The Tax and Practical Aspects of the Installment Sale to a Spousal Grantor Trust

By William R. Culp Jr., Paul M. Hattenhauer and Briani Bennett Mellen

The familiar installment sale to a grantor trust, where a taxpayer sells property to his or her wholly-owned grantor trust, is an effective technique to shift assets among family members on an income and estate tax efficient basis. A variation on this traditional technique is a sale by a trust beneficiary to a grantor trust treated as wholly-owned by the beneficiary’s spouse (the “spousal grantor trust sale”). Similar to the traditional grantor trust sale, the spousal grantor trust sale accomplishes a freeze on the value of the consideration received on the sale for estate tax purposes. However, the spousal grantor trust sale provides several meaningful advantages over the traditional grantor trust sale, including the potential for the spouse selling assets to the trust to be a beneficiary of the trust, serve as trustee, or possess a special power of appointment over trust property. This article reviews the tax and practical aspects of the spousal grantor trust sale in comparison to a traditional grantor trust sale and is an abbreviated version of an article by the same name which the authors have written for The ACTEC Law Journal to be published in the spring of 2019, and which should be referred to for a more complete and heavily footnoted discussion of this topic.

Introduction

In a traditional grantor trust sale, a taxpayer establishes an irrevocable trust for the benefit of the taxpayer’s spouse and/or descendants, makes a seed gift to the trust, and subsequently sells what the taxpayer hopes to be appreciating property to the trust in exchange for a down payment and an installment promissory note. Because the irrevocable trust is treated as wholly-owned by the taxpayer for income tax purposes, no gain is recognized on the sale, no gain is recognized upon receipt of installment payments on the promissory note, and interest payments on the promissory note are not subject to income tax. Importantly, in order to avoid estate tax inclusion, the taxpayer cannot retain a beneficial interest in or power of appointment over the grantor trust and cannot serve as trustee of the grantor trust. This can be a significant impediment for some clients who are concerned about current estate planning beyond their potential future means, or the loss of control over important family assets. In addition, special complications may exist for planning for closely-held business owners where ownership or control of the business may be limited by shareholders agreements, distributor or franchise agreements, or lending or bonding requirements, and negotiation or review of any changes may require the approval or consent of third parties.

A unique alternative to the traditional grantor trust sale involves a sale of property by one spouse (the “selling spouse”) to an irrevocable trust that is treated as wholly-owned by the other spouse (the “grantor spouse”) for income tax purposes. (An irrevocable trust established by the grantor spouse, to which the selling spouse sells property in exchange for an installment note, is referred to throughout this article as a “spousal grantor trust.”) Because the spousal grantor trust is treated as wholly-owned by the grantor spouse for income tax purposes (Rev. Rul. 85-13), a sale of property by the selling spouse to the trust should be treated as a transfer of property between spouses, and thus receive non-recognition treatment by virtue of I.R.C. Section 1041. Among the reasons why a taxpayer may prefer a spousal grantor trust sale to a traditional grantor trust sale are the following:

1. The selling spouse could be a beneficiary of the spousal grantor trust;
2. The selling spouse could have a testamentary special power of appointment over the assets of the spousal grantor trust; and
3. The selling spouse could serve as a trustee of the spousal grantor trust.

Of course, the above-listed considerations are dependent on structural and valuation issues. Nonetheless, there is at least a possibility that the selling spouse could possess some interest in or control over the trust property and yet avoid estate inclusion, aspects that are per se prohibited with the traditional grantor trust sale. There also may be the potential to cure any gift tax or estate inclusion risks by reporting the sale on a gift tax return or future planning for any Sections 2036 or 2038 retained interests if circumstances change during the selling spouse’s lifetime and the initial reasons for the structure of the sale to the spousal grantor trust change.

