

ESTATE PLANNING FOR THE ELDERLY: USE OF THE SHORT TERM TRUST

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American law provides a variety of mechanisms to assist the elderly. Special legislation provides particular income tax benefits, including double personal exemption deductions,¹ the retirement income credit,² and benefits for the elderly person who sells his residence.³ Legislation also provides income tax benefits in the area of pension planning.⁴ If an elderly person is sufficiently fortunate to have a younger relative or friend who is concerned about his welfare, he may also become the beneficiary of a short term trust. The advantages of a short term trust for both the grantor and beneficiary are sufficient to prompt an exploration of the opportunities available in the establishment of such a trust. Accordingly, this Article seeks to examine briefly the short term trust as a vehicle for estate planning. Particular emphasis is placed on the tax consequences and benefits which are inher-

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1. The taxpayer is entitled to claim an additional exemption of \$750 if he or his spouse has attained the age of 65 before the close of his taxable year. INT. REV. CODE OF 1954, § 151(c); Treas. Reg. § 1.151-1(c) (1975).

2. The retirement income credit is designed to give those who have retirement income, but do not receive tax exempt social security or similar types of tax-exempt benefit payments, a tax exemption approximately equal to that received by social security beneficiaries. The calculation of the credit involves a substantial degree of mathematical complexity. INT. REV. CODE OF 1954, § 37; Treas. Reg. §§ 1.37-1 to -5 (1975).

3. An individual who is 65 or older may exclude from gross income any capital gain attributable to the first \$20,000 of the price realized on a sale of his personal residence, so long as the property has been owned and used by the taxpayer as his principal residence for at least 5 years during the 8-year period preceding the sale. INT. REV. CODE OF 1954, § 121; Treas. Reg. §§ 1.121-1 to -5 (1975). Both husband and wife are treated as satisfying the age, ownership, and use requirements where one of them meets the requirements as to a residence which is jointly owned and provided they file a joint return. INT. REV. CODE OF 1954, § 121(d)(i); Treas. Reg. § 1.121-5(a) (1975).

4. The Employment Retirement Income Security Act of 1974, 29 U.S.C.A. §§ 1001-1381 (1975), enacted September 2, 1974, has thoroughly overhauled this entire

ent in such a trust and the various trust alternatives available to the estate planner advising a client interested in the short term trust.

TAX CONSEQUENCES

Income Tax Avoidance

The most important single characteristic of the short term trust is that it allows for the attribution of income to someone other than the grantor, provided the grantor is willing to relinquish control over property for a period in excess of 10 years. Basic to tax thinking in this connection is the United States Supreme Court case of *Helvering v. Clifford*.⁵ In *Clifford*, the trust fund was established to pay the income to the beneficiary for a period of only 5 years. The grantor named himself trustee and retained a large degree of administrative control over the trust fund. Finally, the beneficiary was closely related to the grantor, his wife. Under these circumstances, the Court ruled that the trust income was to be attributed to the grantor.

Clifford was decided in 1940, but it was not until 1946 that the so-called *Clifford* rules⁶ became effective. Under these rules, three factors could cause the income of a trust to be attributed to the grantor: (1) if the principal of the trust could reasonably be expected to revert to the grantor within a 10-year period, or 15 years if the beneficiary is not an exempt organization and the grantor or his spouse retained certain administrative powers; (2) if the grantor or any nonadverse person retained the power to control the beneficial enjoyment of the income or principal; or (3) if the grantor retained certain administrative controls exercisable for his benefit.

In 1954, these basic concepts, modified in some respects, became the basis for sections 671 through 678 of the Internal Revenue Code of 1954. For purposes of the short term trust, section 673 is the most significant. It specifies that the grantor may avoid income attribution only by relinquishing economic control over the trust property for a period in excess of 10 years. The codification of the *Clifford* rules was significant since it allowed the taxpayer to plan for a short term trust under the precise requirements of the Code, thereby obtaining some certainty that he would not be subjected to taxation.

