CBS | BROKERAGE

Wealth Structuring:

Intentionally Defective Grantor Trust

500 Marschall Road, Suite 200, Shakopee, MN 55379

www.cbsbrokerage.net

763.450.1870

Intentionally Defective Grantor Trust (IDGT)

What

An irrevocable trust that removes ownership and estate taxation of the assets placed in the trust from the estate of the grantor, yet the grantor maintains all income tax liabilities.

Why

The trust enables the grantor to avoid using up lifetime exemption by way of gifts, by selling assets to the trust for a note. In doing so, the grantor limits the future value of the asset to the value of the note and all future appreciation is accrued in the trust where it will eventually be subject to capital gains tax at a much lower rate than had the assets remained in the estate and subject to estate taxes. Lastly, the sale of the asset to the trust is a nontaxable and nonreportable event.

How

- Irrevocable trust is established with powers that cause it to be “intentionally defective” for income tax purposes, such that all income tax liability belongs to the grantor of the trust rather than the trust itself.

- Initial assets are gifted to the trust.

- Additional future assets may be gifted, loaned or sold to the trust to leverage the initial gift. For example, a gift of $100,000 can allow the purchase of up to $1,000,000 of assets from the grantor’s estate in exchange for a note paying as little as 24 to 95 basis points of interest a year on a 3 to 9 year installment note. To the extent the assets sold grow faster than the interest rate used, the difference escapes gift and estate taxation within the trust.

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Additional Advantages

- ***Right to Swap Assets:*** The power to substitute or reacquire assets in a nonfiduciary capacity by exchanging assets of equivalent value.

- ***Right to Add Beneficiaries:*** to the trust agreement after inception, except for children born or adopted afterward, without the consent or approval of an adverse party (i.e., any person having a substantial beneficial interest in the trust, which would be adversely affected by the exercise of a power).

- ***Asset Protection:*** certain provisions in the trust called spend thrift provisions would provide protection from creditors that otherwise would not be possible had the gifts been made in the name of children outright. Creditors might be able to attach to income or distributions paid from the trust in a judgment, but could not force distributions, which would protect the assets in trust until a suitable settlement was arranged.

- ***Spousal lifetime access:*** the assets placed in trust need not be for the children alone. The trust could be designed as a family trust where by a spouse (current or future) could be a permissible or even primary beneficiary during their lifetime. This would enable flexibility such that the grantor could make a gift, but know that it's enjoyment could be fulfilled by his or her spouse, which might indirectly benefit the grantor.

- ***Flexibility to change income taxation:*** The very powers that cause income taxation to the grantor can be surrendered by the grantor and taxation would then accrue to the beneficiaries. In addition, powers can be inserted to allow the trust to reimburse the grantor for income taxes paid by the grantor.

Disadvantages

- ***Loss in step up in basis at death:*** Assets that are includable in the gross estate at death and possibly subject to estate taxation do receive a step up in basis that assets outside of the estate do not receive, because they are not subject to possible estate taxation.

- ***Some on going administration:*** professional guidance will occasionally be required to operate the trust in accordance with it's intent and to actualize it's advantages.

Implementation

Grantor:

Step 1: Initial gift, usually of income producing business shares, to trust from grantor to provide economic substance to the trust.

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STEP 2: Sale of income producing business shares in exchange for a note from the trust

