committee or with the grantor and one other member of the distribution committee. The distribution committee can direct distributions to its own members. The members of the distribution committee act in a nonfiduciary capacity.

Although there is no "special power" or language that the distribution committee cannot appoint to themselves, the predominant theory is that the members of the distribution committee do not possess a general power of appointment, and that the decision to direct the trustee to make distributions was not a gift for federal gift tax purposes by any of them. If a person has a power of appointment that is exercisable only in conjunction with the creator of the power, then that power is not a general power of appointment.[39] Because there is no general power of appointment, there is no gift by a member of the distribution committee incurred by exercising the power of a committee member.

The role of the distribution committee in ING trusts is similar to the role of the special powerholder SPATs. The special powerholder holds the power in a nonfiduciary capacity. The difference is that the distribution committee members can cause distributions to themselves. In contrast, the SPAT powerholder cannot exercise the power in favor of himself or herself.

The ING trust generally is structured as an incomplete gift for federal gift tax purposes. There are two powers of an ING trust that, when combined, give comfort that the gift to the trust is incomplete:

1. The grantor retains a testamentary special power of appointment.
2. The lifetime distribution power that is held by the grantor together with a member of the distribution committee.[40]

As discussed above, like an ING trust, the grantor of a SPAT can render the transfer to the trust an incomplete gift by retaining a special testamentary power of appointment. Unlike an ING, in which the grantor, by joining with a member of the distribution committee, can direct distributions, the grantor does not have any ability to affect the special power.

Each of the private letter rulings "approving" ING trusts involved trusts established in DAPT jurisdictions. The reason is that a trust is a grantor trust if the trust assets are subject to the claims of the grantor's creditors. Although, as expressed earlier, a SPAT should not be subject to the claims of the grantor's creditors as it is not a self-settled trust (as no trustee holds the discretionary to make distributions to or for the grantor), it makes sense to consider creating any SPAT in a DAPT jurisdiction.

---

36 Sections 2041(a)(3) and 2514(d).

37 See discussion in Blattmachr and Rivlin, "Searching for Basis in Estate Planning: Less Tax for Heirs," 41 ETPL 3 (August 2014).

38 See Blattmachr and Lipkind, *supra* note 22.

39 Section 2514(c)(3)(A); also see Blattmachr and Lipkind, *supra* note 22.

40 *Id.* (citing Estate of Sanford, 308 U.S. 39 (1939)).

Generation-Skipping Transfer Issues

Assuming the transfer to the SPAT is structured as a completed gift, generation-skipping transfer (GST) tax exemption probably should not be allocated to this type of trust. If the special power is exercised in favor of the grantor, then the GST exemption allocated to the trust is wasted.

> *"Assuming the transfer to the SPAT is structured as a completed gift, generation skipping transfer (GST) tax exemption probably should not be allocated to this type of trust."*

Special care should be taken not to trigger the automatic GST allocation rules under Section 2632. If the trust would qualify as a GST trust under Section 2632(c)(3)(B), then the grantor needs to opt out of automatic allocation of the GST exemption on his or her federal gift tax return, as permitted under Section 2632(6)(3). Moreover, if the Delaware Tax Trap accidentally is triggered (despite the warning above), then the powerholder becomes the new transferor for GST purposes and the grantor's GST exemption is wasted.[41]

Conclusion

The SPAT essentially is a more conservative version of a self-settled trust. As such, it offers much of the benefits of self-settled trusts. The SPAT is a potential solution for grantors who want to take advantage of the temporary increase in applicable exclusion, but do not have so much wealth that they are certain they will never need the assets again. The SPAT seems to create more asset protection for the grantor than a mere a self-settled trust.

41 See Portfolio 825-4th Powers of Appointment-Estate, Gift, and Income Tax Considerations, BNA Tax Management Portfolios.

Talk to a Trust Expert

Have a question about an advanced planning technique? Ready to talk to a Fiduciary Officer? Our seasoned experts are just a phone call away.

(888) 544-6775 expert@peaktrust.com

Copyright 2024 © Abigail E. O'Connor, Mitchell M. Gans, and Jonathan G. Blattmachr. *Reproduction in any form or forwarding to any person prohibited – without express permission. This article is designed to provide accurate and authoritative information regarding the subject matter covered. It is provided with the understanding that* ***Peak Trust Company cannot provide legal advice*** *and this material should not be construed as such. Jurisdiction-specific law should be discussed with appropriately skilled legal counsel. The differences discussed here are general statements and do not cover the many complexities of the subject. Each state frequently proposes and pass updates and clarifications to their respective statutes and regulations.* ***Please consult legal counsel and official state sources for the most up-to-date information on jurisdiction-specific law.*** *Peak Trust Company makes no guarantees as to the completeness or relevance of these statements. Statements of fact or opinion are the responsibility of the authors and do not represent an opinion on the part of the officers or staff of Peak Trust Company.*

Peak Trust Company serves as trustee of trusts nationwide, specializing in administration for trusts pursuant to Alaska and Nevada law. "Peak Trust Company" is the brand for a group of affiliated state chartered professional trust companies headquartered in Anchorage, Alaska. Separate state charters are maintained for operations in Alaska and Nevada as Peak Trust Company-AK and Peak Trust Company-NV. More information about Peak Trust Company, including our services, investment strategies, fees and objectives, are available upon request by calling (888) 544-6775, or visiting www.PeakTrust.com.