In addition to relinquishing control over the trust property,⁷ the

5. 309 U.S. 331 (1940).

6. T.D. 5488, 1946-1 CUM. BULL. 19 (approved Dec. 29, 1945, effective for tax years beginning after Dec. 31, 1945).

7. Clearly, the wisest course of action for any settlor of a *Clifford* trust is to ensure that he retains no economic control, that he has no administrative powers capable of being exercised for his benefit, that the trust is fully irrevocable, and that it can in no way be construed to be for the benefit of himself or his spouse.

grantor must ensure that he complies with the time requirement of the Code. One important provision allows the grantor to use the life of the beneficiary as an alternative period for the duration of the trust.⁸ This is permissible even though the life expectancy of the beneficiary may be less than the minimum 10-year period.⁹

The practitioner must be scrupulous in delivering the assets to the trust, since the term of the trust is measured not from the date of the execution of the instrument, but from the date of the transfer to the trust.¹⁰ A sad, yet typical, story is that related in *C.O. Bibby*.¹¹ There, the trust instrument was executed by the grantors on September 3, 1957, but the farm property involved was not transferred to the trust until August 20, 1958. The trust was to last for "ten years and one day from the date of the execution hereof." According to the tax court: "Since the farm property was not properly deeded to the trust until August 20, 1958, the requirements of a valid *Clifford* trust have not been met because the property has been put in trust for less than 10 years."¹² The intention of the grantors to relinquish control of the property for the required period did not overcome the technical failure of the delivery. Thus, the attorney establishing a *Clifford* trust is cautioned to ensure that the 10-year time period runs from when the property is delivered in trust, not from the date of the execution of the trust instrument.

Capital Gains Consequences

One of the more important concerns of the draftsman creating a short term trust is the handling of capital gains. In the absence of any provision to the contrary, capital gains will be attributed to the grantor since they are considered part of the trust corpus.¹³ Unrealized capital gains inherent in the trust principal at the time of the transfer into trust will return to the grantor in their unrealized form upon the termination of the trust. Capital gains which are realized by the trust are normally taxed to the grantor as income held for distribution to him at a later date.¹⁴ Capital losses also accrue to the benefit of the grantor.¹⁵

The grantor may desire to avoid the immediate payment of taxes on gains which will remain unavailable to him until the termination of

8. INT. REV. CODE OF 1954, § 673(c).

9. Treas. Reg. § 1.673(a)-1(b) (1975).

10. INT. REV. CODE OF 1954, § 673(a).

11. 44 T.C. 638 (1965).

12. *Id.* at 647.

13. See 3 A. SCOTT, THE LAW OF TRUSTS § 233.1 (3d ed. 1967).

14. See INT. REV. CODE OF 1954, § 677(a)(2); Rev. Rul. 58-242, 1958-1 Cum. Bull. 251.

15. INT. REV. CODE OF 1954, § 671; see *Blanche Penn*, 39 B.T.A. 787, 792 (1939).

the trust. As a result, tax planners have tried various approaches to avoid this problem. One such method is to insert a provision in the trust instrument requiring the trustee to distribute to the grantor an amount of the principal necessary to pay the income tax attributable to the capital gain. This is dangerous since it involves revesting in the grantor a portion of the principal within the 10-year period, thereby making the trustee liable for the immediate tax consequences of the revestment.

Another approach is to allow the trustee to pay the grantor's tax on the capital gains, using as much principal as necessary to pay the tax. The danger of this approach is that the tax payment might constructively be deemed income to the grantor.¹⁶ Alternatively, the trust instrument can provide that the capital gains shall be allocated to the income beneficiary. This, however, presents a wholly different set of problems. First, the beneficiary will have to pay taxes on the gain, whether distributed to him at the time it is earned¹⁷ or accumulated and distributed at some later time as part of an accumulation distribution.¹⁸ Second, it can be argued that the amount of the gain constitutes a gift to the beneficiary¹⁹ and this may have tax consequences which adversely affect the grantor's overall estate plan. No wholly satisfactory method of overcoming the capital gain problem has been devised, and the safest course is for the grantor to accept the fact that capital gains will be attributed to him and to pay the tax on such gains from his own funds.

