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## REVOCABLE, IRREVOCABLE, & SHORT TERM TRUSTS

DON W. LEWELLYN

You all know that before you can really learn anything about estate planning, you must know everything about Federal and state death taxes, Federal and state gift taxes, and Federal and state income taxes. My assignment includes the presentation of a broad overview of the tax provisions relating to revocable, irrevocable, and short term trusts so that during the remainder of the program a more detailed analysis can be made of the selected specific subjects. In addition, I will specifically discuss the use of trusts as a tax planning implement.

Once the tax and trust law parameters are established, the use of trusts in estate planning is limited only by the imagination of the planner. Two fundamental principles focus the tax planning aspects with respect to trusts:

1. Taxes should be avoided, where that can be accomplished without substantially altering the settlor's objectives for the disposition and administration of his property; and
2. Where the tax system contains a graduated tax rate, the spreading of the taxable fund among several entities will reduce the tax impact.

### *Revocable Trusts*

Traditionally, we have thought of the revocable trust as one which can be terminated by the settlor thereby causing the trust corpus to be returned to the settlor. No tax benefits result from the creation of such a trust. A revocable trust is not a separate income tax entity.<sup>1</sup> The income from the trust must be included in the gross income of the settlor, and, upon the settlor's death, the corpus of the trust is included in the settlor's gross estate for Federal estate tax purposes.<sup>2</sup> Virginia inheritance tax will be imposed on the corpus of such a trust on the death of the settlor,<sup>3</sup> and no gift tax is imposed as a result of the trust's creation because the settlor has not given up dominion or control of the trust assets.<sup>4</sup>

In what important respects is the situation changed if the trust is amendable and revocable by:

1. The settlor only with another who does not have a substantial adverse interest?<sup>5</sup> There is no change. The trust is not a separate income tax entity and the income is taxable to the settlor.<sup>4a</sup> The

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<sup>1</sup> Int. Rev. Code of 1954 § 676.

<sup>2</sup> Int. Rev. Code of 1954 § 2038.

<sup>3</sup> Va. Code § 58-152 (2).

<sup>4</sup> Treas. Reg. § 25.2511 (1954).

<sup>4a</sup> Int. Rev. Code of 1954 § 676.

- transfer is not considered complete for gift tax purposes.<sup>5</sup> The trust corpus is includable in the gross estate of the settlor at death.<sup>6</sup>
2. The settlor only with another who does have a substantial adverse interest? Some change results. The trust is a separate income tax entity and the income is taxable to the trust.<sup>7</sup> The transfer is complete for gift purposes.<sup>8</sup> The trust corpus is includable in the gross estate of the settlor at his death.<sup>9</sup>
  3. By another alone, not adverse? Again, some change results. The trust is not a separate income tax entity and the income is taxable to the settlor.<sup>10</sup> The transfer is complete for gift purposes.<sup>11</sup> The corpus of the trust is not includable in the gross estate of the settlor at his death.<sup>12</sup>
  4. By the settlor, but on revocation the property must go to someone other than the settlor? There is no change. The trust is not a separate income tax entity and the income is taxable to the settlor.<sup>13</sup> The transfer is not complete for gift tax purposes.<sup>14</sup> The corpus of the trust is includable in the gross estate of the settlor at his death.<sup>15</sup>

Certain general conclusions can be reached from the results set forth above:

1. For income tax purposes, powers held by someone other than the settlor can cause the income of the trust to be taxed to the settlor.
2. On the other hand, powers held by another alone will not result in adverse estate tax consequences, and will not prevent a gift from being complete for gift tax purposes.
3. Any power held by the settlor is for income and gift tax purposes nullified if it can be exercised only in conjunction with an adverse party.
4. On the other hand, a power exercisable in conjunction with anyone including an adverse party will result in the inclusion of the trust corpus in the gross estate of the settlor at death.
5. Not only a power to regain the property, but rather any power to affect the beneficial enjoyment of the property will result in

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<sup>5</sup> Treas. Reg. § 25.2511 (1954).