Income Tax Treatment

The income tax analysis of the spousal grantor trust sale differs from a traditional grantor trust sale because the transaction is not wholly-ignored for income tax purposes. The income tax analysis begins with Revenue Ruling 85-13 and its conclusion that a grantor that is treated as the owner of an entire trust under the grantor trust rules is considered to be the owner of the trust’s assets for federal income tax purposes. It follows that assets held by a spousal grantor trust are treated as held directly by the grantor spouse for income tax purposes (Rev. Rul. 85-13), a sale of property by the selling spouse to the trust should be treated as a transfer of property between spouses, and thus receive non-recognition treatment by virtue of I.R.C. Section 1041. Among the reasons why a taxpayer may prefer a spousal grantor trust sale to a traditional grantor trust sale are the following:

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Taxation of Interest Payments. Section 1041 applies only to property transfers between spouses, and not to all potentially taxable transactions between spouses. In the spousal grantor trust sale context, Gibbs v. Commissioner, 73 T.C.M. 2669 (1997) suggests that the selling spouse should include interest payments received on the note in gross income because the payment of interest is not within Section 1041’s nonrecognition provisions. However, the spousal grantor trust (and thus the grantor spouse) may receive an off-setting deduction for the interest payments. See Seymour v. Comm’r, 109 T.C. 279, 286 (1997).

In contrast, with a traditional grantor trust sale there is no taxation of interest income (or potential deduction) for interest expense related to indebtedness used to finance the acquisition of property purchased by the grantor trust. Because the transaction is wholly ignored for income tax purposes under Revenue Ruling 85-13, there is no inclusion of interest income or recognition of gain on principal payments. The grantor and the grantor trust are viewed as the same taxpayer for all income tax purposes, and so the grantor is both the payor and payee of interest on the promissory note.

Income Tax Treatment Upon the Death of Either Spouse. The tax treatment of the installment note upon the death of the selling spouse or the grantor spouse has not been definitively resolved. However, an examination of relevant authority in other contexts supports the position that no gain should be recognized on the death of either spouse while the note is outstanding.

Death of Selling Spouse. If the installment note is outstanding on the death of the selling spouse, the note should be an asset included in the selling spouse’s estate for estate tax purposes that receives a stepped-up basis at the selling spouse’s death pursuant to Section 1014. In general, the basis in property acquired from a decedent is equal to the fair market value on the date of the decedent’s death or, in the event of an election under Section 2032, the alternate valuation date. I.R.C. § 1014(a). The stepped-up basis provisions of Section 1014 do not apply to property constituting income in respect of a decedent (“IRD”) under Section 691. I.R.C. § 1014(c). Because Sections 1041 and 102 require that payments on the note to the selling spouse be treated as nontaxable gifts excluded from gross income, the note should not be an item of IRD at the selling spouse’s death.

Death of the Grantor Spouse. The death of the grantor spouse causes the grantor trust to be treated as a separate entity for income tax purposes that is no longer treated as owned by the grantor spouse. This may raise questions as to whether the grantor spouse’s death affects the income tax consequences of the spousal grantor trust sale.

- **Timing of Transfer of Note to Selling Spouse for Tax Purposes.** For income tax purposes, the exchange of an installment note for property is a completed transfer of the note from the grantor spouse to the selling spouse at the time that the sale to the spousal grantor trust closes. The deemed gift prescribed by Section 1041 should occur at the same time. If the transfer is complete at the time that the installment sale to the spousal grantor trust is made, then subsequent installment payments made in accordance with the terms of the sale should not be viewed as new “gifts” or transfers to the selling spouse each time they are made. The determination of a completed transfer for gift and income tax purposes will in turn depend on the facts and circumstances surrounding the sale and its enforceability under local law. See Harris v. Comm’r, 178 F.2d 861 (2d. Cir. 1949), rev’d on other grounds, 340 U.S. 106 (1950).

- **Timing of Transfer.** Section 1041(b)(1) treats transfers between spouses as acquired by gift, and the date of the gift should be the date that the obligation to make the transfer becomes enforceable (e.g., the effective date of the closing of the sale transaction), and not when payments are later made as required by the terms of the note (e.g., the date that the transferor arguably has parted with dominion and control of the transferred property). See Rev. Rul. 69-347; Estate of Copley v. Comm’r, 15 T.C. 17 (1950), aff’d 194 F.2d 364 (7th Cir. 1952), acq. C.B. 1965-2, 4.

- **Application of Section 1041 to Payments Received by Selling Spouse after Grantor Spouse’s Death.** If it is determined that the sale, and deemed gift, is complete on the date of the sale for purposes of Section 1041, then any installment payments the selling spouse receives in accordance with the terms of the note should continue to be governed by that section (tax-free treatment) even if the grantor spouse dies while the note is outstanding. If the selling spouse receives all payments as originally promised on the date of the sale, then for income tax purposes the transaction should not be re-characterized as one between non-spouses solely as the result of the grantor spouse’s death prior to receipt of all required payments.