Gift Tax Considerations

Before establishing a short term trust, the planner must consider the effects of such a trust on the grantor's entire estate plan. The short term trust involves a gift of future income for which a gift tax, based on the present value of the future income, may be imposed on the grantor. It may thus be necessary for the estate planner to use a portion of the grantor's lifetime gift exemption or to pay the gift tax.²⁰

16. INT. REV. CODE OF 1954, § 677(a); Treas. Reg. § 1.677(a)-1(c) (1975); see *Old Colony Trust Co. v. Commissioner*, 279 U.S. 716 (1929).

17. INT. REV. CODE OF 1954, § 652. If the beneficiary is a minor child, however, up to \$850 is subject to tax exclusion. See *Money Saving Idea of the Week*, 56 P-H FED. TAXES RPT. BULL., at 60,566 (1975).

18. INT. REV. CODE OF 1954, § 662.

19. Treas. Reg. § 25.2512-3 (1975); see C.E. Weller, 38 T.C. 790 (1962).

20. In computing the present value of a gift of a future income, the Internal Revenue Service relies on an actuarial method operating on the present value of the income generating property transferred into trust. Since 1970, the gift tax law has provided actuarial tables based on a discount factor of 6 percent. Treas. Reg. § 25.2512-9(f), table B (1975). Under the present tables, the value of a 10-year income interest would be approximately 44 percent of the value of the trust property. For a 15-year trust, the corresponding figure would be 58 percent.

This optimum gift tax liability must be weighed against the income tax avoidance advantages offered by the short term trust. Involved in this balancing is a second major gift tax consideration. Normally, in any trust, if the beneficiary is someone other than a minor²¹ and if the trustee has the power to accumulate the income, the benefit of the annual \$3,000 gift tax exclusion must be foregone.²² This, of course, can be an important consideration, particularly where there are numerous beneficiaries.

One of the more desirable approaches to the gift tax problem is the so-called "net gift," which requires the trustee to pay the gift tax. At one time, the Commissioner argued that any time a taxpayer had someone pay his gift tax, he realized income, similar to the way that an employee would realize income if the employer paid his income tax.²³ This argument, however, is not pertinent in the area of gifts, where the question of compensation is not involved. Instead, by requiring the trustee to pay the gift tax, the grantor simply reduces the size of the gift and, accordingly, the amount of tax. Indeed, the Internal Revenue Service [IRS] has ruled that a reduction in the size of the gift, effected by having the trustee pay the gift tax, may in turn place the donor in a lower gift tax bracket.²⁴

For example, a single person may make a gift of future income presently worth \$150,000 and have the donee or trustee pay the tax, approximately \$15,800. Thus, there would be a net transfer of approximately \$134,200.²⁵ If husband and wife make the same transfer, using one exclusion each, plus their lifetime exemptions, they can lower their gift tax bracket so as to cause the total tax to be paid by the trustee or donee to be \$6,800, resulting in a net transfer of approximately \$143,200.²⁶ A caveat is in order, however. The net gift is viewed as a gift in part and a sale in part.²⁷ Thus, the planner must also consider the income tax consequences of the sale.²⁸

21. Cf. INT. REV. CODE OF 1954, § 2503(c) (allowing accumulations to some extent where the beneficiary is a minor).

22. *Id.* § 2503(b); Treas. Reg. § 25.2503-3(c), example (1) (1975).

23. See Estate of Kenneth W. Davis, 40 P-H TAX CT. REP. & MEM. DEC. ¶ 71,318 (1971), *aff'd per curiam*, 469 F.2d 694 (5th Cir. 1972).

