

**IRREVOCABLE NONGRANTOR TRUST, SALE OF HIGHLY APPRECIATED  
REAL PROPERTY FOR A PRIVATE ANNUITY RULES AND RECOMMENDATION**

Sale of the taxpayer's highly appreciated real property, to an Irrevocable Nongrantor Trust, in exchange for a Single Premium Deferred Private Annuity Contract, for purposes of Income Tax Deferral, Estate Tax Avoidance, and Asset Protection.

**1. INTRODUCTION.**

**1.1 Purpose.** This Tax, Estate, and Asset Protection Strategy (the "Strategy") is an important part of a sophisticated and advanced Estate Plan for affluent high net worth taxpayers. The purpose of this Article is to briefly describe the various legal entities, legal instruments, and rules of law, all acting collectively together to make an effective Strategy which will achieve the taxpayer's objectives in his Estate Plan. Specifically, this consists of the following:

- (i) Intentionally Defective Irrevocable Grantor Trust;
- (ii) Single Premium Deferred Private Annuity Contract (the "Private Annuity"; and
- (iii) The substantial Tax, Estate, and Asset Protection Benefits available to a Taxpayer when selling the Taxpayer's highly appreciated real and/or personal property (the "Property"), in exchange for the above Deferred Private Annuity, for equivalent value (the "Private Annuity Contract").

The type of Irrevocable Nongrantor Trust aforementioned is technically referred to as a Discretionary ("Sprinkle") Trust (hereinafter the "Nongrantor Trust"). The substantial benefits of the Nongrantor Trust for the Taxpayer are as follows:

- (iv) Income Tax Deferral (and possibly Income Tax Avoidance);
- (v) Estate Tax Avoidance; and
- (vi) Asset Protection

Briefly, the Nongrantor Trust is a specially designed trust to specifically hold title to the Taxpayer's highly appreciated property. The Nongrantor Trust is intentionally structured so that the distribution provisions of this trust gives the Trustee the flexibility to distribute income and/or assets to the persons from the list of beneficiaries which the Trustee chooses most in need (for example, spouse, children, etc.). This enables the Grantor to defer the decision as to which beneficiary needs the most money or assistance until the time for the payments occur. The Private Annuity is a special payment contract whereby the taxpayer ("Annuitant") sells their Property to another separate legal entity, such as the Nongrantor Trust ("Obligor"), in our instant case, in exchange for the Obligor's promise to make periodic payments in fixed

amounts to the Annuitant for the remainder of the Annuitant's life. The first annuity payment may begin immediately or it may be deferred to future years, depending on the intent of the Annuitant. Hence, the Private Annuity may be "deferred," because the Private Annuity Contract may be lawfully structured so that the first annuity payment is due at a future date. Unlike the customary installment sale/promissory note payment contract ("Note"), requiring the Payor to pay an exact monetary amount for an exact number of payments over an exact period of years (See IRC §453) to the Holder of the Note, the Private Annuity Contract obligates the Obligor to pay the Annuitant annually an exact monetary amount over an unspecified number of years to the Annuitant, for as long as the Annuitant lives. Upon the death of the Annuitant, the Private Annuity Contract terminates automatically by operation of law due to a "self canceling feature." Hence, the termination date of the Private Annuity Contract remains unspecified because the remainder of the Annuitant's life also remains unspecified.

- 1.2 **"Grantor Trust" versus "Non Grantor Trust"**. The income tax rules operate independently from the estate and gift tax rules for federal tax reporting purposes. The differences between these two federal taxation systems are very important for our present purposes in understanding the important differences between a Grantor Trust and a Nongrantor Trust, thereby illustrating the usefulness of this special type of Nongrantor Trust.
- 1.3 **Recap and Summary of Strategy and Benefits.** After the Nongrantor Trust is properly formed, the Grantor Transfers by "sale" the Grantor's Property to the Nongrantor Trust in exchange for a Private Annuity. The Grantor's benefits are: (i) The Grantor defers paying the income tax on the "gain realized" but not "recognized" on the sale; (ii) The Grantor's Estate Avoids paying the Estate Tax on the Property's current fair market value at the time of the Grantor's death; and (iii) The Grantor protects the Property from the collection enforcement activities of future potential judgment creditors.
- 1.4 **DISCLAIMER - THIS ANALYSIS IS NOT A LEGAL OPINION. TO BE CERTAIN, THIS ANALYSIS DOES NOT PURPORT TO GIVE A "LEGAL OPINION" TO ANY PERSON OR ENTITY INVOLVING ANY GENERAL OR SPECIFIC SET OF FACTS OR CIRCUMSTANCES DESCRIBING THE NONGRANTOR TRUST, THE PRIVATE ANNUITY, AND/OR THE SALE OF THE TAXPAYER'S PROPERTY TO THE NONGRANTOR TRUST IN EXCHANGE FOR A PRIVATE ANNUITY. THIS ANALYSIS IS INTENDED TO SERVE TO THE READER ONLY AS A "CONCEPT ANALYSIS," ILLUSTRATING THE GENERAL PRINCIPAL INVOLVED IN A SOPHISTICATED AND ADVANCED STRATEGY FOR TAX AND ASSET PROTECTION PURPOSES. NO PERSON OR ENTITY MAY RELY UPON ANY COMMENT MADE BY THE AUTHOR OF THIS ANALYSIS CONCERNING ANY PART OF THE AFOREMENTIONED STRATEGY.**

## II. ANALYSIS.

The following analysis examines this subject in four (4) parts: the First Part more fully describes the “pure” Grantor Trust, the “pure” Nongrantor Trust, and their respective differences; the Second Part describes the Private Annuity; the Third Part describes the Tax and Asset Protection Benefits when selling the Taxpayer’s highly appreciated property to the Nongrantor Trust in exchange for the Private Annuity; and the Fourth Part describes the Grantor’s income tax reporting compliance requirements to the IRS when using the Nongrantor Trust in this factual scenario.

**2.1 First Part - Trusts in General.** In its simplest form, a trust is an agreement between the Grantor and the Trustee to hold, invest, administer, and distribute the Principal and its accumulation on the Principal of the Trust for the benefit of its Beneficiaries, as provided in the Trust Agreement.

**2.1.1 Grantor Trust.** A “pure” Domestic Grantor Trust is treated by the Internal Revenue Code (“IRC”) as a Trust which is controlled by the Grantor. Thus, the Grantor is treated as the “deemed owner” of the Trust for federal income tax and estate tax purposes. Therefore, all of the trust income and trust losses are reported by the Grantor and not by the Trust, as required under IRC Sections 671 through 679 (“Grantor Trust Rules”). In addition, the Trust Assets are included in the Grantor’s estate upon the Grantor’s death, as required by IRC §2033 through §2041. Thus, the Grantor and not the Trust or its Beneficiaries report the Trust Income and Trust Losses for federal income tax purposes and the Grantor’s Estate includes the Trust Assets for federal estate tax purposes. Consequently, a “pure” Grantor Trust is not treated as a separate taxpayer, and therefore it does not require a separate federal identification number (“EIN”) for federal income tax reporting purposes (See IRC §671). Usually, the identity of the Grantor and the identity of the Trustee are the same in a “pure” Grantor Trust. However, the identity of the Grantor and the Trustee may be different in a “pure” Grantor Trust provided (1) the identity of the Trustee is deemed “subservient” to the Grantor; and (2) the Grantor (or a third party) retains sufficient control of the Trust according to one or more of the Grantor Trust Rules under IRC Sections 671 through 679, and/or IRC Sections 2033 through 2041. To be certain, a “pure” Grantor Trust is a trust whose Trust Income is taxed to the Grantor, and the Trust Assets are included in the Grantor’s Estate upon the Grantor’s death. For example, the specific retained power by the Grantor to reacquire the Trust Assets in exchange for substituting other property of equal value to the Trust is a good example of one of the above Grantor Trust Rules. Thus, this specific Grantor Trust Rule requires the Grantor and not the Trust to report the Trust Income and Trust Losses for income tax purposes (See IRC §675(4)). In addition, another example of a retained power is when the Grantor retains the right to revoke the Trust (IRC §2038), giving the Grantor

“excessive control” over the Trust, thus causing the Trust Assets to be included in the Grantor’s Estate upon the death of the Grantor for federal estate tax purposes

**2.1.2 Nongrantor Trust.** In contrast, a “pure” Domestic Nongrantor Trust is not classified by the IRS as a trust controlled by the Grantor, and therefore the IRS does not treat the Grantor as the “deemed owner” of the Nongrantor Trust. Thus, IRC Sections 671-679 and IRC Sections 2033 through 2041 do not apply to the Nongrantor Trust. Hence, the Trust Income and Trust Losses are reported by the Nongrantor Trust and/or its Beneficiaries, and not by the Grantor, for federal income tax purposes. In addition, the Trust Assets held by a Nongrantor Trust are not taxed in the Grantor’s Estate upon the death of the Grantor for federal estate tax purposes. Consequently, a Nongrantor Trust is treated as a separate Taxpayer and thus it requires a separate federal identification number (EIN) for federal income tax reporting purposes. Once the Nongrantor Trust is determined to be a “pure” Nongrantor Trust, the Nongrantor Trust is classified as either a “Simple Nongrantor Trust” or a “Complex Nongrantor Trust” for federal income tax purposes. In a Simple Nongrantor Trust, all income is required to be paid to the Beneficiaries currently, and no amounts are payable for charitable purposes. In a Complex Nongrantor Trust, the Trustee has the discretion whether to pay or accumulate income and/or principal of the Nongrantor Trust. Almost always, the Nongrantor Trust is irrevocable to some degree. In addition, the identity of the Grantor and the Trustee are different. Furthermore, the Trust is managed by a Trustee who must be genuinely independent from the Grantor. For example, the Trustee “should” not be a “related” or “subordinate” to the Grantor. To be certain, under no circumstances should the Trustee be “subservient” to the Grantor, whether or not related or subordinate (See IRC §672 (c) and Reg §1.672 (c) –1). In a pure Nongrantor Trust, the Grantor must not retain any powers which would violate the “Grantor Trust Rules” (IRC §671 through IRC §679, inclusive). Thus, the Trust is called a “Nongrantor Trust,” because (1) the Trustee is not presumed “subservient” to the Grantor; and (2) the Grantor lacks sufficient control to direct the Trustee’s actions in this Trust. To be certain, a “pure” Nongrantor Trust is a Trust whose trust income and trust losses are taxed to the Nongrantor Trust or its Beneficiaries, and not to the Grantor. Moreover, the Trust Principal (Trust Assets) is not taxed in the Grantor’s Estate upon the Grantor’s death.

**2.1.3 Discretionary “Sprinkle” Nongrantor Trust.** This special type of Trust gives the Trustee various Trustee powers, conveying to the Trustee substantial discretion to distribute Trust Income and Trust Assets to its Beneficiaries. The consequence to the Beneficiaries is that no Beneficiary has any definitive right to any part of the Trust Income or Trust Assets, except perhaps at the termination of the Trust. The Trustee holds the Trust Asset

and Trust Income for a class of beneficiaries to whom the Trustee may distribute all or part of the Trust Income and Trust Assets, at the Trustee's sole and absolute discretion. However the Trustee may be guided by a private letter written by the Grantor to the Trustee which outlines the Grantor's wishes (intentions) but it has no legal force and effect. One advantage of this Trust is that distribution of Trust Income and Trust Assets to its Beneficiaries can be varied according to changes in circumstances with little difficulty. Another advantage is the protection of the Trust Assets and Trust Income from the collection enforcement activities from future potential judgment creditors. As a general rule, creditors can only attach and levy upon a tangible interest, owned by the Judgment Debtor (Beneficiary), provided the same Beneficiary has a legal right to enjoy the tangible interest immediately, or deferred to some time in the future. However, Trust Beneficiaries have no definitive right of receiving a distribution of Trust Income or Trust Assets, immediately or in the future, in a pure Discretionary Nongrantor Trust, and therefore it is difficult, if not impossible, for any potential future judgment creditor to find a tangible interest of the Beneficiary to attach and levy upon. The reason this type of Trust is characterized with the term "Sprinkle," is because the Trustee has the absolute and unconditional discretion to make all or part of the Trust distributions of Trust Income and Trust Assets to any one or more of the Beneficiaries, within the class of Beneficiaries, without treating the same Beneficiaries equally, at the Trustee's sole and absolute discretion.

**2.2 Second Part - Private Annuities in General.** In its simplest form, a Private Annuity Contract is an agreement between two parties by which one person, the Seller, transfers certain valuable property to the Buyer in exchange for the Buyer's promise to make a series of periodic annuity payments for the Seller's lifetime (the "Annuitant"). The first annuity payment may start immediately or it may start at a future date (sometimes referred to as a "Deferred Private Annuity Contract"). A Private Annuity Contract must make payments on a regular periodic basis. Private annuities are generally used by Individuals as a means of financing the sale of an asset to a related party while saving a substantial income tax and estate tax. A Private Annuity Contract is not an annuity issued by an insurance company.

2.2.1 In our instant case, the Taxpayer (the "Annuitant") transfers certain valuable and highly appreciated real property to a Nongrantor Trust, who is not in the business of selling annuities. The Nongrantor Trust (the "Obligor") agrees to make periodic payments in fixed amounts to the Annuitant for the remainder of the Annuitant's life.

2.2.2 Payments received by the Annuitant pursuant to the Private Annuity Contract are composed of three elements: (i) return of capital (which is not taxable); (ii) taxable gain on the sale of the asset (ordinary gain or long term capital gain); and (iii) taxable interest accumulating thereon (ordinary gain).

- 2.2.3 The Private Annuity operates like an installment sale promissory note (“Note”), in that a Note is a special type of payment contract which requires the Obligor to pay a certain fixed amount annually over a certain fixed period of time. The Private Annuity is also a special type of payment contract but it differs from the Note in that the period of time for each annual payment is not “fixed” because the period of time is equal to the Annuitant’s life. Also, the Private Annuity Contract has certain advantages over a Note as follows: (1) the Private Annuity Contract avoids immediate 100% recapture of depreciation (applicable only upon the sale of depreciable Property); and (2) the Note makes a predetermined exact number of payments to the Annuitant, whether or not the Annuitant dies before the final payment is made, whereas the Private Annuity Contract makes payments to the Annuitant until the Annuitant’s death, then the Private Annuity Contract terminates. The unpaid balance under the Private Annuity Contract is not reportable to the Seller or to the Buyer for income tax or estate tax purposes, as opposed to the unpaid balance due under the Note.
- 2.2.4 Upon the death of the Annuitant, all payments to the Annuitant pursuant to the Private Annuity Contract cease. Also, once the payments cease on the death of the Annuitant, the Private Annuity has no further value. Thus, there is no value remaining in the Private Annuity Contract to be includable in the Annuitant’s gross estate for federal estate tax purposes. Thus, the Taxpayer’s real property sold to the Obligor has been removed from the Annuitant’s gross estate for federal estate tax purposes.
- 2.2.5 The Obligor of the Private Annuity, in exchange for the Real Property purchased, may claim a “Cost Basis” in the Private Annuity equal to the purchase price of the Real Property received. Therefore, the Obligor of the Private Annuity may thereafter resell the Property for a cash payment and not be taxed on the sales price provided it does not exceed its Basis.
- 2.2.6 In the event the Annuitant dies before receiving the Final Annuity Payment, all future Annuity payments due the Annuitant will cease, the unpaid balance will be cancelled, and the Obligor of the Private Annuity will not be taxed on the forgiveness of the unpaid balance (sometimes referred to as “debt relief”), notwithstanding that the Obligor has been granted “debt relief,” which is usually subject to income tax. Thus, the Obligor retains the balance unpaid to the Annuitant, and the Obligor is not liable for any federal income taxes equal to the amount of the “debt relief.” Also, the Annuitant’s Estate does not include the unpaid amount remaining in the Private Annuity Contract as part of the Grantor’s Estate.
- 2.2.7 The total amount of the life time payments in the aggregate will be identical to the face value of the Private Annuity Contract plus interest accumulated thereon. The payments may begin immediately or they may be deferred to a

future date, depending on the sole discretion of the Annuitant. The amount of each periodic payment is then calculated according to various rules and regulations specifically issued by the Internal Revenue Service (“IRS”) in order for the Private Annuity Contract to be in full compliance with the IRC, sometimes referred to as a “Safe Harbor” (IRC §7520; Actuarial Value Book of Aleph; and Rev. Ruling 2001-3 (Tables #2 and #5)).

## **2.3 Third Part - Tax and Asset Protection Benefits When Selling the Property to the Nongrantor Trust in Exchange for a Private Annuity.**

**2.3.1 Income and Estate Tax Benefits.** As indicated earlier, a “pure” Nongrantor Trust reports all Trust Income and Trust Losses for income tax purposes because the Grantor does not violate the Grantor Trust Rules per IRC Sections 671-679. Also, the “pure” Nongrantor Trust is taxed on the gain from the resale of the Trust Asset. Moreover, the Trust Assets are removed from the Grantor’s estate when the Grantor dies because the Grantor does not violate the applicable estate tax rules per IRC Sections 2033-2041. The specific income and estate tax benefits to the Grantor are more fully described below:

### **(a) Income Tax Benefits.**

- (1) A “pure” Nongrantor Trust is taxed on the Trust Income, and the Grantor of the same Nongrantor Trust is not taxed on the Trust Income.
- (2) The Grantor’s gain is deferred when selling the highly appreciated Property to a Nongrantor Trust in exchange for a properly structured Private Annuity. In addition, the Nongrantor Trust receives a “stepped up basis” in the Property purchased, equal to its purchase price. Thus, there is no taxable event at the time the Private Annuity Transaction is fully executed when utilizing the Nongrantor Trust. Also, the Nongrantor Trust may resell the Property previously purchased from the Grantor, and no tax will result on the gain up to the “stepped up basis” in the Property. Furthermore, the Grantor may receive the first Private Annuity payment immediately, or defer the same to a future date, provided Grantor is in full compliance with the IRC and other applicable federal tax laws, rules, and policies. Once the payments start, each payment is treated for income tax purposes in three parts as follows: the first part is not taxed because it is a “return of capital;” the second part is taxed at the “capital gains rate;” and the third part is taxed at “ordinary rates.”

(b) **Estate Tax Benefits.**

- (1) The Nongrantor Trust is not taxed on the unpaid balance of the Private Annuity in the event the Grantor dies, the annuity payments cease, and the Private Annuity becomes null and void. Although there is “cancellation of debt,” or sometimes referred to as “debt relief,” the Nongrantor Trust is not taxed on the same.
- (2) The Grantor obtains the Estate Tax Benefit because the Grantor’s Estate Tax is substantially reduced or in some cases completely eliminated upon the Grantor’s death for federal estate tax purposes. The reason is that the Property is not included in the Grantor’s Estate upon the Grantor’s death.

**2.3.2 Asset Protection Benefits.** The “transfer” of the Property to the Nongrantor Trust by gift or sale will provide the Grantor in most cases a certain level of Asset Protection depending upon whether the transfer is made by “gift” or a “sale.” In the event a transfer is made by gift, a gift tax shall be assessed on the Grantor based upon the full value of the Gift over the value of the Annual Exclusion (\$11,000). Assuming the Grantor fully satisfies certain “variables” in this scenario, the Grantor’s Property should be protected from federal estate taxes upon the subsequent death of the Grantor, and the Property should also be protected from the collection activities from potential future judgment creditors seeking to set aside the Gift, alleging a “fraudulent conveyance” (which is beyond the scope of this discussion). Some of the most important variables referred to above include but are not limited to the following: (1) the Gift must be “fully completed”; (2) the Gift must not be a “fraudulent conveyance”; and (3) the Gift must be completed at least three years from the date of the Grantor’s death. If the above variables are fully satisfied, (as well as other variables not mentioned herein), a transfer by gift will provide the Grantor a certain level of “effective” Asset Protection. However, the above variables become very problematic for the Grantor to achieve a minimum level of asset protection if any one of the above variables are in doubt, or are not fully satisfied. In order for the Grantor to effectively achieve a more certain predictable level of asset protection, a transfer by “sale” of the Property in exchange for “full and adequate consideration in money or moneys worth” is the most preferred method of transfer (See IRC 2043 (a)). The Private Annuity Transaction is one of the most effective methods to execute a transfer by sale for income tax and estate tax purposes, because the IRS recognizes the exchange of the Property for the Private Annuity as a bonafide genuine transfer for equivalent consideration provided

the Taxpayer properly structures the Private Annuity in full compliance with the applicable Internal Revenue Code, Treasury Regulations, Revenue Rulings, and Case Law (IRC §1035). In such an event, the Property will not be taxed in the Grantor's Estate upon the subsequent Grantor's death for federal estate tax purposes. Likewise, the transfer of the Property in exchange for the Private Annuity should not be set aside by a subsequent judgment creditor's claim, on the basis that the transfer was a fraudulent conveyance to defraud creditors. The reason is that a transfer by Sale in exchange for "full and adequate consideration," such as a Private Annuity does not violate IRC §2043 and is almost always a valid defense against a fraudulent conveyance allegation. Thus, the transfer by sale of the Property to the Nongrantor Trust in exchange for a properly structured Private Annuity is preferred over a "transfer by gift" in order to ensure the maximum level of Asset Protection possible for the Grantor's Property.

**2.3.3 The Income and Estate Tax Consequences When the Transfer is Made by Gift or Sale to the Irrevocable Nongrantor Trust.** In order to illustrate the income and estate tax consequences of a transfer by "sale" as opposed to a transfer by "gift" in a Private Annuity Transaction using a "pure" Nongrantor Trust, it is helpful to illustrate below the tax consequences between a transfer by "sale" and a transfer by "gift."

- (a) ***Gift.*** The Grantor may "gift" substantially appreciated Property to the Nongrantor Trust at its fair market value, incurring a gift tax provided the gift of the Property by the Grantor to the Nongrantor Trust is complete. One of the reasons the gift is complete is due to the specific type of powers which are not retained by the Grantor in the Nongrantor Trust. Assuming the Grantor's Asset has been effectively transferred to the Nongrantor Trust for income tax purposes, the Nongrantor Trust reports all Trust Income and Trust Losses attributable to the Trust Asset. The primary disadvantage of transferring assets by "gift" to the Nongrantor Trust is that the gift is more likely to be attached and set aside by a judgment creditor as a fraudulent conveyance, as opposed to a transfer by "sale." If the fraudulent conveyance issue is not considered important to the Grantor when transferring the Property to the Nongrantor Trust, then the transfer by gift is an acceptable method of transferring Property.
  
- (b) ***Sale.*** The Grantor may sell the Property to the Nongrantor Trust at its fair market value without incurring an estate or gift tax because the transfer of the Property by a properly structured lawful sale transaction is not subject to the estate or gift tax provisions of the federal tax laws (IRC §2043(a)). To be certain, the sales price for the

Property should equal its fair market value. There are basically three (3) types of “sale transactions” which are generally used in this instant case to sell the Grantor’s Property to the Nongrantor Trust. (1) The first type involves the Installment Sale Promissory Note Contract pursuant to IRC §453. (2) The second type involves the Self-Canceling Installment Note (sometimes referred to as a “SCIN”). Briefly, both types of sales transactions involve promissory notes, which requires the Nongrantor Trust to make installment payments to the Grantor, until the purchase price is fully paid. However, the “SCIN” is cancelled upon the Grantor’s death by operation of law, notwithstanding that the balance of the Note remains unpaid; and (3) The third type of sale transaction involves the Private Annuity aforementioned. As stated above, the Private Annuity is more similar to the SCIN than the Installment Note. The Private Annuity is a special payment contract whereby the Nongrantor Trust promises to pay the Grantor (“Annuitant”) a stated amount over his/her lifetime, payable monthly, quarterly, or annually pursuant to the terms of the Private Annuity Contract, in exchange for the Property. Like the SCIN, all payments under the Private Annuity cease upon the Grantor’s death. However, the Private Annuity is more suitable to the sale of highly appreciated real estate than the SCIN for various reasons beyond the scope of this discussion. The estate tax benefit is that the sale of the Grantor’s Property to the Trust in exchange for the Private Annuity removes the Property from the Grantor’s estate for estate tax purposes, and thus protects the Trust Asset from the collection enforcement activities of potential future judgment creditors against the Grantor. Moreover, the income tax applicable to the Grantor associated with the sale is deferred pursuant to the terms of the Private Annuity. Since the Private Annuity cancels upon the Grantor’s death, the remaining unpaid balance (if any) will not be includable in the Grantor’s gross estate for federal estate tax purposes. Also, the Nongrantor Trust is not taxed on the cancelled unpaid balance notwithstanding there is “debt relief” to the Nongrantor Trust.

- 2.4 Fourth Part - Income Tax Reporting Compliance Requirements.** Section 6012(a)(4), IRC, requires a trust to file a federal income tax return if it has either “any taxable income” or “gross income of \$600 or over.” Thus, the Nongrantor Trust is required to file trust income tax returns on Form 1041 U.S. Income Tax Return for Estates and Trusts.

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### III. CONCLUSION

The Grantor substantially benefits from properly structuring the Private Annuity Transaction with the Nongrantor Trust.

- 3.1 The entire value of the Property is removed from the taxable estate of the Grantor (“Annuitant”). When the Annuitant dies, the payments to the Annuitant cease, and the Private Annuity becomes null and void. Thus, the Property is not taxed in the Grantor’s estate. The Property, along with the balance of the Trust Assets will pass to its Beneficiaries free of estate and gift taxes.
- 3.2 If the Grantor transfers the Property to the Nongrantor Trust by Gift and not by Sale, this transfer by Gift will trigger a gift tax because the Property may have a substantial net worth in excess of the Annual Exclusion. The reason there is a gift tax is because the gift was fully completed to the Nongrantor Trust. Thus the Trust Income and Trust Losses generated from the Property are reported by the Trust on IRS Form 1041.
- 3.3 If the Grantor transfers the Property to the Nongrantor Trust by Sale and not by Gift, using the Private Annuity Transaction to consummate the sale as aforementioned, this transfer by Sale will not trigger any gift tax consequences even though the property has a substantial net worth. The reason is that the transfer is for “full and adequate consideration” (IRC §2043 (a)). The Private Annuity Transaction is treated by the IRS as a lawful arm’s length genuine bonafide transfer for consideration of equivalent value (IRC §1035).
- 3.4 The Property will not be probated when the Grantor (Annuitant) dies. The reason is that the Property is removed from the Grantor’s estate because it was sold in exchange for the Private Annuity of equivalent value.
- 3.5 The Property generally will not be subject to Medicaid claims, should the Grantor (Annuitant) later require Medicaid assistance with nursing home care. The Private Annuity payment may be subject to Medicaid claims during the life of the Grantor (Annuitant), however, in most states the Property is free from Medicaid claims.
- 3.6 The deferral of capital gains tax or ordinary income tax when using the Private Annuity Transaction produces a dramatic increase in disposable income for the Taxpayer.
- 3.7 The Grantor and the Beneficiaries of the Trust may advise (but not dictate) the Trustee’s actions concerning the disposition of the Trust Income and Trust Assets. All Trust Assets, including but not limited to the resale proceeds from the Property, and all Accumulation on the Trust Assets, will be paid to the Grantor’s Beneficiaries according to the type of discretionary Irrevocable Nongrantor Trust. When the

Grantor (Annuitant) dies, the Private Annuity terminates and only the balance of all Trust Assets remaining in this Trust are distributed to its Beneficiaries, according to the terms of the Trust Agreement.

- 3.8 The Nongrantor Trust may resell the Property on a cash basis later to the ultimate buyer of the Property, without incurring a taxable event, assuming the resale price to the ultimate buyer is less than or equal to the purchase price paid by the Nongrantor Trust to the Grantor. Therefore, the Nongrantor Trust is not forced to make an installment sale to the ultimate buyer, in order to spread out and defer the capital gains tax. A cash sale over an installment sale is a substantial advantage because there is no guarantee the ultimate buyer will ultimately make all of the installment payments on the installment sale - promissory note.
- 3.9 The Private Annuity is the equivalent of receiving a tax-free loan from the federal government, because the capital gain tax or ordinary income tax may be deferred, benefiting the Grantor (Annuitant) for the period deferred. This assumes the interest accruing on the Private Annuity in less than the accumulation being earned on the Trust Assets.
- 3.10 The formal mechanics of the Private Annuity Transaction between the Grantor (Annuitant) and the Nongrantor Trust provides the additional discipline that some taxpayers may find necessary and helpful in forming and funding their own retirement plan. Moreover, the Private Annuity works equally well for single or married Grantors (Annuitants). Married couples can have the private annuity written as a joint, last to die single premium Private Annuity contract.

The final point is that the use of the Nongrantor Trust depends ultimately upon whether the Grantor's estate is suitable for this advanced and sophisticated Tax and Asset Protection Strategy. To be certain, the benefits afforded the Grantor when adopting the Nongrantor Trust with the Private Annuity Transaction are substantial, and therefore this strategy should merit serious consideration for any high net worth Taxpayer with highly appreciated real and/or personal property. If you have any questions or require additional information, please do not hesitate in contacting our office.

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