- **Selling Spouse’s Basis in the Note.** The death of the grantor spouse, which causes the spousal grantor trust to be treated as a separate entity for income tax purposes, raises an additional question – what is the selling spouse’s basis in the note received from the spousal grantor trust? Historically, the IRS has taken the position that basis in a self-made note should be zero, and that the maker of the note only receives basis as principal payments are made. The IRS appears to be stepping back from its zero basis position (see Rev. Rul. 2006-2, 2006-1 C.B. 261), but it has made no pronouncements or otherwise taken a position on a promissory note’s basis in a spousal grantor trust sale context. It further should be noted that, unlike most of the situations involving self-made notes (e.g., contribution of self-made note to a business followed by a sale of the business interests), the note is given in exchange for valuable property purchased by the trust, and not in exchange for an equity interest in a business that is later sold. Section 1041 requires that all gain on the sale be deferred, not eliminated. The economics of an installment obligation in the context of a spousal grantor trust sale thus do not present the same considerations involved with questions regarding basis for contributions of self-made notes to businesses.

Section 1012 provides that an individual’s basis in property is its cost, and cost includes the value of any cash or other property given to obtain the property. Treas. Reg. § 1.1012-1(a). If a promissory note is given in exchange for a sale of property, the purchaser’s cost basis
will include the value of the note. The question becomes whether the selling spouse's transferred basis under Section 1041 will be the face amount of the note, or whether the basis should be zero until principal payments are actually made from the trust. If both spouses survive beyond the date that the note is paid in full, the zero basis approach should not have any income tax effect on the sale. Even assuming that the selling spouse receives a zero basis for the note under Section 1041, then, the selling spouse should receive a carry-over basis for any payments received in cash (or other property) treated as made by the grantor spouse pursuant to that section. If, however, the grantor spouse dies while the promissory note is still outstanding, the selling spouse's basis in the note may become relevant to determine whether the selling spouse recognizes gain on principal payments received after the grantor spouse's death.

Permitting the selling spouse to receive a cost basis in the note as principal payments are made after the grantor spouse's death would further the purposes of Section 1041. Section 1041's nonrecognition and transferred basis provisions were intended to defer recognition of gain or loss on any property transferred between spouses, not reduce or eliminate it. This treatment would further the non-recognition provisions of Section 1041 by preserving the original income tax attributes of the installment sale between spouses, but eliminating the deferral of gain on payments that are not made between spouses (e.g., payments made by the new non-grantor trust with appreciated property after the death of the grantor spouse).

**Gift Tax Treatment**

The gift tax consequences of a spousal grantor trust sale are similar to the gift tax consequences of a traditional trustor trust sale. Under Section 2512, if a transfer is made for less than an "adequate and full consideration in money or money's worth," then a deemed gift occurs to the extent that the value of the transferred property exceeds the value of the consideration received. The selling spouse makes a taxable gift to the spousal grantor trust to the extent that the property sold to the trust exceeds the value "in money or money's worth" of the consideration received in the sale. Treas. Reg. § 25.2512-8. Thus, a high-quality, independent business valuation of the property sold to the trust is a critically important part of a grantor trust sale. In the context of a gift tax audit the IRS could assert a gift tax deficiency if it determines that the taxpayer sold property to the grantor trust for less than fair market value.

Fortunately there are a couple of effective techniques that taxpayers can utilize to minimize the risk that the IRS successfully asserts a gift tax deficiency based on an undervaluation of the property sold to the grantor trust. First, the selling spouse may decide to file a gift tax return to adequately report the non-gift grantor trust sale transaction and start the running of the gift tax statute of limitations. Treas. Reg. § 301.6501(c)-1(f)(4). If the statute of limitations runs for gift tax purposes, the selling spouse will not be regarded as making a taxable gift to the trust, whether complete or incomplete -- there is no gift. This would help ameliorate any later planning to eliminate or reduce the selling spouse's interests in the trust by removing concerns about completion of any potential incomplete gift on the sale to the trust at the time the retained interests are extinguished. If a gift tax return is not filed at the time of the sale, it could later be filed after removal of the selling spouse's retained interests in the spousal grantor trust by filling a gift tax return to report a completed non-gift transaction, although the gift tax statute of limitations would begin to run when the return is filed, and not back to when the sale was completed.