24. Rev. Rul. 71-232, 1971-1 CUM. BULL. 275. *But see* Estate of Kenneth W. Davis, 40 P-H TAX CT. REP. & MEM. DEC. ¶ 71,318 (1971), *aff'd per curiam*, 469 F.2d 694 (5th Cir. 1972).

25. Rev. Rul. 71-232, example 1, 1971-1 CUM. BULL. 275.

26. *Id.*, example 2.

27. *Id.* at 277.

28. The calculation of the income tax consequences on such a bargain sale is not easy. If the transferor's basis in the property exceeds the amount of tax paid by the trustee or donee, the transferor would realize a nondeductible loss. In the last textual example, the donee or trustee's basis would be \$6,800 cost, plus that portion of the transferor's basis allocable to the fair market value of the net transfer, here, \$143,200. See INT. REV. CODE OF 1954, § 1015. This result assumes that the basis to the donee would be equal to the fair market value of the property at the time of transfer.

The principle that the value of the gift may be reduced where the trustee is obliged to pay the gift tax for the donor was first established by *Sarah Helen Harrison*.²⁹ Although the tax court allowed the introduction of parol evidence to establish the trustee's obligation, dictum in the case indicates that from the standpoint of estate planning, it is desirable for the trustee to be committed in writing to pay the tax. In *Pamela N.W. Lingo*,³⁰ the trust instrument provided that the trustee should pay, or refund to any person required to pay, any gift tax finally determined to be due from the grantor. This is the simplest and most desirable method for establishing, in writing, the trustee's obligation to pay the gift tax.

The cases dealing with net gifts are concerned with situations where the gross gift was an outright transfer of assets and not the typical short term trust involving a gift of income. Thus, the IRS will probably continue to attack short term trusts involving net gifts. The planner should be very careful, therefore, in creating such a trust. He should ensure that the trustee is not permitted to use income from the trust to pay the gift tax. In *Estate of Craig R. Sheaffer*,³¹ the trustee was given the discretion to pay the gift tax with trust income. The court concluded that, to this extent, the income from the trust was attributable to the grantor. Part of the draftsman's error in *Sheaffer* was his failure to make it clear that, as between grantor and donee, the grantor was relieved of any liability for the gift tax.

Estate Tax Consequences

Unlike the gift tax, the estate tax consequences for a short term trust are simple. Typically, the grantor will survive the term of the trust, and the property will then revert in him. At that time, he becomes a candidate for further estate planning. If, however, he should die while the trust is in existence, the value of his reversionary interest in the trust will be included in his gross estate.³²

The value includible in the decedent's estate will be the fair market value of his reversionary interest at the date of his death or at the later optional valuation date.³³ If the latter date is used, any change in value from the date of death due to mere passage of time will be ignored.³⁴ The actuarial tables adopted for 1971 and later tax years

29. 17 T.C. 1350 (1952).

30. 13 CCH TAX CT. MEM. 436 (1954).

31. 37 T.C. 99 (1961), *aff'd*, 313 F.2d 738 (8th Cir.), *cert. denied*, 375 U.S. 818 (1963).

32. INT. REV. CODE OF 1954, § 2033.

33. *See* Treas. Reg. § 20.2031-10 (1975).

34. INT. REV. CODE OF 1954, § 2032(a)(3).

have had the effect of reducing the value of the grantor's reversionary interest as of the time of establishing the short term trust. This value, of course, increases during the term of the trust with each passing year, ultimately becoming equal to the value of the property itself when it reverts to the grantor.³⁵

Effects of Tax Reform Act of 1969

As with most areas of tax law, the Tax Reform Act of 1969³⁶ wrought important changes in the law governing short term trusts. One important change was to place the grantor's spouse on the same footing as the grantor for purposes of the rules governing the income taxation of trusts where the grantor has retained substantial control.³⁷ Since 1948 and the adoption of income splitting via the joint return, however, the need for shifting income allocation between spouses has decreased in importance as an aspect of tax planning.