<sup>6</sup> Int. Rev. Code of 1954 § 2038.

<sup>7</sup> Int. Rev. Code of 1954 § 676.

<sup>8</sup> Treas. Reg. 25.2511-2 (e) (1954).

<sup>9</sup> *Helvering v. City Bank Farmers Trust Co.*, 296 U.S. 85 (1935); Treas. Reg. 20.2038-1 (a) (3) 1954.

<sup>10</sup> Int. Rev. Code of 1954 § 676.

<sup>11</sup> W. Warren and S. Surry, *Federal Estate and Gift Tax* 406 (1961); Treas. Reg. § 25.2511-2 (1954).

<sup>12</sup> W. Warren and S. Surry, *Federal Estate and Gift Tax* 406 (1961); Int. Rev. Code of 1954 §§ 2036, 2038.

<sup>13</sup> Int. Rev. Code of 1954 § 674.

<sup>14</sup> Treas. Reg. 25.2511-2 (c) (1954).

<sup>15</sup> Treas. Reg. 20.2038-1 (a) (3) (1954).

adverse tax consequences to the settlor. This last concept will be discussed later in connection with the treatment of irrevocable trusts.

### *Reasons for the Creation of a Revocable Trust*

The nontax benefits and detriments of a revocable trust should be examined with respect to the period prior to the death of the settlor and the period following the death of the settlor.

The primary lifetime benefit is the creation of an arrangement to administer, preserve, and maintain property which will not be affected by the incompetency of the settlor. Assume you have a client who is growing older and approaching senility, what alternatives are there for the creation of an arrangement to administer his or her property? 1. A proceeding for the appointment of a guardian may be instituted, an alternative not only unpleasant but probably premature. 2. An agency or power of attorney may be created but in many states such a power is terminated on the incompetency of the client. In Virginia, a specific provision may be inserted in the instrument creating the power which will permit its continuation beyond incompetency.<sup>16</sup> In spite of this statutory provision permitting continuation of the power, however, the revocable trust seems superior from an administrative standpoint simply because the trustee has legal title to the property. Of course, if the settlor is incompetent at the time of the transfer to the trust it is void. However, the chances of such a contention being raised are remote enough to make the revocable trust a good risk.

Other benefits mentioned frequently for the creation of a revocable trust, such as the training of the trustee under the supervision of the settlor seem inconsequential when considered in light of the gravity of such a step.

The lifetime detriments to the creation of a revocable trust include:

1. Legal fees and expenses are incurred in the creation of such a trust. However, these expenses are income tax deductions for the settlor.<sup>17</sup> The income from the trust is taxable to the settlor so the expenses for the management, conservation, and maintenance of this income producing property are proper deductions. If the trust is not funded, an unfunded insurance trust, for example, the expenses of creation are not deductible except to the extent connected with tax determination advice and counsel.<sup>18</sup>
2. Trustees' and legal fees incurred during administration cause additional expense but are also deductible by the settlor for income tax purposes.

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<sup>16</sup> Code of Virginia § 11-9.1.

<sup>17</sup> See Casner, *Estate Planning* 121.

<sup>18</sup> Int. Rev. Code of 1954 § 212 (3).

3. If corporate stock is transferred to the trust, that corporation cannot make a subchapter S election.<sup>19</sup>
4. A more serious detriment is the imposition of a double tax on the income, especially where the trust situs is in one state and the beneficiary resides in another. If the state in which the trust was located had a conformity statute such as that in Virginia, the revocable trust would not be a taxable entity.<sup>20</sup> Even where the state in which the trust had its situs did not have a conformity statute, if the beneficiary resided in the same state, some form of corresponding inclusion and deduction scheme similar to the federal system of taxing irrevocable trusts would probably operate to prevent double taxation of the same income. The most precarious situation with respect to the imposition of double or multiple state income taxation would arise where more than one state would consider the trust as having its situs in that state. For example, the Virginia income tax law defines a "resident trust" *inter alia* as a trust created by a "Virginia settlor."<sup>21</sup>