Shares

Notes

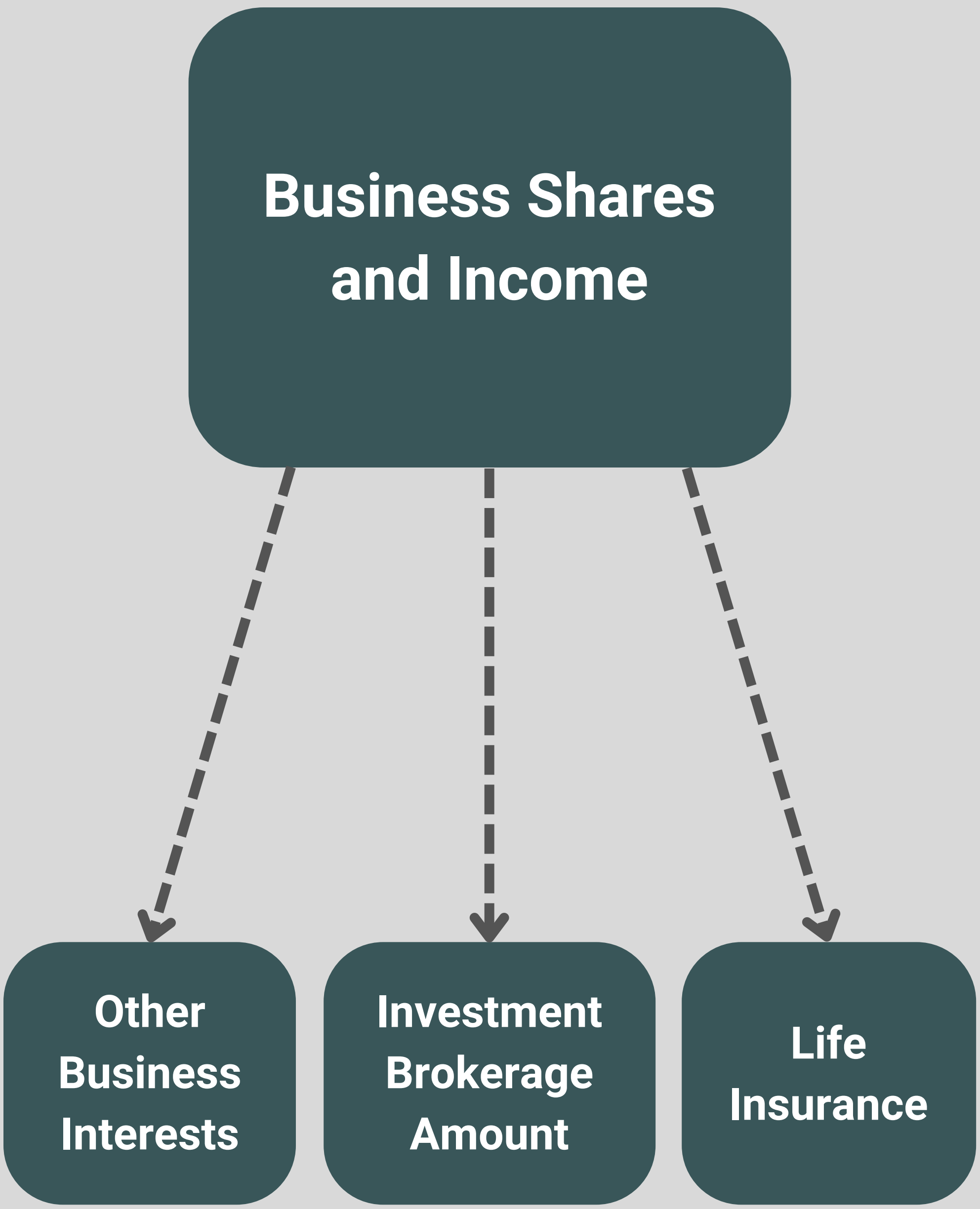
Spousal lifetime Access Provisions for noncontributory Spouse4

During lifetime or at death discretionary Income to spouse, children, charities or others.

Other Permissible Beneficiaries: Children, Charities, & Others

Trust Management

Intentionally Defective Grantor Trust (IDGT):



Trust Income- Business Income is owned by the trust and held in a trust checking account.

Trust Assets- Trustee can use funds in the trust to apply towards life insurance premiums, brokerage account, the business purposes or make distributions to beneficiaries depending on the powers and discretion given in the trust agreement.

Taxes- The Trust applies for its own tax ID number though the income taxes flow through to the Grantors tax return. The Grantor should have the power to stop being responsible for income taxes if he or she surrenders the powers that made the trust income taxable to him or her. The trust or trust beneficiaries would then be responsible.

Sample Note Design using excess Income & returns in trust to fund life insurance

Summary:
This page is meant to demonstrate what could be achieved through an installment sale of stocks worth $5,000,000 to an Irrevocable trust in exchange for a 9 year note with an IRS mandated interest rate of .93%.

In this example, a $10,000,000 survivorship universal life insurance product is purchased. The annual premiums are $107, 175.

The premiums are paid for by the excess returns, between 7 and 2.5% in the examples at the bottom, of the equity returns inside the Irrevocable Trust that owns the life insurance and Equities purchased from the grantor.

In years where there were no positive returns premiums could be gifted to the trust and use some available lifetime exemption.

	Assumptions	
	7% Rate of Return	**2.5% Rate of Return**
New Survivorship Death Benefit	$10,000,000	$10,000,000
Annual Premium	$107,175	$107,175
Sale of Stock to Trust	$5,000,000	$5,000,000
Interest Rate on Interest only annual payments	0.93%	0.93%
Annual Interest	$46,500	$46,500
Assumed Rate of Return on Loan in Trust	7%	3.1%
Amount of Annual Return less Interest Due on Installment Sale Note	$303,500	$108,500
Less Annual Premium on New Life Insurance	$107,175	$107,175
Excess Earnings	$196,325	$1,325