Another major change of the 1969 Act was the abolition of the 2-year minimum term for the short term trust in favor of a charitable beneficiary.³⁸ If one desires to transfer an income interest to a charity, he now must proceed in much the same fashion as he would if the beneficiary were a noncharity. Thus, the gift of income to a charity for a temporary period has become an estate planning device of limited utility.

CONSIDERATIONS IN THE USE OF THE SHORT TERM TRUST

The Grantor's Situation

Several considerations enter into determining who should create a short term trust. The ideal grantor should be a person who is able to part with the property which is to be the subject of the trust for the minimum 10-year period. This temporary relinquishment of property may not be feasible for one who needs capital to meet pressing business or personal needs. Conversely, if the grantor is very wealthy, the short term trust might be a poor substitute for more extensive estate planning whereby a greater measure of control, including any expectation of the property ultimately reverting, is relinquished. Such a grantor might find that it would be wiser to adopt a more conventional estate plan, including trusts for his children, an annual gift program to take advan-

35. Treas. Reg. § 20.2031-10 (1975).

36. Act of Dec. 30, 1969, Pub. L. No. 91-172, 83 Stat. 487, amending INT. REV. CODE OF 1954.

37. Act of Dec. 30, 1969, Pub. L. No. 91-172, § 332(a)(1), 83 Stat. 487, amending INT. REV. CODE OF 1954, § 677(a).

38. INT. REV. CODE OF 1954, § 201(c).

tage of the gift tax exclusions, and fully irrevocable trusts to reduce the estate tax burden. Finally, the ideal grantor is an individual between the ages of 45 and 60, since when the property reverts to him he will be in a much better position to make a definitive estate plan, including plans for the disposition of property at death and for the future effective utilization of the assets he accumulated during his lifetime.

The Problem of Support

Normally, the grantor will not be under a legal duty to support his chosen beneficiary.³⁹ In this respect, the short term trust will not acquire the characteristics that typify the support trust, sometimes established for the benefit of the grantor's wife or minor children. If the trust, by its terms, is a support trust, the income will be taxed to the grantor to the extent that it is in fact used to satisfy the legal obligation of support.⁴⁰ Out of an abundance of caution, some draftsmen sought to create what might be called a nonsupport trust, where the trust instrument specifically provides that the trust income is not to be used for support purposes.⁴¹ Such provisions are only necessary if support is in fact a questionable issue.

Selecting the Assets for the Short Term Trust

In determining what assets should be used to fund the short term trust, the planner will be presented with typical estate planning problems and considerations. A dividend-paying stock of a publicly held corporation or corporate bonds which pay regular interest constitute excellent property for such a trust since the beneficiary will receive a regular income, and since the value of the principal will remain relatively constant. A growth stock, on the other hand, would not be desirable for a short term trust since the beneficiary would receive limited income, and the grantor would be responsible for capital gains taxes. Rental

39. In some jurisdictions, however, one may come under a legal duty to support an elderly relative. See VA. CODE ANN. § 20-88 (Supp. 1975) (requiring one to "provide or assist in providing for the support and maintenance of his or her mother or father, he or she being then and there in necessitous circumstances").

40. INT. REV. CODE OF 1954, § 677(b). Such a trust will be included in the grantor's gross estate for federal estate tax purposes without regard to whether the income is in fact used for support. The test for includibility is whether the terms of the trust require the use of income for purposes of support. *Richards v. Commissioner*, 375 F.2d 997 (10th Cir. 1967); *Estate of Robert Manning McKeon*, 25 T.C. 697 (1956); INT. REV. CODE OF 1954, § 2036.