At least in traditional thinking, the primary benefit for the creation of a revocable trust is that on the death of the settlor the corpus of the trust will not be a part of the probate estate. It is an understatement to say that the advantages of avoiding inclusion in the probate estate are grossly overemphasized. The detriments in probate most frequently mentioned, delay in appointment of an administrator or personal representative,<sup>22</sup> delay in distribution,<sup>23</sup> and the public exposure of the decedent's assets and his dispositive plan<sup>24</sup> are, in my opinion, trivial. The revocable trust may serve as a vehicle for the removal of assets not merely from the probate estate, but from the reach of creditors or the surviving spouse.<sup>25</sup> A former professor of mine, Professor Charles Lyons of the New York University Law School, once said that some people, having acquired a working knowledge of the tax law, feel entitled to *guess* at the law in other fields. I did not adopt that position when I began preparing my comments on the Virginia law relating to the surviving spouse's right to reach under the forced share provisions, the assets of a revocable trust on the death of the settlor. But by the

<sup>19</sup> Int. Rev. Code of 1954 § 1371 (a) (2).

<sup>20</sup> The definition of Virginia Taxable Income starts with the concept of Federal Taxable Income; Code of Va. § 58-151.022.

<sup>21</sup> Code of Virginia § 58-151.02 (f) (iii).

<sup>22</sup> Delay may take place in a state like New York but there is no significant delay in Virginia.

<sup>23</sup> Casner, *Estate Planning*, 123 (Supp. 1973) n.36; The personal liability of the trustee of a revocable trust with respect to a Federal Estate Tax is not as severe as it is for the Executor. Thus the trustee will probably be more willing to make an early distribution of property.

<sup>24</sup> Trust assets do not become a matter of public record. Estate assets and the scheme of disposition are placed on the public records.

<sup>25</sup> See *Norris v. Barbour* 188 Va. 723, 51 S. E. 2d 334 (1949).

time I finished my modest research, I determined that one could only guess.

Unlike many states, Virginia does not have a statute which covers the question of the spouse's right to assets removed from the probate estate by a transfer which has a testamentary flavor.<sup>26</sup> Therefore, since little case law exists, it remains an open question. Although the court states explicitly that only an irrevocable transfer can put property beyond the reach of the surviving spouse, when the opinions are examined in detail, the court seems to be concerned only with the question of whether the transfer was real or illusory. A revocable trust, even where the income is retained by the settlor, is neither illusory or testamentary.

Even where it is regarded as a real advantage, achieving probate avoidance through a revocable trust must be compared with other methods of avoiding probate. The most commonly used "will substitute" is a joint tenancy with right of survivorship. The joint tenancy causes a considerable amount of tax planning problems. The proper funding of a marital deduction bequest may be impossible where the gross estate consists of a substantial amount of property held as tenants by the entirety. In addition, difficult proof problems exist in establishing the contributions made by each spouse for the acquisition of the property.<sup>27</sup> Also, multiple gift tax is imposed where the tenancy is terminated. This imposition of a tax on the termination of the joint tenancy may be avoided by an equal division of the funds.

However, with respect to a tenancy by the entirety, only a division of the funds in accordance with the values fixed by the life expectancy tables will be free from gift tax.<sup>28</sup> No gift tax will be imposed on the creation of a tenancy by the entirety in real property unless the grantor elects to treat the transfer as a gift.<sup>28a</sup> Such an election should not be exercised unless it is expected that the property will substantially appreciate in value, the tenancy will be terminated prior to the death of either tenant, and the proceeds will not be divided proportionally with the contributions. The estate tax consequences are not altered by the exercise of the election to treat the transfer as a taxable gift.<sup>29</sup> It should be noted that in Virginia a tenancy by the entirety in residential realty has the added advantage that a maximum of only one half of the value of the property will be subject to inheritance tax.<sup>29a</sup> The minimum value will depend on the decedent's spouse's contribution for the property. On the other hand, the full value of the revocable trust corpus

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<sup>26</sup> The Uniform Probate Code and many states place assets of this nature in an augmented estate and the surviving spouse may reach such assets and must account for any asset of this nature received from the decedent spouse.