The terms of the spousal grantor trust sale documents also could protect against the possibility that the selling spouse is treated as having transferred property to the trust as a taxable gift by including a formula clause that provides for an alternative non-taxable disposition of property that is not sold to the trust for full and adequate consideration for gift or estate tax purposes, or by including provisions in the trust that would render any potential gift to the trust incomplete for gift tax purposes (and thus not subject to gift taxes or penalties at the time of the sale).

**Risk of Inclusion in Selling Spouse's Estate**

The primary advantage of a spousal grantor trust sale over a traditional grantor trust sale - access to and control over the trust assets by the selling spouse - increase the risk of estate inclusion to the selling spouse, a risk that likely is not ameliorated by adequately disclosing the transaction on a timely filed gift tax return. These risks, of course, should be considered in relation to the particular reasons for the spousal grantor trust sale, and the potential to cure any estate tax inclusion issues if circumstances change in the future.

**Sections 2036 and 2038 – Generally.** To avoid inclusion in the selling spouse's gross estate under Sections 2036 or 2038, the sale must be bona fide and for full and adequate consideration in money or money's worth, as determined at the time of the selling spouse's death. Because the running of the gift tax statute of limitations only works for gift tax purposes, it will not similarly bar inquiry into the adequacy of the sale for estate tax purposes.

If the sale is determined to be made for less than full and adequate consideration, the selling spouse may be viewed as a settlor of the spousal grantor trust with respect to the property sold to the trust to the extent it may be viewed as a taxable gift, which would result in estate inclusion under Sections 2036 and 2038. In general, Section 2036 provides that the value of a decedent's gross estate “shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth)" and retained any interest in the property or right to designate the persons possessing or enjoying the property. Section 2038 generally provides that, except in the case of a bona fide sale for an adequate and full consideration in money or money’s worth, property transferred to a trust is includable in the decedent's gross estate to the extent the decedent retained a power to alter, amend or revoke the transfer at the decedent's death. These estate tax provisions are invoked where the selling spouse possessed a beneficial interest in the spousal grantor trust or a special power of appointment over trust property or served as trustee of the trust at death.

**Estate Tax Consequences – Transfers for Insufficient Consideration.** Sections 2036 ("transfers with retained life estate") and 2038 ("reversible transfers") both contain an exception for a “bona fide sale for an adequate and full consideration in money or money's worth.” This creates a two-part test to determine whether property sold to a spousal grantor trust may be subject to inclusion in the selling spouse's gross estate under Sections 2036 and 2038: (1)
whether there was a bona fide sale – a question of motive; and (2) whether the sale was for adequate and full consideration in money or money's worth – a question of value.

"Bona Fide Sale" Requirement. In general, a bona fide sale will require a credible, non-tax purpose, and must alter the decedent's relationship with the transferred property. Estate of Bongard, 124 T.C. 124 T.C. 95 (2005). The transaction also must be made in "good faith." Treas. Reg. § 20.2043-1(a). A bona fide transaction must be made at arm's-length, with some objective proof that ordinary parties to a business transaction would deal with each other in a similar manner. An installment sale to a spousal grantor trust will be subject to heightened scrutiny because of the potential to shift tax burdens in intra-family transactions without diminishing the transferor's ability to control or benefit from the transferred property.

"Adequate and Full Consideration" Requirement. It will be necessary to determine whether a transfer was for "adequate and full consideration," even if it is determined to be a "bona fide" sale. Furthermore, although the estate and gift tax provisions include the same language regarding "adequate and full consideration in money or money's worth" (see I.R.C. §§ 2036(a), 2038(a)(1), 2043(a), 2512(b), and accompanying regulations), it has not been determined whether, and it may be unlikely that, the running of the statute of limitations on a deemed gift resulting from a transfer for insufficient consideration would estop the IRS from challenging the sufficiency of the consideration on the same transfer for estate tax purposes. In other words, any relief that a taxpayer (and the taxpayer's advisors) may feel when the statute of limitations expires for an audit of the gift tax return reporting the sale to the spousal grantor trust should be tempered by the fact that the IRS retains the ability to argue that the spousal grantor trust sale failed the "adequate and full consideration" test for estate tax purposes, resulting in potential estate inclusion even where the IRS is prevented from making the same argument for gift tax purposes.