41. The concept of what constitutes support has been narrowly construed for purposes of the personal exemption deduction. "The term 'support' includes food, shelter, clothing, medical and dental care, education and the like." Treas. Reg. § 1.152-1(a)(2) (i) (1975). Support has been given a more general meaning for purposes of what constitutes a support trust, but draftsmen might be guided by the more specific definition in seeking to frame a nonsupport trust.

real estate may also be used to fund a short term trust. While the grantor normally loses the benefit of the depreciation deduction, it is available to the beneficiary.⁴² By careful drafting of the trust instrument, the planner can provide for the most effective allocation of the depreciation deduction as between the trust and the beneficiary.⁴³

Stock in a closely held company is sometimes used to fund a short term trust in order to avoid the penalty tax of section 531 of the Code for accumulation of earnings beyond the corporation's reasonable needs. The grantor funds the trust with a portion of the stock of the corporation and the corporation then pays a substantial dividend to avoid the penalty tax. The portion of the dividend received by the trust normally will be taxed at rates considerably below those of the grantor.

Where a short term trust is established for the benefit of a minor, life insurance may be a suitable corpus for the trust. The trustee purchases life insurance on the life of the child beneficiary. When the trust terminates, the investment in insurance for the child's benefit is converted to suit his needs and may become the basis for the child's own future estate plan. Life insurance is a less suitable trust investment where the beneficiary is an elderly person because of the high premiums and the possible uninsurability of the beneficiary. Normally, the income from a short term trust should not be used to purchase insurance on the life of the grantor or his spouse, since the attribution of the trust income to the grantor should be avoided.

Trust Leasebacks

Some planners have sought to combine the short term trust with a leaseback of the property which the grantor has placed in trust. In the case of an elderly beneficiary, if a leaseback is desired, it would be advisable not to attempt a short term trust, but to simply use a fully irrevocable trust for the benefit of the elderly person.⁴⁴ When the leaseback is combined with a fully irrevocable trust in which the grantor retains no economic control over the principal or the reversionary interest, the trust leaseback may well be an excellent estate planning vehicle. Where, however, the trust is a short term trust, the retention

42. INT. REV. CODE OF 1954, § 167(h).

43. *Id.*

44. On the death of the beneficiary, the property should then be passed to other members of the family, or possibly to a charity. If to a charity, it would be necessary to conform to the strict rules governing charitable remainder trusts which came into the Internal Revenue Code as part of the Tax Reform Act of 1969. See Wren, *Charitable Remainder Trusts: Some Considerations to Draftsmanship*, 8 U. RICHMOND L. REV. 25 (1973).

by the grantor of control over the principal or reversionary interest will undoubtedly lead the Commissioner to question the transaction, and there is a likelihood that the plan will fail.⁴⁵

In attacking these transactions, the Commissioner has relied on three major doctrines: (1) the requirement of a business purpose to ensure against the possibility of a sham transaction;⁴⁶ (2) the requirement that the grantor retain no equity interest in order to obtain a deduction for rent;⁴⁷ and (3) the requirement that the trustee not be subject to any sort of control by the grantor.⁴⁸ In the typical cases that have been litigated, two or three of these issues have been raised by the IRS. While it is still theoretically possible to establish a short term trust with an "independent" trustee, who would lease the transferred property back to the grantor, the dangers inherent in the transaction are so great that only the most cavalier would counsel a client to proceed in this direction.⁴⁹

Charities and the Elderly Beneficiary

Much of the estate planning involves satisfying the desires of the grantor to benefit both charities and an elderly relative. Generally, two types of trusts will be involved. The grantor may create either an in-

45. The Commissioner lists the short term trust leaseback arrangement on the Service's "National List of Prime Issues." See Internal Revenue Manual MT 1277-8, Nov. 19, 1974.

46. The famous business purpose doctrine of *Gregory v. Helvering*, 293 U.S. 465 (1936), has been generally equated with the requirement that the transaction be grounded in "economic reality." See, e.g., *Hall v. United States*, 208 F. Supp. 584, 586 (N.D.N.Y. 1962) ("economic reality, rather than the validity of the trust instrument, must be the basis upon which the right to the deduction exists"); *Irvin K. Furman*, 45 T.C. 360 (1966) (no economic reality where building conveyed to short term trust was leased back to grantor at a rent which was less than the mortgage payments on the building).