<sup>27</sup> Int. Rev. Code of 1954 § 2040.

<sup>28</sup> Treas. Reg. § 25.2515-2(b) (1954).

<sup>28a</sup> Int. Rev. Code of 1954 § 2515.

<sup>29</sup> Int. Rev. Code of 1954 § 2040.

<sup>29a</sup> Code of Virginia § 58-153.

will be subject to Virginia inheritance tax on the death of the settlor.<sup>30</sup>

Although the assets of the revocable trust are not probate assets, the value of the assets is included in the gross estate, and the administration expenses incurred in administering those assets are deductible for Federal estate tax purposes.<sup>31</sup> It should be noted that the expenses of administering property not subject to claims of the estate are deductible only if paid before the expiration of the period for the assessment of the tax.<sup>32</sup> In Virginia, which has no statutory provisions covering the rights of creditors of the settlor in a revocable trust and little, if any, case law, a revocable trust would probably be treated as a retained power of appointment and be free from the rights of creditors except where an income interest is also retained by the settlor. Under such circumstances, the creditors can reach the property subject to general power of appointment only on death and only if the other assets are not sufficient to satisfy their claims. The deductible expenses would include termination fees for trustees and lawyers where those fees were occasioned by the death of the settlor. Where the trust does not terminate on the death of the settlor, a difficult determination must be made in finding the point where the expenses cease being attributable to the death of the settlor and become attributable to the beneficiaries. It should be noted that where the administration expenses exceed the assets subject to claims, the excess must be paid by the filing date for the estate tax return.<sup>33</sup> Section 642(g) of the Internal Revenue Code prohibits a deduction for trust income tax purposes of such expenses unless a waiver of the estate tax deduction is filed. The executor, not the trustee, probably makes the choice.<sup>34</sup>

Section 303 of the Code permits the redemption of stock forming a major part of the gross estate to be treated as a sale or exchange, without compliance with Section 302. The value of the stock redeemed under Section 303 cannot exceed the amount of death taxes, administration expenses and funeral expenses, but no requirement exists that the stock included in the gross estate be subject to the claims of creditors.<sup>35</sup> Therefore, stock forming a part of the corpus of a trust revocable at the settlor's death is eligible for capital gains treatment under Section 303. Where eligible stock is present both in the probate estate and in the trust corpus, Section 303 treatment will be available on a "first come, first serve" basis.

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<sup>30</sup> Code of Virginia § 58-152 (2).

<sup>31</sup> Int. Rev. Code of 1954 § 2053 (a).

<sup>32</sup> Int. Rev. Code of 1954 § 2053 (b).

<sup>33</sup> Int. Rev. Code of 1954 § 2053 (c) (2).

<sup>34</sup> The executor would be the only one who could waive the estate tax deduction.

<sup>35</sup> Int. Rev. Code of 1954 § 303 applies only where the stock included in the gross estate is either more than 35% of the value of the gross estate or more than 50% of the taxable estate. Qualification under section 302 which requires at least a disproportionate loss of control as a result of the redemption is quite difficult especially because of the application of the § 318 attribution rules.

The recent history of steady depreciation in stock values has greatly increased the importance of the alternate valuation date. The alternate valuation date is fixed at six months from the date of death or at the time of disposition or distribution of the assets.<sup>36</sup> Property held in a revocable trust is deemed distributed on the first of the following to occur: (1) the entry of a decree of distribution if it becomes final, (2) the segregation of assets so that the assets become subject to the unqualified demands of a beneficiary, or (3) the actual payment of the property to a beneficiary.<sup>37</sup> A distribution includes separation of the trust fund into two or more funds as a result of the death of the settlor even where the same trustee administers all funds. It does not include a separation into shares in the same trust fund.<sup>38</sup> The Virginia inheritance tax now contains an alternate valuation date provision which conforms to the Federal estate tax provision.<sup>39</sup>