Estate Tax Return Statute of Limitations. A final determination that a transfer was made for "adequate and full consideration" for gift tax purposes by running of the statute of limitations does not similarly result in a final determination of value for purposes of Sections 2036 or 2038 for estate tax purposes. See, e.g., Austin W. Bramwell, Considerations and Consequences of Disclosing Non-Gift Transfers, 116 J. Tax'n 19, 22 (2012). It is well-established that arguments regarding the statute of limitations are construed strongly against the taxpayer and in favor of the IRS. Badaracco v. Comm'r, 464 U.S. 386 (1984). Indeed, Section 2001(f) in large part was passed to help provide finality for taxpayers and prevent the IRS from revaluing taxable gifts for estate tax purposes that were otherwise barred from revaluation for gift tax purposes. It does not necessarily follow, however, that the same purposes would be applied to limit inquiry into whether a transfer was made for an adequate and full consideration for estate tax purposes, even if the statute of limitations prevents the same inquiry for gift tax purposes.

For example, if the gift tax return statute of limitations has passed on an adequately disclosed non-gift transaction, it appears that Section 2001(f) prevents the IRS from revaluating the transaction to determine whether a deemed gift occurred in accordance with Section 2512. A strict and limited application of Section 2001(f), however, does not appear to extend to a revaluation of the same transaction (which is not a gift) to determine whether it was made for a full and adequate consideration for estate tax purposes under Sections 2036 and 2038.

The effect, however, appears to be much the same in both circumstances: if there is a deemed taxable gift on the initial sale, Section 2001 would not include the gift in adjusted taxable gifts, thereby eliminating double taxation of the same transfer. The full value of the transferred property, reduced by the consideration received at the time of the sale, would be included in the decedent's gross estate. On the other hand, if the initial determination of a taxable gift is barred by running of the statute of limitations, the IRS may nevertheless argue that the transfer is included under Sections 2036 or 2038 as having been made for less than an adequate and full consideration. Again, the full value of the transferred property, reduced by the consideration received at the time of the sale, would be included in the decedent's gross estate. Because the statute of limitations has run on the gift, however, the estate would not incur penalties or interest if the deemed gift would have exceeded the available unified credit and required payment of gift tax.

Planning to Minimize the Risk of Estate Inclusion, and Extent of Retained Interests or Powers

Sections 2036 and 2038 provide a basis for the IRS to include the spousal grantor trust property in the selling spouse's estate if the selling spouse makes a transfer for less than full and adequate consideration and retained the possession, enjoyment, or right to the income from the property (Section 2036(a)(1)); the right to designate the persons who shall possess or enjoy the property or the income therefrom (Section 2036(a)(2)); or where the enjoyment of the transferred property was subject to any change through the exercise of a power to alter, amend, revoke, or terminate (Section 2038(a)). It may be possible to minimize this risk in certain scenarios.

Sale to Spousal Grantor Trust in a Domestic Asset Protection Trust Jurisdiction. If the selling spouse is a resident of a state that has a self-settled asset protection trust statute, and the selling spouse remains a beneficiary of the trust, but is willing to forego the ability to be a trustee of the spousal grantor trust or hold a special testamentary power of appointment over the trust property, then the risk of inclusion in the selling spouse's estate as a result of a sale for less than full and adequate consideration can be greatly reduced. The basis for estate inclusion under Section 2036(a)(1) in a non-domestic asset protection trust state is that if the selling spouse's creditors can attach the trust assets because the selling spouse is a beneficiary of the trust, then the transfer to the trust is considered to be incomplete and thus includible in the selling spouse's estate. Rev. Rul. 76-103, 1976-1 C.B. 293. Over two dozen states now have domestic asset protection trust statutes, and the IRS has ruled that a taxpayer who is a resident of such a state and who properly follows the exercise of a power to alter, amend, revoke, or terminate Section 2038(a)). It may be possible to minimize this risk in certain scenarios.

For example, if the gift tax return statute of limitations has passed on an adequately disclosed non-gift transaction, it appears that Section 2001(f) prevents the IRS from revaluating the transaction to determine whether a deemed gift occurred in accordance with Section 2512. A strict and limited application of Section 2001(f),
2036(a)(2) and 2038(a) if the spousal grantor trust does not grant the selling spouse a power of appointment over the trust, and does not make the selling spouse a trustee of the trust, avoids all other Sections 2036 and 2038 strings, and the trust otherwise complies with the applicable self-settled trust statute.

Sale to Spousal Grantor Trust of Assets Having Little Undervaluation Risk. The risk of estate inclusion under Sections 2036 and 2038 is premised on the IRS successfully arguing that the sale of assets to the spousal grantor trust was made for less than full and adequate consideration. In many planning scenarios that involve a traditional grantor trust sale or a spousal grantor trust sale, part of the planning involves utilizing valuation discounts. Typically, the selling spouse sells a minority interest (perhaps a non-voting minority interest) in a closely held entity to the spousal grantor trust. A third-party appraisal documents the value of the interest sold, including valuation discounts for lack of marketability and lack of control, and these combined valuation discounts can sometimes exceed forty percent (40%) when compared to the proportionate share of the underlying enterprise value of the closely-held entity. These valuation discounts are often the main source of controversy with the IRS with respect to the valuation of the property sold to the trust. Studies have shown, however, that the estate tax benefits of engaging in grantor trust sale planning are not limited to the level of the valuation discount experienced at the time of the sale, but also include the growth of the assets transferred outside of the selling spouse's estate for the remainder of the selling spouse's lifetime, as well as the tax-burn associated with the grantor spouse paying the income tax on the grantor trust's income out of personal assets. Todd Steinberg, Jerome M. Hesch, and Jennifer M. Smith, Grantor Trusts: Supercharging Your Estate Plan, 32 Tax Mgt. Estates, Gifts, and Trust J. 66 (January 1, 2007). Recognizing this fact, a taxpayer could structure a spousal grantor trust sale so that no valuation discounts are applicable (such as the sale of ownership interests that possess liquidation rights). Similarly, if there are truly independent third-party transactions in the equity of the closely-held entity in close proximity to the date of the spousal grantor trust sale, the price at which the equity interests changed hands in a third-party sale could establish the “full and adequate consideration” requirement in a manner that a third party appraisal may not. Since estate inclusion under Sections 2036 and 2038 is based on getting the valuation wrong on the date of the sale, any method of minimizing this valuation risk decreases the risk of estate inclusion. Obtaining a high quality, independent appraisal can greatly minimize the estate inclusion risk.

Disposition of the Selling Spouse’s Retained Interests in the Spousal Grantor Trust Prior to Death. Although the running of the gift tax statute of limitations would not prevent inquiry into a taxable transfer for estate tax purposes, application of Sections 2036 and 2038 is determined based on the facts in existence at the time of the selling spouse’s death. See, e.g., PLR 9644053. As a result, subject to Section 2035’s three-year lookback rule, Sections 2036 and 2038 should be inapplicable if the selling spouse’s retained interest as a trust beneficiary, trustee, or holder of a special testamentary power of appointment terminates more than three years prior to death, even if the initial transfer was an incomplete gift. I.R.C. § 2035. See also Treas. Reg. § 25.2511-2(g).

Even if the gift tax statute of limitations has run on the initial sale to the spousal grantor trust, the selling spouse’s voluntary transfer or relinquishment of his or her beneficial interest in the spousal grantor trust would likely be treated as a gift by the selling spouse to the other trust beneficiaries. However, query whether a third-party independent trustee’s decision to decant the spousal grantor trust assets to a trust over which the selling spouse is neither a beneficiary, trustee, or the holder of a special testamentary power of appointment successfully avoids the application of Sections 2036 and 2038 at the death of the selling spouse, without the selling spouse being treated as making a gift to the other trust beneficiaries. If one of the primary objectives of a sale to a spousal grantor trust was to provide for financial security to the selling spouse or address business reasons requiring the selling spouse’s interests to be held in the trust, future decantings by an independent trustee to trusts for the selling spouse’s children, spouse, or charities could be used to transfer the entire trust property, or to bleed off the amount of trust property that might otherwise be subject to estate inclusion under Sections 2036 and 2038, or if circumstances change to reduce or eliminate the need to retain the selling spouse’s interests in the trust. These decantings could help minimize the amount that may be included in the selling spouse’s estate in the event of a sale for inadequate consideration. The trust could also contain provisions providing for automatic termination of the selling spouse’s rights or interests, such as at a certain age, or granting an independent trustee or a trust protector the authority to cause an early termination of the trust sufficient to cut off the selling spouse’s retained powers or interests (e.g., by treating the selling spouse as deceased for all purposes of the trust).

Sale Between Two Grantor Trusts. If the selling spouse sells property in a traditional grantor trust sale to a trust that benefits the selling spouse’s descendants (the “first grantor trust”), the ability of the IRS to argue for estate tax inclusion under Sections 2036 and 2038 is more limited because the selling spouse is not a beneficiary of the first grantor trust. In a separate transaction, the spouse of the selling spouse could establish and fund a grantor trust for the benefit of the selling spouse and his or her descendants (the “second grantor trust”). If the trustee of the second grantor trust purchases the assets of the first grantor trust, the selling spouse may be in a similar position as the selling spouse in a regular spousal grantor trust sale (a beneficiary of the trust, a trustee of the trust, and the holder of a power of appointment over the trust), but possibly without the added risk of estate tax inclusion under Sections 2036 and 2038 because the selling spouse did not transfer assets to the second trust.

Conclusion

In conclusion, if special circumstances exist that require or support a taxpayer’s retention of interests in property sold to a trust, then the installment sale to a spousal grantor trust may provide an attractive alternative to the traditional grantor trust sale. Although an installment sale to a spousal grantor trust is not without its risks for gift or estate tax purposes, the income tax treatment of the sale should be fairly well established to prevent the selling spouse from recognizing gain on the sale of appreciated property to the trust. If circumstances later change to reduce or eliminate the selling spouse’s initial reasons for the retained interests in the trust, further planning may be available to address any potential gift or estate tax issues, possibly in a
much more efficient manner than if the selling spouse had waited
do estate planning at a much later date. A practitioner should
review the benefits and potential transfer tax risks associated with a
spousal grantor trust sale to determine whether it is transaction that
may meet a particular client's needs and desires to engage in
estate planning, but adhere to conditions requiring retention of a
certain amount of access to or control over property sold to the
trust.

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1. Be a member in good standing for twenty-five or more
   years of the NC Bar Association and EPFL Section.
2. Be a currently licensed member in good standing of the
   North Carolina State Bar, or otherwise be retired to “inac-
   tive status” by the State Bar under “honorable” conditions.
3. Be a person of high character and reputation within his or
   her community and in the Bar.
4. Have served on the council, one or more committees, or as
   an officer of the EPFL Section.
5. Have provided CLE services to the section as a speaker,
   panelist, organizer and/or facilitator.
6. Have received prior public recognition by his or her peers
   for expertise in the area of estate planning and fiduciary
   law, such as being a fellow in ACTEC; being recognized
   by Best Lawyers, The Legal Elite or Super Lawyers; being
   a Board Certified Specialist in Estate Planning and Probate
   Law by the NC State Bar Board of Legal Specialization; or a
   similar recognition.
7. Have exhibited the utmost professionalism in the practice
   of law consonant with the NC Bar Association's “Purposes”
   as defined in Article 1.2 of said Association's bylaws and in
   Article 1, Section 2 of the EPFL bylaws.
8. Have provided exemplary, outstanding and distinguished
   service to the section, the North Carolina Bar, its practitio-
   nal and the public which has made a significant impact for
   betterment of legal practice in the area of estate planning
   and fiduciary law. (By way of example, and not limitation,
   such distinguished service may include such matters as pro
   bono activities, publications, educational programs, special
   expertise, mentoring, public service, philanthropic activi-
   ties, and all other activities which reflect favorably on the
   highest standards of integrity, service and professionalism
   to be exhibited by members of the NC Bar Association.)

Please submit a written nomination, which outlines how your
choice of nominee meets the above criteria, by April 15, 2019 to ei-ther
Rebecca Smitherman, Section Chair, rsmitherman@craigejenkins.com
or Andrea Bradford, NCBA, abradford@ncba.org. We have many
qualified candidates in our section!