47. INT. REV. CODE OF 1954, § 162(a)(3), requires that in order to obtain a deduction for rent, a taxpayer must not have any equity. Arguably, the retention of a reversionary interest would constitute equity. See *Burroughs Corp.*, 33 T.C. 389 (1959) (to be deductible, rental must be for continued use or possession of property in which taxpayer has not taken or is not taking title or in which taxpayer has no equity). Despite this, the Commissioner has been only partially successful in his contention that the retention of a reversionary interest constitutes equity. Compare *Perry v. United States*, 376 F. Supp. 15 (D.N.C. 1974), *reversed*, 520 F.2d 235 (4th Cir. 1975), with *C. James Mathews*, 61 T.C. 12 (1973).

48. The taxpayer clearly cannot act as trustee. E.g., *Van Zandt v. Commissioner*, 341 F.2d 440 (5th Cir. 1965); *Failor v. United States*, 66-2 U.S. Tax Cas. ¶ 9766 (W.D. Wash. 1966); *Sidney W. Penn*, 51 T.C. 144 (1968). Similarly, the grantor's spouse is ineligible. *Chace v. United States*, 303 F. Supp. 513 (M.D. Fla. 1969), *aff'd per curiam*, 422 F.2d 292 (5th Cir. 1970) (wife and colleague, co-trustees); see *Irvin K. Furman*, 45 T.C. 360 (1966), *aff'd per curiam*, 381 F.2d 22 (5th Cir. 1967). But the courts have allowed a rental deduction in some cases where the true independence of the trustee may have been a matter of some question. E.g., *Brown v. Commissioner*, 180 F.2d 926 (3d Cir.), *cert. denied*, 340 U.S. 814 (1950) (grantor's attorney trustee); *Skemp v. Commissioner*, 168 F.2d 598 (7th Cir. 1948) (corporate fiduciary); *John T. Potter*, 27 T.C. 200 (1956) (wife, father, and accountant trustees; no reversionary interest retained).

49. Bad planning may put the grantor in a worse position than if he had done nothing.

come trust or a remainder trust. Several considerations enter the choice between the two.

Charitable income trusts may be of two types: those where the grantor relinquishes economic control of income generating property for a period in excess of 10 years, in much the same way as the short term trust, and those in which the grantor transfers the property for a lesser period. In either case, depending upon the other demands of the grantor's overall estate plan, the grantor may wish to leave the ultimate remainder interest to a private beneficiary, such as an elderly parent.

The principal advantage of the charitable income trust for a period in excess of 10 years is that it enables the grantor to give to charity more than 50 percent of his adjusted gross income, the maximum allowable under present law.⁵⁰ Under this trust, the grantor irrevocably transfers property for a term in excess of 10 years, with the proviso that the income shall be paid to the charity for the term of the trust. At the end of the trust period, the principal may be held in trust for a member of the grantor's family, or it may be distributed to him outright. These decisions, of course, will be based on the anticipated needs of the grantor at the time the trust is created.

It is important to note that in order for the grantor to avoid a gift tax, the interest must be in the form of a guaranteed annuity or a fixed percentage of the fair market value of the property and must be calculated and distributed annually.⁵¹ The grantor may not claim an income tax deduction for the charity's income interest,⁵² but he gains a substantial income tax advantage by having the annual payment to the charity excluded from his gross income.⁵³ By making this type of transfer, the donor may give away as much income as he wishes without regard to the 50 percent limitation, and he will be able to make other charitable gifts up to 50 percent of his adjusted gross income. If the grantor desires to avoid a gift tax on a remainder interest to a noncharitable beneficiary, he may do so by retaining a power of revocation exercisable only after the 10-year period.⁵⁴ He would then be in a position to alter

ing. By the time his tax position has been ascertained (for example, the denial of a deduction for rent), it may be too late to proceed on a different theory.

50. INT. REV. CODE OF 1954, § 170. It is beyond the scope of this Article to deal with the many complex problems of estate planning involving charities.

51. *Id.* § 2055(e)(2)(B).

52. *Id.* § 170(f)(2)(B).

53. Nondeductibility presupposes that the trust income is not income to the grantor. See *id.* §§ 170(f)(2)(B), 671.

54. The retention of the power of revocation would cause the transfer of the remainder interest to be an incompleting gift not subject to gift tax. *Id.* § 2511. The remainder interest would, however, be includible in the grantor's gross estate for purposes of the estate tax. *Id.* §§ 2036(a)(2), 2038.

the plan in the event of a change in his own needs or those of his beneficiary.

In the second type of charitable income trust, the property in trust is deliberately transferred for a period of less than 10 years. In that event, the grantor will be entitled to an immediate income tax deduction equal to the value of the commuted interest provided two conditions are met: (1) the charity's interest must either be in the form of a guaranteed annuity or a fixed percentage of the trust properly, distributed yearly, and (2) the trust income, though distributed to the charity, must be taxed to the grantor.⁵⁵ This type of plan, however, is of limited utility. Even though the grantor may be successful in obtaining an income tax deduction equal to the commuted value of the gift, the deduction will be limited to 20 percent of the taxpayer's adjusted gross income since the gift is for the use of the charity rather than an outright gift.⁵⁶

Overall, it appears that the use of the charitable trust in conjunction with an estate plan that seeks, through a remainder interest, to aid an elderly member of the family would hardly be productive. The grantor can gain far more by making outright gifts of property, rather than income, to the charity. In addition, when it is remembered that charitable trusts are subject to the strict rules governing private foundations,⁵⁷ as well as the prohibited transactions rule,⁵⁸ it may be concluded that few planners will find it desirable to take this approach.

In contrast to the charitable income trust, many planners may find it desirable to establish a charitable remainder trust in conjunction with the protection of an elderly member of the family. In such a trust, the property is typically transferred to the trustee to pay an annuity or fixed percentage of the trust's fair market value to the beneficiary during his life and at his death to distribute the principal to the charity.⁵⁹

It is beyond the scope of this Article to discuss the many advantages obtainable through the charitable remainder trust. It is sufficient here to note that much of the planning is similar to that done in connection with the short term trust where the planner seeks to provide for an elderly family member or friend. In the case of the short term trust, the grantor retains some interest by virtue of the fact that the property will return to him upon termination of the trust. The charitable remainder trust on the other hand provides for the beneficiary for a defi-

55. *Id.* § 170(f)(2)(B).

56. *Id.* § 170(f)(3).

57. *Id.* §§ 4941-4945.

58. *Id.* § 508(e).

59. *Cf. id.* § 664(d).

nite period of time and then passes the principal on to the favorite charity of the grantor or the beneficiary. The grantor may retain a measure of control over the trust corpus by a provision in the tax regulations which allows him a power of revocation exercisable by will.⁶⁰ Such a transfer would not be subject to gift tax,⁶¹ but it would be includible in the grantor's gross estate for purposes of the federal estate tax. It would be fully deductible, however.⁶² The transfer would also cause a "ballooning" of the grantor's adjusted gross estate, thereby increasing the size of the available marital deduction.⁶³

CONCLUSION

Elsewhere in this Symposium, the authors have addressed the human needs of the elderly. The short term trust provides a vehicle whereby one who is moderately wealthy can care for the material needs of an elderly person for a period of time without losing ultimate control over the trust assets. In return, the grantor receives some substantial tax advantages. The beneficiary, meanwhile, gains a degree of financial independence which can be quite significant insofar as his relationship with the younger generation is concerned. Most importantly, however, the short term trust helps eliminate some of the financial problems that can easily befall one of advanced years.

60. Treas. Reg. §§ 1.664-2(a)(4), -3(a)(4) (1975).

61. INT. REV. CODE OF 1954, § 2522(c)(2).

62. *Id.* § 2055(e)(2); Treas. Reg. § 20.2055-2(e)(2)(iv) (1975).

63. *See generally* Wren, *supra* note 44, at 36-40.