*The Revocable Trust As a Receptacle for the Payment of Insurance Proceeds and Pension Funds*

The receipt of the face amount of insurance on the death of the insured does not constitute gross income for income tax purposes.<sup>40</sup> The face amount of insurance will be included in the gross estate for estate tax purposes where the decedent had any incidence of ownership of the insurance at his death including a reversionary interest which immediately before his death exceeded 5% of the value of the policy.<sup>41</sup> The face amount of the insurance will also be included where the proceeds are paid to the insured's estate.<sup>42</sup>

Payment of the proceeds to a trust revocable by the insured at the time of his death will not alter the estate tax treatment of the proceeds. It might be argued that the insured's control of the trust at death constitutes a reversionary interest in the insurance and, thus, insurance payable to such a trust would be included in the gross estate even where the insured had no incidence of ownership in the policy. However, the reversionary interest, immediately before the death of the insured, must exceed 5% of the value of the policy. The power in one other than the insured (the owner of the policy) to cash surrender the policy would keep the value of the reversionary interest under 5%.<sup>43</sup>

If the trustee is required by the terms of the trust to pay from the insurance proceeds obligations of the estate the proceeds will be included

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<sup>36</sup> Int. Rev. Code of 1954 § 2032.

<sup>37</sup> Rev. Rul. 57-495, 1957-2 C.B. 616.

<sup>38</sup> Rev. Rul. 56-688, 1956-2 C.B. 889; as modified by Rev. Rul. 73-971 RB 1973-8, 10.

<sup>39</sup> Code of Virginia § 58-155.

<sup>40</sup> Int. Rev. Code of 1954 § 101.

<sup>41</sup> Int. Rev. Code of 1954 § 2042.

<sup>42</sup> *Id.*

<sup>43</sup> Treas. Reg. 20.2042-1 (c) (2).

in the gross estate.<sup>44</sup> Where the trustee merely has the authority to use the insurance proceeds for the payment of such expenses, the insurance proceeds will not be considered to be received by the executor.<sup>45</sup> Virginia inheritance taxes can be avoided so long as a designated beneficiary, including a testamentary trust, other than the estate is the recipient of the insurance proceeds.<sup>46</sup>

It is advisable to have the insurance proceeds paid to a trust rather than having the proceeds retained by the insurance company in accordance with one of the insurance options. None of the insurance options permit the flexibility available under a trust. However, a tax consideration which favors the use of an insurance option is the annual exclusion from income of \$1,000 of interest on the proceeds where the proceeds are payable in installments to a spouse.<sup>47</sup>

All employee death benefits in excess of \$5,000 which are attributable to employer contributions excluded from gross income under the qualified pension or profit sharing provisions will be included in the gross income of the recipient.<sup>48</sup> The income will be characterized as capital gain income if it is attributable to contributions made prior to 1974— or ordinary income if it is attributable to contributions made after 1974.<sup>49</sup>

Section 2039(c) of the Code excludes from the gross estate any fund forming a part of a pension or profit sharing plan received by any beneficiary, other than the executor, on the death of the employee. Payment of such a fund to a revocable trust will not cause the fund to be included in the gross estate unless the trustee is required to apply such a fund to the payment of obligations of the estate. The Virginia inheritance tax provisions specifically exclude pension and profit sharing funds where the Federal estate tax grants an exclusion.<sup>50</sup>

### *The Irrevocable Trust*

The irrevocable trust can be used to alter the tax consequences to the settlor. Income and death taxes can be reduced but it must be emphasized that irrevocability in the trust sense alone will not insure the exclusion of the trust corpus from the gross estate. Obviously if the settlor retains a beneficial interest in the income, the income of the trust will be included in his gross income even where the income is not distributed but accumulated for his benefit.<sup>51</sup> Also, the corpus of the trust and any

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<sup>44</sup> Casner, Estate Planning 128 *et seq.*

<sup>45</sup> *Id.*

<sup>46</sup> Virginia Statutes Ch. 524, effective June 28, 1968.

<sup>47</sup> Int. Rev. Code of 1954 § 101 (d) (1) (B).

<sup>48</sup> Int. Rev. Code of 1954 § 402 (a).

<sup>49</sup> Int. Rev. Code of 1954 § 402 (a) (5).

<sup>50</sup> Code of Virginia § 58-153.

<sup>51</sup> Int. Rev. Code of 1954 § 677.

accumulated income will be included in his gross estate on his death.<sup>52</sup> The tax impact in the areas that fall between virtually total retention of power or immediate enjoyment by the settlor and complete divestment by the settlor of all influence, interest or control depends on the application of very precise statutory provisions and case law. However, the tax consequences can be predicted.

Assume the settlor will live for three years following the transfer of property to the trust and thereby avoid the estate tax contemplation of death presumption.<sup>53</sup> Also assume the settlor is willing to give up all beneficial enjoyment of the trust property. Under these circumstances what control can be retained by the settlor without jeopardizing the separate income tax status of the trust or causing the value of the trust assets to be included in the gross estate? The settlor's control would have to be restricted to a power to distribute corpus to a designated beneficiary in accordance with an ascertainable standard. The retention of any additional control over the beneficial enjoyment of the income or any additional control over the corpus will result in the loss of one tax benefit or another.<sup>54</sup>

Unfortunately there is no correlation between the estate tax provisions and the grantor income tax provisions with respect to the standards used to determine severance of ownership or control by the settlor. A third standard is involved in determining when a transfer is beyond the dominion of the settlor and thus subject to a gift tax.

The lack of correlation between the three taxes can be illustrated best by an analysis of the tax treatment of four rather routine transfers to a trust. Examples:<sup>55</sup>

- (1) A transfers to T, an unrelated party, 20 shares of stock to hold in trust and pay the income to B, A's son, until he reaches age 35, then to pay the corpus to B. A retains the power to instruct the trustee to pay any part or all the corpus to B before reaching age 35. Note that A's retained power is merely the power to accelerate B's vested interest. This mere power to affect the time of enjoyment of an interest already vested does not prevent a gift from being complete.<sup>56</sup> Nor does it cause the settlor to be taxed on the trust income.<sup>57</sup> On the other hand, the entire value of the corpus and probably the entire value of the income interest as well will be included in the gross estate of A if he dies before

<sup>52</sup> Int. Rev. Code of 1954 § 2036.

<sup>53</sup> Int. Rev. Code of 1954 § 2035.

<sup>54</sup> Int. Rev. Code of 1954 §§ 674-677; §§ 2036, 2038.

<sup>55</sup> Llewellyn, *Estate and Gift Tax Reform: Inter Vivos Transfers with a Testamentary Flavor*, 13 *William and Mary L. Rev.* 553.

<sup>56</sup> Treas. Reg. § 25.2511-2(d) (1954). "A gift is not considered incomplete, however, merely because the donor reserves the power to change the manner or time of enjoyment. . . ."

<sup>57</sup> See Int. Rev. Code of 1954, § 674(b) (5) (B); Treas. Reg. § 1.674(b)-1(b) (5) (ii) (1956).

B reaches 35, without having executed or relinquished the power.<sup>58</sup>

- (2) A transfers 10 shares of stock to himself and his adult son B in trust for B for life, remainder to D, the nephew of B and grandson of A. A retains the power, in conjunction with B, to invade corpus for the benefit of D. Since the power over the corpus retained by A can only be exercised in conjunction with B, an adverse party, the gift is complete<sup>59</sup> and in addition A will not be taxed on the trust income.<sup>60</sup> On the other hand, if A predeceases B, the entire value of the property will be included in A's gross estate.<sup>61</sup>
- (3) A declares himself trustee of 20 shares of stock for B, for life, then to D and E. A retained the power as trustee to pay during the life of B the income or any portion thereof to D and E if required for educational purposes. Since the power to distribute income to D and E is held in a fiduciary capacity and subject to an ascertainable standard, the gift of income and corpus is complete<sup>62</sup> and no portion of the property will be included in the grantor's gross estate.<sup>63</sup> On the other hand, the power to control the disposition of income, even if limited by an ascertainable standard, will cause the income to be taxable to the grantor unless the power is exercisable by a trustee other than the grantor or his spouse.<sup>64</sup>
- (4) A transfers 20 shares of stock to W, his wife, in trust, the income to be distributed by W among B, C, or D, as she may determine, the remainder to E. There is no attempt under either estate or gift taxation to impute to the grantor powers held by another, no matter how subservient to the grantor that other party may be.<sup>65</sup> On the other hand, the grantor trust income tax provisions do impute to the grantor, in varying degrees, powers held by another depending on the relationship of the holder and the extent of the power.<sup>66</sup> Of course, in this case the power held by the

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<sup>58</sup> *Lober v. United States*, 346 U.S. 335 (1953); Treas. Reg. § 20.2038-1(a) (3) (1954).

<sup>59</sup> *Camp v. Comm'r*, 195 F.2d 999 (1st Cir. 1950); Treas. Reg. § 25.2511-2(e) (1954).

<sup>60</sup> Treas. Reg. § 1.672(a)-1 (c) (1956) clearly indicates that B is an adverse party and Int. Rev. Code of 1954 § 674(a) excepts powers held in conjunction with an adverse party.

<sup>61</sup> *Helvering v. City Bank Farmers Trust Co.*, 206 U.S. 85 (1935); Treas. Reg. § 20.2038-1(a) (3) (1954).

<sup>62</sup> Treas. Reg. § 25.2511-1(c) (1954). See *Jennings v. Smith*, 161 F.2d 74 (2d Cir. 1947).

<sup>63</sup> *Jennings v. Smith*, 161 F.2d 74 (2d Cir. 1947).

<sup>64</sup> See Int. Rev. Code of 1954 § 674.

<sup>65</sup> *W. Warren & S. Surry*, Federal Estate and Gift Tax 406 (1961); Int. Rev. Code of 1954 §§ 2036, 2038; Treas. Reg. § 25.2511-2 (1954).

<sup>66</sup> Int. Rev. Code of 1954 §§ 672-76.

spouse causes the grantor to be taxed on the income of the trust.<sup>67</sup>

### *Short Term Trust*

The so-called short term trust is a trust which suspends the grantor's beneficial enjoyment or control for a certain minimum period of time and thereby permits the trust to be treated as a separate income tax entity for the period of suspension. The minimum period of suspension is 10 years and begins with the transfer of the property to the trust.<sup>68</sup>

Where the trust is amended to provide an extension of the suspension period, separate income entity status during the extended period is determined not by the extension period but rather by the duration of the period beginning with the date of the amendment and ending with the termination of the extension period.<sup>69</sup> Where additional property is transferred to the trust the income from such property will be taxable to the settlor unless the settlor's beneficial interest or control is suspended with respect to that property for the minimum period determined from the date of the transfer of that property to the date fixed for termination of the suspension period.

An alternative minimum period of suspension is the lifetime of the income beneficiary.<sup>70</sup> If a measuring life of one other than the income beneficiary is used as the suspension period, that life expectancy must have a duration of at least 10 years.<sup>71</sup>

The short term trust is used in estate planning as an income shifting device. The income is shifted from the gross income of the settlor to the trust.

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<sup>67</sup> Int. Rev. Code of 1954 § 674.

<sup>68</sup> Int. Rev. Code of 1954, § 673.

<sup>69</sup> Treas. Reg. § 1.673(d)-1.

<sup>70</sup> Int. Rev. Code of 1954 § 673(c).

<sup>71</sup> Treas. Reg. § 1.673(a)-1(c).

