

**Wyoming Trusts for Colorado Residents:  
Reduced Income Tax, Asset Protection, and Other Advantages**

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I. WHY SHOULD COLORADO RESIDENTS SETTLE WYOMING TRUSTS?

Colorado does not offer the ideal location for settlors seeking to use trusts to preserve dynastic family wealth, particularly in comparison to Wyoming, its northern neighbor. While both Colorado and Wyoming allow settlors to create near-perpetual 1,000-year trusts,<sup>1</sup> other considerations, including potential tax burdens and asset protection opportunities, demonstrate that Wyoming offers a superior trust situs.

A. *No Income Tax*

The state of Colorado imposes a tax on the income of resident trusts<sup>2</sup> and non-resident trusts that have Colorado source income.<sup>3</sup> A trust is a Colorado resident trust if it is administered in Colorado.<sup>4</sup> Any other trust is a non-resident trust.<sup>5</sup> A trustee or other fiduciary must register a trust as a resident Colorado trust if Colorado is the trust's principal place of administration.<sup>6</sup> Unless the trust designates otherwise, a trust's principal place of administration is the trustee's usual place of business at which trust records are kept or the trustee's residence if no such place of business exists.<sup>7</sup> If a trust has a single corporate co-trustee, that co-trustee's place of business will be deemed the trust's principal place of administration.<sup>8</sup>

In contrast, Wyoming imposes no tax on trust income under any circumstances.<sup>9</sup> Eliminating application of Colorado income tax to a trust by migrating to Wyoming should be a

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<sup>1</sup> See WYO. STAT. ANN. § 34-1-139; COLO. REV. STAT. § 38-10-111.

<sup>2</sup> COLO. REV. STAT. § 39-22-401(1).

<sup>3</sup> *Id.* § 39-22-403(1).

<sup>4</sup> *Id.* § 39-22-103(10).

<sup>5</sup> *Id.*

<sup>6</sup> *Id.* § 15-16-101(1).

<sup>7</sup> *Id.*

<sup>8</sup> *Id.*

<sup>9</sup> Christopher M. Reimer, *The Undiscovered Country: Wyoming's Emergence as a Leading Trust Situs Jurisdiction*, 11 WYO. L. REV. 165, 176-77 (2011); Max Gutierrez, Jr. & Frederick R. Keydel, *State Taxation on Income of Trusts with Multi-State Contacts*, in ACTEC STUDIES 6-1, 6-26, 6-58 (2001) (contribution of Thomas N. Long).

relatively simple matter. Unlike some states, Colorado does not impose income tax on trusts on the basis of whether a trust has Colorado residents who have vested beneficial interests in the trust.<sup>10</sup> Colorado will only subject a trust to income tax if the trust has Colorado source income or is a resident trust because it is primarily administered in Colorado.<sup>11</sup> As such, changing a trust's principal place of administration to Wyoming by appointing Wyoming trustees, selecting Wyoming as the trust's governing law, locating assets in Wyoming, and having the trust administered in Wyoming should prevent Colorado taxation of a trust's non-Colorado source income.

## B. *Strong Asset Protection*

### 1. *Asset Protection Trusts*

An asset protection trust is a spendthrift trust in which a settlor may retain a beneficial interest. By placing assets beyond the settlor's control, such a trust prevents the settlor's creditors from attaching the trust's assets (subject to certain limitations). Under a long-standing U.S. rule, a settlor cannot create such a trust for his or her own benefit. But several states, including Wyoming, have now adopted statutes that abrogate the common law rule and permit asset protection trusts.

Colorado has a very old law that could arguably permit settlors to create asset protection trusts.<sup>12</sup> According to the statute: “[A]ll conveyances, and all transfers or assignments, verbal or written, of goods, chattels, or things in action, or real property, made in trust for the use of the person making the same shall be void as against the creditors existing of such person.”<sup>13</sup> The United States Court of Appeals for the Tenth Circuit interpreted this provision to mean that self-settled spendthrift trusts are effective against future creditors, but not existing creditors.<sup>14</sup> The Colorado Supreme Court has rejected this reasoning and has stated in dicta that self-settled spendthrift trusts may be void.<sup>15</sup> Even if the statute is effective, it is old and not clearly tailored towards asset protection needs. The statute does not address a wide array of important issues, including what interests and powers a settlor may retain, the trustee's distribution authority, whether foreign trusts may become subject to the statute, and whether attorneys and other advisors are protected from liability for helping to create such trusts. Establishing an asset protection trust in Colorado remains risky given the lack of clear legislative or judicial guidance.

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<sup>10</sup> Gutierrez & Keydel, *supra* note 9, at 6-31.

<sup>11</sup> See COLO. REV. STAT. §§ 39-22-401(1), -403(1).

<sup>12</sup> See Joseph G. Hodges, Jr. & Eugene P. Zuspahn, II, *Can Some Colorado Trusts Provide Protection from Claims of Creditors?*, 28 COLO. LAW. 61 (Aug. 1999); Howard D. Rosen & Gideon Rothschild, *Asset Protection Planning*, BNA TAX MGMT. PORTFOLIO A-96 (2008).

<sup>13</sup> COLO. REV. STAT. § 38-10-111.

<sup>14</sup> *In re Baum*, 22 F.3d 1014, 1017 (10th Cir. 1994); see also *Alberico v. Health Mgmt. Sys.*, 5 P.3d 967, 970 (Colo. Ct. App. 2000) (finding that section 38-10-111 invalidated a conveyance to a trust by a creditor).

<sup>15</sup> *In re Cohen*, 8 P.3d 429, 433 (Colo. 1999).

Wyoming authorizes the creation of self-settled spendthrift trusts in the form of Wyoming Qualified Spendthrift Trusts (WQSTs).<sup>16</sup> Other than certain fraudulent transfer, secured, and child support claims, assets held in such trusts are not subject to creditor claims.<sup>17</sup> By appointing a Wyoming trust company, such as Jackson Hole Trust Company, as trustee and making the trust irrevocable, clients and their heirs may benefit from trust assets without placing them at risk of creditor attachment.

A Colorado settlor of a Wyoming trust can satisfy the requirements necessary to create a trust that will not be subject to Colorado income tax by creating a new WQST administered by a Wyoming trust company. To create an effective WQST, the settlor must execute a trust instrument that (i) appoints a trustee that is a Wyoming resident (other than the settlor) or a person authorized to act as a trustee to act as a trustee by Wyoming law; (ii) states that it is a “qualified spendthrift trust” under Wyoming Statutes section 4-10-510; (iii) expressly provides that Wyoming law governs questions of the trust’s validity, construction, and administration; (iv) provides that the settlor’s interest in income or principal is held subject to a spendthrift provision that restricts transfer of the settlor’s beneficial interest in the trust enforceable under applicable nonbankruptcy law; and (v) is irrevocable.<sup>18</sup> In addition, an affidavit negating the possibility of a fraudulent transfer must accompany a transfer to a WQST.<sup>19</sup>

A Wyoming Incomplete Gift Non-Grantor Trust (WING) is a WQST that is not treated as a grantor trust. Settlor who live in states that tax trust income or capital gains can use WING trusts to minimize the trust’s state tax liability. If a WING trust meets the requirements of non-grantor status by (1) not providing the settlor with impermissible interests or powers over the trust, (2) requiring that distributions to the settlor be approved by a committee composed of persons who have a substantial, adverse interest in the trust’s assets, and (3) ensuring that WING’s assets are not subject to claims by the settlor’s creditors, the trust should not be subject to income tax imposed by the settlor’s state of residence.<sup>20</sup>

## 2. *Discretionary Trusts*

Another means of obtaining asset protection, regardless of the existence of a spendthrift protection, is by giving a trustee discretion to distribute or not distribute assets to a trust’s beneficiaries. In many states, this deprives beneficiaries of a property interest in a trust’s assets, which prevents creditor attachment. Wyoming and South Dakota are the only top-trust situses that provide a clear definition of discretionary interests and trusts, ensuring that a properly

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<sup>16</sup> WYO. STAT. ANN. § 4-10-510(a).

<sup>17</sup> *Id.* §§ 4-10-502(b), 4-10-517, 4-10-520.

<sup>18</sup> *Id.* § 4-10-510(a). Wyoming Statutes section 4-10-103(a)(xxxv) defines a “qualified trustee.” Certain powers and rights retained by the settlor will not endanger a WQST’s irrevocable status, such as veto power over distributions, receipt of income, an inter vivos or testamentary general or limited power of appointment, the right to receive 5% of the trust’s value per year, the right to add or remove fiduciaries, etc. *Id.* § 4-10-510(a)(iv).

<sup>19</sup> *See id.* §§ 4-10-512(b), 4-10-523.

<sup>20</sup> For a more thorough discussion of how to avoid grantor status, see *infra* Section II.

drafted trust will provide such protection.<sup>21</sup> Colorado courts have held that beneficiaries do not have property interests in discretionary trusts and that trustees cannot be compelled to make distributions absent fraud or an abuse of discretion.<sup>22</sup> But the lack of a statute makes such a rule less certain than it would be under Wyoming law. There is also no clear definition of a “discretionary trust” under Colorado law, creating the risk that improper drafting will negate such a trust’s asset protection advantages.

### 3. *Sole Charging Order Remedy Protection for LLCs*

Settlers can achieve an even greater degree of asset protection by combining Wyoming trusts with Wyoming limited liability companies (LLCs).<sup>23</sup> The Wyoming LLC Act provides the charging order as the sole remedy of a creditor against a member’s interest in an LLC’s assets.<sup>24</sup> This is true even if an LLC has a single member.<sup>25</sup> Creditors who have obtained charging orders cannot foreclose on a debtor’s membership interest.<sup>26</sup> Additionally, the Act provides that the charging order is a creditor’s sole means of satisfying a judgment from the LLC’s assets,<sup>27</sup> which should effectively prevent the risk of a creditor using reverse veil piercing to satisfy a member’s debts from LLC assets. While the charging order entitles the creditor to distributions that the debtor–member would have received, it can allow an LLC to withhold distributions to the debtor–member until the parties have reached a favorable settlement. The Act clarifies that the charging order is against the member’s “transferable interest” only,<sup>28</sup> which is defined as the right to receive distributions according to the terms of the LLC’s operating agreement.<sup>29</sup> This definition ensures that the creditor cannot use the charging order to obtain management rights with respect to the LLC and cannot compel distributions.

Colorado law does not provide that the charging order is a creditor’s sole remedy against a member’s interest in a Colorado LLC.<sup>30</sup> In the infamous *Albright* case, a bankruptcy court interpreted Colorado’s statute as providing that the charging order was not the sole remedy of a creditor against a single-member LLC.<sup>31</sup> While a judgment creditor has only the rights of a

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<sup>21</sup> See *id.* §§ 4-10-103, -504; S.D. CODIFIED LAWS § 55-1-38.

<sup>22</sup> See, e.g., *In re Marriage of Jones*, 812 P.2d 1152, 1156 (Colo. 1991).

<sup>23</sup> WYO. STAT. ANN. §§ 17-29-101 to -1105 (2010). See generally Dale W. Cottam et al., *The 2010 Wyoming Limited Liability Company Act: A Uniform Recipe with Wyoming “Home Cooking,”* 11 WYO. L. REV. 49 (2011) for a detailed discussion of the Act.

<sup>24</sup> WYO. STAT. ANN. § 17-29-503(g).

<sup>25</sup> *Id.*

<sup>26</sup> *Id.*

<sup>27</sup> *Id.*

<sup>28</sup> *Id.* § 17-29-503(a).

<sup>29</sup> *Id.* § 17-29-102(a)(xxii).

<sup>30</sup> See COLO. REV. STAT. § 7-80-703.

<sup>31</sup> *In re Albright*, 291 B.R. 538, 541 (Bankr. D. Colo. 2003).

assignee or transferee of a membership interest, Colorado's statute contemplates that the interest may be foreclosed upon and expressly permits appointment of a receiver that may make the same orders and inquiries that the debtor could make.<sup>32</sup> Finally, Colorado's statute says only that a creditor of a member may obtain a charging order. It does not provide that the charging order is a creditor's sole means of satisfying a judgment from an LLC's assets, meaning that a creditor may be able to use reverse veil piercing to satisfy a judgment against a member from an LLC's assets. In certain circumstances, the Colorado Supreme Court authorizes reverse veil piercing against Colorado corporations.<sup>33</sup> In the context of veil-piercing, Colorado's LLC statute requires courts to apply applicable case law regarding corporate veil-piercing.<sup>34</sup> Colorado courts may also use other equitable doctrines to hold persons liable in connection with an LLC.<sup>35</sup>

### C. *Other Substantive Trust Law Advantages*

Wyoming offers a variety of substantive trust laws that allow for effective, low-cost, and flexible trust administration. These features include directed trusts,<sup>36</sup> trust protectors,<sup>37</sup> flexible trust modification and reformation procedures,<sup>38</sup> special purpose entities,<sup>39</sup> purpose trusts,<sup>40</sup> virtual representation,<sup>41</sup> and the choice of regulated or unregulated private trust companies.<sup>42</sup> Colorado has yet to adopt many of these useful doctrines by statute or case law.<sup>43</sup> Until it does so, settlors, trustees, beneficiaries, and fiduciaries of Colorado trusts will be sharply limited in

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<sup>32</sup> COLO. REV. STAT. § 7-80-703

<sup>33</sup> *In re Phillips*, 139 P.3d 639, 644 (Colo. 2006). In dicta, one federal court refused to extend the holding of *Phillip* to a Colorado LLC, but did not analyze the issue. See *Stich v. BAC Home Loans Servicing, LP*, No. 10-cv-01106-CMA-MEH, 2011 WL 1135456 (D. Colo. March 29, 2011) (Order Granting in Part and Denying in Part Defendant's Motion to Dismiss).

<sup>34</sup> COLO. REV. STAT. § 7-80-107.

<sup>35</sup> *Sheffield Servs. Co. v. Trowbridge*, 211 P.3d 714, 720 (Colo. Ct. App. 2009) (holding that, despite the provision of the LLC statute requiring Colorado courts to apply corporate veil-piercing case law, a court could use an equitable doctrine to hold a non-member manager liable for an LLC's improper actions).

<sup>36</sup> WYO. STAT. ANN. § 4-10-712.

<sup>37</sup> *Id.* § 4-10-710.

<sup>38</sup> *Id.* §§ 4-10-411, 4-10-412, 4-10-413, 4-10-415, 4-10-416, 4-10-417 (2010) (providing for trust modification, termination, and reformation).

<sup>39</sup> *Id.* § 4-10-710.

<sup>40</sup> *Id.* § 4-10-410(a).

<sup>41</sup> *Id.* § 4-10-304.

<sup>42</sup> See *id.* §§ 13-4-101 to -104; Letter from Joseph B. Meyer, Wyo. Att'y Gen., to Sue Mecca, State Banking Comm'r, Wyo. Banking Comm'n (Mar. 1, 1993).

<sup>43</sup> Daniel G. Worthington & Mark Merric, *Which Situs is Best?*, TR. & EST., Jan. 2010, at 64 tbl. (noting that Colorado has a directed trust statute, but does not have a trust protector statute, flexible reformation or decanting statute, special purpose entities, or enhanced virtual representation).

their ability to take advantage of recent developments in modern trust law, especially in comparison to Wyoming.<sup>44</sup>

## II. AVOIDING GRANTOR TRUST STATUS

Twelve states currently permit settlors to create spendthrift trusts for their own benefit.<sup>45</sup> Wyoming's modified version of the Uniform Trust Code offers settlors a competitive form of domestic asset protection trust: the WQST.<sup>46</sup> In addition to providing creditor protection, effectively drafted WQSTs can allow settlors living in states that impose tax on trust income to create trusts that will not be subject to such tax. In order for a WQST with a Colorado settlor to effectively avoid income tax, a trust cannot be a grantor trust. Grantor status requires the settlor to report trust income on his or her personal state income tax returns, preventing a WQST from serving state income tax minimization goals.

The Internal Revenue Code treats settlors who contribute property to certain kinds of trusts as the owners of some or all of such trusts. If a trust is classified as a grantor trust, any income attributable to the part of the trust to which the settlor is treated as the owner will be included in the settlor's taxable income.<sup>47</sup> If income is included in a Colorado resident's federally taxable income, it will also be subject to Colorado income tax.<sup>48</sup> Generally, the settlor of a WQST must avoid five pitfalls that will trigger grantor trust status: (1) the settlor cannot retain a reversionary interest exceeding 5% of the trust's initial value;<sup>49</sup> (2) the settlor cannot have the power to control beneficial enjoyment of the trust's assets,<sup>50</sup> (3) the settlor cannot have the power to revoke the trust,<sup>51</sup> (4) the settlor cannot be able to receive impermissible distributions from the trust,<sup>52</sup> and (5) trust assets must not be subject to claims by the settlor's creditors.<sup>53</sup> Requiring a distribution committee composed exclusively of beneficiaries with

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<sup>44</sup> For a thorough discussion of the benefits of Wyoming trust law, see generally Reimer, *supra* note 9.

<sup>45</sup> See ALASKA STAT. § 34.40.110; DEL. CODE ANN. tit. 12, § 3570(11)(a) & (b); HAW. REV. STAT. § 554G; MO. REV. STAT. § 456.5-505(3)(2); NEV. REV. STAT. § 166.040(1)(b); N.H. REV. STAT. ANN. § 564-D:1-18; OKLA. STAT. tit. 31, §§ 10-18; R.I. GEN. LAWS § 18-9.2-2(10); S.D. CODIFIED LAWS §§ 55-16-1 to 55-16-17; TENN. CODE ANN. §§ 35-16-101 to 35-16-112; UTAH CODE ANN. § 25-6-14(1)(a); WYO. STAT. ANN. §§ 4-10-510.

<sup>46</sup> See WYO. STAT. ANN. § 4-10-510(a).

<sup>47</sup> I.R.C. § 671.

<sup>48</sup> COLO. REV. STAT. § 39-22-104(1.7) (imposing Colorado income tax on the basis of a Colorado resident's federal taxable income).

<sup>49</sup> I.R.C. § 673(a).

<sup>50</sup> *Id.* § 674(a).

<sup>51</sup> *Id.* § 676(a).

<sup>52</sup> Treas. Reg. § 1.677(a)-1(d) (1971).

<sup>53</sup> Other trust features can trigger grantor status, including impermissible administrative powers, I.R.C. § 675, and foreign trusts with U.S. beneficiaries, *id.* § 679.

substantial adverse interests in the trust to authorize distributions to the settlor should solve these problems and ensure that a WQST avoids grantor status as summarized below.<sup>54</sup>

A. *Reversionary Interests (I.R.C. § 673)*

A WQST will receive grantor trust treatment if, at the trust's inception, the settlor has a reversionary interest in part of the trust exceeding 5% of that part's value.<sup>55</sup> This raises the question of whether a settlor's ability to receive distributions at a trustee's discretion constitutes a reversionary interest. Code § 672 does not define the term "reversionary interest."<sup>56</sup> However, § 673 likely uses the term in its traditional sense, in which a reversionary interest is created when a person who owns a vested estate transfers a lesser vested estate to another person.<sup>57</sup> The part of the estate retained by the transferor constitutes the reversionary interest. From this perspective, the settlor of a properly drafted WQST has no reversionary interest because he or she has transferred all of his or her legal interest to a third party trustee. The settlor's ability to receive distributions at the trustee's discretion is not a reversionary interest, but a beneficial interest. Support for the argument that § 673 is using the term in this traditional sense—and thus does not describe a settlor's beneficial interest in a WQST—can be found in I.R.S. guidance, case law, and the statute's legislative history.

In 1981, the I.R.S. issued a Technical Advice Memorandum considering whether the full amount of a taxpayer's recovery following termination of a trust should be included in the taxpayer's gross income.<sup>58</sup> As part of the memorandum, the I.R.S. determined whether the taxpayer's reasonable expectation of enjoyment of the trust property within ten years of the initial transfer created a reversionary interest. The I.R.S. stated that it would not: "a reversionary interest is the interest a transferor has when less than his entire interest and property is transferred to a trust and which will become possessory at some future date."<sup>59</sup> The I.R.S. defined a reversionary interest in a similar fashion in a General Counsel Memorandum.<sup>60</sup> The memorandum concluded that a trust that contained a provision deeming the trust void and returning assets to the grantors upon the I.R.S.'s disallowal of a deduction conflicted with § 676(a). Yet the memorandum defined reversionary interests in the traditional fashion, which would allow a properly drafted WQST to avoid a grantor trust status. The memorandum

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<sup>54</sup> See I.R.S. Priv. Ltr. Rul. 200612002 (Mar. 24, 2006); I.R.S. Priv. Ltr. Rul. 200502014 (Jan. 14, 2005); I.R.S. Priv. Ltr. Rul. 200247013 (Aug. 14, 2002); Priv. Ltr. Rul. 200148028 (Nov. 30, 2001).

<sup>55</sup> I.R.C. § 673(a).

<sup>56</sup> See *id.* § 672.

<sup>57</sup> *E.g.*, 1 JOHN A. BARRON, JR. & LEWIS MALLALIEU SIMES, *THE LAW OF FUTURE INTERESTS* § 82 (3d ed. 2004); 2 HERBERT T. TIFFANY & BASIL JONES, *TIFFANY ON REAL PROPERTY* § 311(a) (2010).

<sup>58</sup> I.R.S. Tech. Adv. Mem. 8127004 (Feb. 25, 1981).

<sup>59</sup> *Id.*

<sup>60</sup> I.R.S. Gen. Couns. Mem. 36,410, at 5–6 (Sept. 11, 1975).

distinguished a reversionary interest from a possibility of reverter and stated, “the reversionary interest arises only when the transferor transfers an estate of lesser quantum than he owns.”<sup>61</sup>

In *Crane v. Commissioner*, the United States Court of Appeals for the First Circuit addressed an unusual trust arrangement in which the settlor transferred stock to a trust.<sup>62</sup> Upon termination of the trust, the settlor would receive either the proceeds from the sale of the stock to the beneficiaries or a return of the stock.<sup>63</sup> The court considered whether the arrangement gave the settlor a reversionary interest in the trust. It applied the traditional definition of a reversionary interest and held that the settlor did have such an interest: “when we look at the obvious purpose of section 673(a), it must be to prevent a grantor from making a temporary transfer of assets in order to diminish, for a limited period, the receipt of taxable income therefrom.”<sup>64</sup> By characterizing a reversionary interest as a temporary transfer, the court appears to have applied the traditional definition of a reversionary interest to § 673. The settlor’s transfer of a lesser vested estate (the temporary transfer) left the settlor with a reversionary interest. A properly executed transfer to a WQST is distinguishable from *Crane* because it is not a temporary transfer. While the settlor retains a beneficial interest in the property, full legal title to the property is transferred to the trustee.

The legislative history of § 673 also suggests that the statute applies the traditional definition of a reversionary interest. Congress enacted § 673 in 1954 with the intent of codifying § 39.22(a)-121(c) of Treasury Regulation 118.<sup>65</sup> According to that regulation, “[i]ncome of a trust is taxable to the grantor where the grantor has a reversionary interest in the corpus or income.”<sup>66</sup> The regulation noted instances in which a reversionary interest arises, all of which use the traditional definition of a reversion. While the list is not exhaustive, it suggests legislative contemplation of the traditional definition.

Finally, several Private Letter Rulings from the I.R.S. appear to confirm that the ability to receive distributions from a WQST will not cause a trust to be deemed a grantor trust. In 2002, the I.R.S. stated that it would not apply grantor treatment to a trust in which the settlor could receive distributions from the trust subject to the sole discretion of a distribution committee composed of potential recipients of trust distributions.<sup>67</sup> Taxpayers cannot rely upon or cite Private Letter Rulings as precedent. However, they indicate that the I.R.S. has accepted this interpretation in the past and may apply a similar analysis to a WQST.

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<sup>61</sup> *Id.* (citing *Helvering v. Wood*, 309 U.S. 344 (1940)).

<sup>62</sup> 368 F.2d 800, 803 (1st Cir. 1966).

<sup>63</sup> *Id.*

<sup>64</sup> *Id.*

<sup>65</sup> H.R. Rep. No. 83-1337 (1954), *reprinted in* 1954 U.S.C.C.A.N. 4025, 4353. The two changes are unrelated to the definition of a reversionary interest.

<sup>66</sup> Treas. Reg. § 39.22(a)-121(c) (1953).

<sup>67</sup> I.R.S. Priv. Ltr. Rul. 200247013 (Aug. 14, 2002).

Drafters of WQSTs seeking to avoid grantor trust status should be careful to ensure that a settlor's spouse not be entitled to a reversionary interest in the trust. This can complicate attempts to create marital trusts because the Internal Revenue Code treats a settlor as possessing any power or interest held by his or her spouse.<sup>68</sup> Yet the settlor may retain a testamentary limited power of appointment in favor of the spouse or a QTIP trust without retaining an impermissible interest.<sup>69</sup>

*B. Power to Control Beneficial Enjoyment (I.R.C. § 674)*

According to § 674,

The grantor shall be treated as the owner of any portion of a trust in respect of which the beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition, exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party.<sup>70</sup>

A WQST can retain non-grantor status consistent with this provision even if it gives a trustee discretion to make distributions to the settlor, the settlor's spouse, or other beneficiaries. The trust agreement should specify that one or more members of a distribution committee must consent to distributions. All members of the distribution committee should be adverse parties. An "adverse party" is "any person having a substantial beneficial interest in the trust which would be adversely affected by the exercise or nonexercise of the power which he possesses respecting the trust."<sup>71</sup> Such persons must have a substantial beneficial interest in the trust that will be adversely affected by the exercise or nonexercise of the power to make distributions.

In 2002, the I.R.S. stated in a Private Letter Ruling that it would not treat a settlor as the owner of a trust because a distribution committee of a non-grantor trust consisting of members with substantial, adverse interests in the trust retained discretion over distributions and accumulations.<sup>72</sup> Each member of the distribution committee was eligible to receive distributions from the trust estate and had the nonfiduciary power to participate in deliberations and vote in favor of distributions. The ruling involved a distribution committee that exercised its powers by unanimous consent, although any member acting alone could direct a trustee to make a distribution after receiving the settlor's prior written consent. A planner may structure the distribution committee's decisionmaking process differently, so long as approval by one or more members with substantial adverse interests in the trust is required before making distributions.

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<sup>68</sup> I.R.C. § 672(e) (2006).

<sup>69</sup> *See id.* § 654(b)(3).

<sup>70</sup> *Id.* § 674(a).

<sup>71</sup> *Id.* § 672(a).

<sup>72</sup> I.R.S. Priv. Ltr. Rul. 200247013 (Aug. 14, 2002); *see also* I.R.S. Priv. