Structuring Trusts to Permit the Donor to Act as Trustee

Although a donor often wishes to be trustee of a trust to which he or she has contributed property, this can cause tax problems. This article analyzes when the donor may serve as trustee of a variety of commonly used trusts.

by LOUIS S. HARRISON, Attorney

With the continued growth in the number of taxable estates, the prevalence of making lifetime gifts has correspondingly increased. Although sophisticated giving techniques, such as transfers of discounted or leveraged business interests, are sometimes used, the most common types of inter vivos gifts involve annual exclusion gifts and taxable gifts using the unified credit to shield any actual gift tax payment. Further, gifts of interests in qualified personal residence trusts (QPRTs) and grantor retained annuity trusts (GRATs) have become more available since the enactment of Chapter 14. Annual exclusion and unified credit gifts, as well as gifts of interests in QPRTs and GRATs, share one common feature in that they are often made in trust for the benefit of one or more donees.

The decision to make gifts in trust raises the question of whom to select as trustee. The most conservative route and the one usually advocated is to name a third party as trustee—someone other than the donor or the donor's spouse. Frequently, however, that choice for trustee is not palatable to the client. In many instances, the client wishes to be trustee of gift assets to maintain decision-making authority over the investment and distribution of the assets.

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Estate tax concerns when donor is trustee

Even when the donor retains no equitable interest in a trust he created and funded, Sections 2036(a)(2) and 2038 pose statutory obstacles to the donor acting as trustee. Section 2036(a)(2) provides that the gross estate includes property previously given by a decedent over which the decedent retained at death the right to "designate" the persons who will possess or enjoy the gift property or receive the income from the property. Section 2038 states that if the enjoyment of the transferred property was subject to change through a right to "alter" or "amend" held by the decedent at death, the gift property is included in the decedent's estate.

The right of a donor to act as trustee over the transferred property may invoke these provisions. Under Section 2036(a)(2), certain authority of a trustee is arguably tantamount to a right to "designate" who will enjoy the trust property. Under Section 2038, those powers may equate to "altering" a beneficiary's interests. For example, Reg. 20.2036-1(b)(3) indicates that the "right to designate" includes a reserved power to designate the persons "to receive the income from the transferred property, or to possess or enjoy nonincome-producing property." The Regulation implies that certain powers as trustee equal that right.

Reg. 20.2038-1(a) is more express in the dangers of a donor acting as trustee: "[S]ection 2038 is applicable to a power reserved by the grantor of a trust to accumulate income or distribute it to A, and to distribute corpus to A, **even though the remainder is vested in A or his estate.**" (Emphasis added.)

Moreover, there is a line of cases holding that a donor who, as trustee over gift property, has discretion to accumulate income or to distribute principal to the beneficiary has a Section 2036(a)(2) and Section 2038 power. For example, in the Supreme Court case of *O'Malley,*[1] the donor as co-trustee had the power to accumulate income in a trust. The court held that "[t]his is a significant power ... and of sufficient substance to be deemed the power to 'designate.'" Other cases stand for the same proposition.[2] The reasoning of these cases is that the right as trustee to determine whether and when a beneficiary is to receive property is tantamount to "designating" the beneficiary who will receive the property.

As a result of these cases, plus IRS Rulings on the issue,[3] practitioners tend to recommend that a donor not act as a trustee of a trust holding gift property. Nevertheless, where the donor insists on serving as trustee, the exceptions to the application of Sections 2036(a)(2) and 2038 should be understood and a permissible format developed.

Trusts designed to avoid the application of Sections 2036(a)(2) and 2038. The Regulations provide no explicit exceptions to the rule invoking Sections 2036(a)(2) and 2038 if the donor acts as trustee over the gift property. But there is a line of cases creating an exception to the application of those sections if the grantor can act only pursuant to an ascertainable distribution standard in the trust instrument.

A leading case is *Jennings v. Smith.*[4] There, the trust income could be distributed as "reasonably necessary to enable the beneficiary in question to maintain himself and his family . . . in comfort and in accordance with the station in life to which he belongs." Principal could be invaded for extraordinary medical expenses, financial misfortune, or the purchase of a home. The court ruled that neither Section 2036(a)(2) nor Section 2038 applied because the trustees did not have "unlimited discretion to act or withhold action under the power, since the trust instrument provided an external standard which a court of equity would apply to compel compliance by the trustees...." The court required only that the distribution power be "sufficiently definite to be capable of determination by a court of equity."

Other cases also stand for the proposition that Sections 2036(a)(2) and 2038 can be avoided if the trustee must act pursuant to an ascertainable distribution standard.[5] These cases all reason that an ascertainable standard is one that is enforceable under state law, thereby allowing a court to delineate the specific purposes for which funds are to be used. The unstated premise is that the trustee does not, in essence, have discretionary power as to distributions but only the right to carry out the terms of the trust according to specific conditions. Consequently, the donor-trustee has not retained any Section 2036(a)(2) or 2038 power to designate, alter, or

1 383 U.S. 627, 17 AFTR2d 1393, 66-1 USTC ¶12,388 (S.Ct., 1966).

2 See also Estate of O'Connor, 54 TC 969 (1970); Estate of Alexander, 81 TC 757 (1983); Old Colony Trust Co., 423 F.2d 601, 25 AFTR2d 70-1549, 70-1 USTC ¶12,667 (CA-1, 1970); and Estate of Yawkey, 12 TC 1164 (1949).

3 Rev. Rul. 70-513, 1970-2 CB 194; Rev. Rul. 73-143, 1973-1 CB 407; Rev. Rul. 57-366, 1957-2 CB 618.

4 161 F.2d 74, 35 AFTR 1203, 47-1 USTC ¶10,551 (CA-2, 1947).

5 See also Estate of Budd, 49 TC 468 (1968); Estate of Wilson, 187 F.2d 145, 40 AFTR 265, 51-1 USTC ¶10,795 (CA-3, 1951); Estate of Wier, 17 TC 409 (1951); Estate of Pardee, 49 TC 140 (1967).

amend the enjoyment of the transferred property. These judicial decisions emphasize the ability of a beneficiary to have a state court compel the distribution. Hence, in structuring these trusts, the following rules should be followed.

1. The trust instrument should provide that the trustee "shall" make the distributions pursuant to the specific standards. The use of the permissible language, "may," though implicitly allowed by the *Jennings* court, arguably removes a court's ability to compel distribution even pursuant to ascertainable standards.[6]

2. Unascertainable standards should be avoided. Discretion to distribute funds for a beneficiary's "comfort," "welfare," or "happiness" are not ascertainable, and a court cannot construe the trustee's authority.[7] The same result applies to distribution standards for a beneficiary's "benefit" or "best interest" or "if the circumstances so require."[8] Standards limited to "support, education or maintenance," "care, support and medical attention," "support in reasonable comfort," or "education," or "in the event of sickness, accident, misfortune or other emergency," have been held to be ascertainable[9] and are therefore exceptions to the application of Sections 2036(a)(2) and 2038.

3. Unlike Section 2041, the ascertainable

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6 See Bogert, *The Law of Trusts,* at ¶89.
7 See, e.g., Reg. 20.2041-1(c)(2).
8 Leopold, 510 F.2d 617, 35 AFTR2d 75-1588, 75-1 USTC ¶13,053 (CA-9, 1975); Estate of Yawkey, 12 TC 1164 (1949); Hurd, 160 F.2d 610, 35 AFTR 1014, 47-1 USTC ¶10,546 (CA-1, 1947).
9 Estate of Budd, *supra* note 5; see also Estate of Wier, *supra* note 5, and Reg. 20.2041-1(c)(2).

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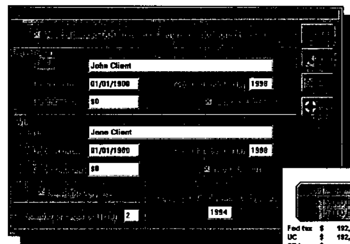

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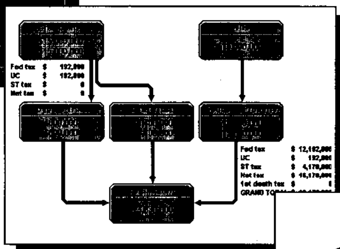

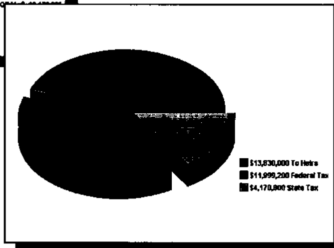

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standard exception need not necessarily relate to health, support, maintenance, or education. Thus, a standard requiring distribution of funds to develop a business, purchase a house, buy a boat, or take specific trips, or when certain ages are reached or a certain income attained, should be acceptable.

While it may be possible to include such provisions in certain gift trusts, the use of ascertainable standards is not allowed in all trusts. Thus, the type of gift and trust must be analyzed and coordinated with the use of an ascertainable standard.

Annual exclusion and unified credit gifts

Section 2503(b) provides that a gift by a donor to a donee of a present interest in property is not a taxable gift to the extent the total amount given to the donee by the donor in any one year does not exceed $10,000. Section 2513 increases this amount to $20,000 per donee if the donor's spouse consents to have the gift deemed made one-half by him or her. This $10,000 amount (or $20,000, if the spouse consents to split the gift) per donee per year is often referred to as the "gift tax annual exclusion." There is no limit on the number of potential donees in any year.

Another strategy for giving is the use of the $192,800 unified credit during life. Sections 2010 and 2505 provide that the first $192,800 in gift or estate taxes incurred by an individual does not require the payment of any gift or estate tax. This amount, referred to as the "unified credit," shields the first $600,000 in taxable transfers from any actual payment of tax. The use of the unified credit during life can be more beneficial than at death because the unified credit is not indexed for inflation. (Legislation that would index the unified credit has been proposed, however.) This means that in an era of inflation, the value of the $600,000 exemption equivalent becomes worth less each year.

Annual exclusion and unified credit gifts can be made outright or in a manner that defers actual ownership, such as a trust or custodial arrangement. Not all deferral strategies permit the donor to act as trustee.

Retaining custodianship in a transfer pursuant to a custodial arrangement. Section 2503(b) provides that a gift of a future interest does not qualify for the annual exclusion. Neither an outright transfer nor a transfer to a custodial account is a transfer of a future interest. Accordingly, to the extent a donor makes an annual exclusion gift to a beneficiary's custodian under the state's Uniform Gifts to Minors Act (UGMA) or Uniform Transfers to Minors Act (UTMA), the transfer qualifies for the annual exclusion.

Importantly, these custodial arrangements do not meet the ascertainable standard requirement. UTMA grants the custodian broad discretionary distribution powers with respect to gifts made under that Act. For example, UTMA provides that a custodian may use for a minor's benefit so much of the custodial property as the custodian "considers advisable for the use and benefit of the minor."[10] These standards are not necessarily ascertainable, creating concerns about Sections 2036(a)(2) and 2038. The Service agrees. In *Rev. Rul.* 57-366,[11] the Service concluded that the custodial property was included in the gross estate of the donor when the donor acted as custodian, a result followed by the courts.[12]

Retaining trusteeship in annual exclusion trusts and Section 2503(c) trusts. Gifts in trust are generally gifts of future interests that do not quality for the annual exclusion. Two widely used exceptions are so-called *Crummey* trusts and Section 2503(c) trusts.

It is possible to make annual exclusion gifts to a *Crummey* trust and retain trusteeship over the gift assets without adverse consequences under Section 2036 or 2038. *Crummey* trusts are not statutory creatures but a result of the decision of the Ninth Circuit in *Crummey*[13] and the Seventh Circuit in *Kieckhefer.*[14] For gifts to a *Crummey* trust to qualify for the annual ex-

10 See ¶14 of UTMA of Uniform Laws Annotated, 2d ed.
11 1957-2 CB 618.
12 See, e.g., Surrey, *Federal Wealth Transfer Taxation,* 2d ed. (1982), at 371.
13 397 F.2d 82, 22 AFTR2d 6023, 68-2 USTC ¶12,541 (CA-9, 1968).
14 189 F.2d 118, 40 AFTR 661, 51-1 USTC ¶10,812 (CA-7, 1951).

clusion, it is required only that the beneficiary have a meaningful right to withdraw the property from the trust for what can be a relatively short time period. No further rights to receive distributions of income or principal from the trust are required.[15] Therefore, limiting a trustee's discretion to an ascertainable standard is permissible in *Crummey* trusts.

Conversely, Section 2503(c) trusts require, in effect, that distributions be allowed to be made pursuant to a broad unascertainable standard. Section 2503(c) provides that a transfer in trust to a donee under age 21 qualifies for the annual exclusion if certain requirements are met. One is that "the property and the income therefrom . . . may be expended by, or for the benefit of, the donee before his attaining the age of 21 years . . . ."[16] Reg. 25.2503-4(b) interprets this requirement to allow the trustee discretion to make distributions provided there are no "substantial restrictions" in the trust instrument on the exercise of that discretion. No definition is provided in the Regulations for the term "substantial restrictions."

Recent case law and prior Rulings have hinted that a substantial restriction may exist when the trustee's distribution power is limited by an ascertainable standard. For example, in *Pettus,*[17] the Tax Court upheld prior Rulings that trust distribution standards under a Section 2503(c) trust could be no more restrictive than those required of guardians under state law.[18] Further, in *The Illinois Nat'l Bank of Springfield,*[19] the court considered the following standard:

"Until termination, the income and principal may be paid to or expended for the benefit of the beneficiary in such amounts as the Trustee deems advisable:

a.) For college preparatory school, college, university, graduate school or technical school education of the beneficiary.

b.) In the event of an accident, illness or disability affecting the beneficiary, or in the event of the death or disability of either or both of the beneficiary's parents, for the care, support, health and education of the beneficiary."

In reviewing this distribution standard, the court determined that a substantial restriction applied to the trustee because the trustee did not have distribution authority as broad as that of a guardian under Illinois law. Because a guardian under Illinois law has the authority, with court approval, to make distributions in the beneficiary's "best interest," any standard

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less than this, such as one relating to health, support, or maintenance, was a restriction that the court in *Nat'l Bank of Springfield* viewed as substantial.[20]

Interestingly, there is no specific authority for the conclusion that an ascertainable standard is an "applicable restriction." In *Heidrich,*[21] the Tax Court determined that a narrow distribution standard that related to "education, comfort and support"—an arguably ascertainable standard—was **not** an applicable restriction.

Nevertheless, in light of *Nat'l Bank of Springfield* and *Rev. Rul.* 67-270,[22] the prudent approach from a gift tax perspective is to draft discretionary language in Section 2503(c) trusts broadly, with an expansive distribution standard. Such a distribution standard is, by definition, one that is not ascertainable. Consequently, the donor will not be able to meet the judicial exception to Section 2036(a)(2) or 2038 and should not, under any circumstances, act as trustee.

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15 See Cristofani, 97 TC 74 (1991), *acq.*
16 Section 2503(c)(1).
17 54 TC 112 (1970).
18 See also Rev. Rul. 67-270, 1967-2 CB 349, and Ross, 348 F.2d 577, 16 AFTR2d 6134, 65-2 USTC ¶12,337 (CA-5, 1965).
19 756 F.Supp. 1117, 67 AFTR2d 91-1194, 91-1 USTC ¶60,063 (DC Ill., 1991).
20 See also Faber, 309 F.Supp. 818, 25 AFTR2d 70-1485, 70-1 USTC ¶12,652 (DC Ohio, 1969), *aff'd* 439 F.2d 1189, 27 AFTR2d 71-1734, 71-1 USTC ¶12,760 (CA-6, 1971).
21 55 TC 746 (1971), *acq.*
22 1967-2 CB 349.

Retaining trusteeship in unified credit trusts. Lifetime taxable gifts that make use of the unified credit need not meet any requirement with regard to distribution standards. As a result, these gifts can be structured to fall within the ascertainable standard exception to Sections 2036(a)(2) and 2038 when the donor acts as trustee (as discussed earlier). In this regard, distribution standards only for emergency medical needs, for education, at certain defined ages, or upon certain achievements would be conservative routes to follow. This type of trust, as well as a *Crummey* trust, should be carefully drafted to avoid any right in the trustee to discharge his or her legal obligation of support. Under the Regulations to Section 2041, a trustee (such as the donor's spouse) who may discharge a legal obligation of support arguably has a general power of appointment.[23]

Retaining trusteeship in insurance trusts. A life insurance trust may be structured as a *Crummey* trust or as a unified credit trust, but typically is set up in the *Crummey* manner. If the donor is the insured, he should not act as the trustee. Even though Sections 2036(a)(2) and 2038 may not apply, Section 2042 could cause inclusion of the trust in the insured's estate.

Section 2042 includes in the insured's gross estate any life insurance policy over which the insured has an incident of ownership at death. The insured may be considered to have an incident of ownership if a policy on the decedent's life is held in trust and the insured is the trustee.[24] Conversely, if the insured's spouse is the trustee, Section 2042 should be inapplicable unless the spouse is also an insured, as would be the case if a second-to-die policy is used.

23 Reg. 20.2041-1(c)(1).
24 See, e.g., Rose, 511 F.2d 259, 35 AFTR2d 75-1635, 75-1 USTC ¶13,063 (CA-5, 1978); *cf.* Hunter, 624 F.2d 833, 46 AFTR2d 80-6160, 80-2 USTC ¶13,362 (CA-8, 1980).
25 Section 2702(a)(1).
26 Section 2702(a)(3)(A)(i).
27 Regs. 25.2702-1(c)(3) and 25.2702-1(c)(4).
28 Section 2702(a).
29 Section 2702(a)(2)(A).
30 Sections 2702(a)(2)(B) and 2702(b).
31 Section 2702(a)(3)(A)(ii); Reg. 25.2702-2(c).

QPRTs and GRATs

Section 2702 of Chapter 14 was intended to correct valuation abuses associated with grantor retained income trusts (GRITs). This section now applies in determining the gift tax value of a transfer of certain interests in trust to or for the benefit of a member of the transferor's family when the transferor retains an interest in the trust.[25] The statute does not apply to an incomplete transfer,[26] and hence has no application to the so-called living trust. The rules also do not apply to charitable remainder trusts or pooled income funds.[27]

Under Section 2702, the gift tax value of the transfer of an interest in trust to a member of the family is the full value of the property transferred less the value, determined pursuant to specific rules, of the property rights retained by the grantor.[28] A retention of a right determined by reference to the income (a GRIT) or a contingent reversionary right to trust corpus is valued at zero for gift tax purposes.[29] Only "qualified interests" have value; these consist of (1) a fixed amount payable at least annually (a GRAT); (2) an amount payable at least annually, which is a fixed percentage of the value of the trust's assets determined annually (a GRUT); or (3) a noncontingent remainder interest if all the other interests in the trust consist of interests described in (1) or (2) above.[30] Certain GRITs, funded with a personal residence or tangible property, are outside the special rules of Section 2702.[31] In the transfer tax context, GRATs and personal residence GRITs are the most commonly used strategies.

In the case of a GRAT, property is transferred to a trust, and the donor (grantor) retains the right to a specific, set amount each year. The retained dollar amount is ascribed a value for gift tax purposes. This value is then subtracted from the value of the property transferred, and the balance is typically the taxable gift resulting from the transfer.

The specific amount of the retained interest is flexible and can be structured to absorb most of the value of the property transferred.[32] Each year, the trustee must pay such amount to the grantor. When the term of years for which this amount is retained expires, any remaining prop-

erty passes to the beneficiaries named in the trust, with no additional gift or estate tax cost.

A GRAT has the potential to achieve transfer tax benefits greater than those realized via an outright gift. The establishment of a GRAT results in a transfer tax gain when the GRAT experiences an average rate of return and growth greater than the discount rate used to value the GRAT for gift tax purposes when it was established. A gain (i.e., the transferred interest appreciating at a rate greater than the appreciation rate of the retained interest) results in that situation because the discounted present value of the annuity for gift tax purposes is greater than its true value under the rate of return experienced by the GRAT.

The retained interests in a personal residence GRIT are valued pursuant to Reg. 25.2512-5 and Section 7520.[33] The grantor could retain two property interests: first, the right to use the trust property for a fixed term and, second, a reversionary right— that is, the right to receive the trust property if the grantor dies during the term. Both property interests are assigned a value for gift tax purposes.

This exception to Section 2702 is narrow in scope; it applies only to personal residences. A personal residence must be (1) a principal residence of the term holder, as defined in Section 1034; (2) any other residence of the term holder, within the meaning of Section 280A(d)(1) (but without regard to Section 280A(d)(2)); or (3) an undivided fractional interest in either of the above.[34] An individual may not be the holder of a term interest in more than two personal residence trusts nor may a personal residence trust include household furnishings or other personal property.[35] A personal residence must be used primarily as a residence of the term holder "when occupied by the term holder."[36] The residence may be rented, however, provided the requirements of Section 280A(d)(1) are satisfied.[37] In addition, a personal residence may include appurtenant structures used for residential purposes and adjacent land "not in excess of that which is reasonably appropriate for residential purposes."[38]

Without the application of the new Section 2702 valuation rules, both retained interests (i.e., the term interest and the reversion) are ascribed a value for gift tax purposes, thereby reducing the value of the remainder interest (i.e., the gift portion) in the GRIT. Because the reversion is given a value and because there is a possibility of appreciation, a personal residence GRIT provides transfer tax saving opportunities.[39]

Retaining trusteeship in a GRIT and GRAT. The grantor may be the trustee of property transferred to a residence GRIT during the retained interest term. If the grantor dies during that time, the property is included in his estate under Section 2036(a)(1). Accordingly, during the retained term, the grantor acting as trustee adds no further estate tax disadvantage.

A different result occurs when the retained interest term ends and the property continues to be held in trust for third parties. If the property is then held for the benefit of third parties pursuant to unascertainable standards, the grantor serving as trustee creates concerns about Sections 2036(a)(2) and 2038.

In that situation, one strategy is for the grantor to resign as trustee (or for the grantor's tenure as trustee to end under the terms of the document) at the end of the retained term. Termination of the grantor's position as trustee should not cause the three-year rule of Section 2035 to apply. Section 2035 provides that in the context of Sections 2036 and 2038, the three-year rule applies when there has been a transfer of property or a relinquishment that removes a Section 2036 or 2038 taint. One question, then, is whether there has been a "transfer of property" or a "relinquishment" when the trustee resigns. Although there is arguably no transfer with a mere resignation as trustee, that

32 See Covey, *Practical Drafting*, p. 3411.
33 Section 2702(a)(3)(A)(ii); Reg. 25.2702-5(a).
34 Regs. 25.2702-5(b)(2) and 25.2702-5(c)(2). See also Ltr. Rul. 9151046.
35 Reg. 25.2702-5(c)(2)(ii).
36 Regs. 25.2702-5(b)(2)(iii) and 25.2702-5(c)(2)(iii).
37 *Id.* See also Reg. 25.2702-5(d), Example 2.
38 Reg. 25.2702-5(b)(2)(ii).
39 See, e.g., Fox, Hodgman, and Van Meter, "Qualified Personal Residence Trusts Yield Tax Savings," 22 EP 206 (Jul/Aug 1995).
40 See Rev. Rul. 76-273, 1976-2 CB 268.
41 See Wood, "Is the Step-Transaction Doctrine Still a Threat for Taxpayers," 72 J. Tax'n 296 (May 1990).

action appears to be tantamount to a relinquishment. Therefore, to avoid any affirmative act of "relinquishing," the terms of the document should provide that the trustee's tenure ends at the end of the retained interest period.

A GRAT presents a slightly different analysis, but even in the case of a GRAT, the grantor acting as trustee should be permissible during the retained interest term. If the grantor dies during the retained term, it is uncertain whether the full amount, or only a portion, of the trust is included in her estate under Section 2036(a)(1).[40] Partial inclusion is likely if the grantor dies toward the end of the retained interest term. In such instance, if the application of Section 2036(a)(2) or 2038 required full inclusion, that would be a problem.

But as trustee of a GRAT, the grantor is directed to distribute a fixed amount each year. Although the trustee has investment and other administrative powers, the trustee of a GRAT ordinarily has no discretionary distribution authority during the retained interest term. This limited distribution authority, because there is no discretion, should be sufficient to avoid Section 2036(a)(2) or 2038.

Grantor's spouse as trustee

One step removed from the scenarios discussed above is the situation in which the grantor's spouse acts as trustee, contributes no property to the trust, and retains no economic benefit from the trust. If the total gifts to a trust are made by only one of two spouses, there is no prohibition against the other spouse acting as trustee with broad discretionary powers. (To avoid the argument that the spouse-trustee has a general power of appointment under Section 2041, the spouse-trustee should not be able to discharge a legal obligation of support.) Because the non-donor spouse has not made any "transfer," that spouse acting as trustee will not invoke Section 2036(a)(2) or 2038. Unlike Section 672 of the grantor trust rules, there is no analogous spousal attribution rule with regard to Section 2036(a)(2) or 2038. Further, there is no proposed legislation that would impose this type of rule.

Nevertheless, the step transaction doctrine may pose an obstacle to this strategy.[41] For example, if assets are taken from a joint account, given to one spouse, and then contributed to a trust of which the other spouse is a trustee, the Service would have a strong argument for applying Section 2036(a)(2) or 2038, based on the step transaction doctrine.

Assuming the step transaction doctrine does not apply, under current law the non-contributing spouse may act as trustee even if an election to split the gift is made under Section 2513. For example, suppose a Section 2503(c) trust is established and the full $20,000 transferred to the trust is contributed by the husband. To qualify the contribution for the husband's and wife's annual exclusions, the wife consents on the husband's gift tax return to have one-half of the gift deemed made by her. Even though the wife acts as trustee of the Section 2503(c) trust, this fact still should not cause Section 2036(a)(2) or 2038 to apply. The wife has made no "transfer." Assuming the funds contributed by the husband did not emanate from the couple's joint account, this strategy should be successful.

Importantly, the income tax effects of this transaction must be considered. With respect to a Section 2503(c) trust, where unascertainable distribution standards are required, the non-contributing spouse acting as trustee would result in a grantor trust under Section 674. Accordingly, all income would be taxed to the grantors. Although this is a beneficial result from an estate or income tax planning standpoint, the clients should be advised upfront so as not to be surprised.

Conclusion

In creating trusts to hold lifetime gifts, the most prudent and versatile course is to name as trustee a third party, other than the donor or the donor's spouse. Sometimes, though, the donor wishes to act as trustee and will not make gifts pursuant to certain lifetime strategies unless able to serve in that capacity. In those situations, certain trusts, with carefully drafted ascertainable distribution standards, will allow the donor to act as trustee while avoiding the application of Sections 2036(a)(2) and 2038 under current law. ◆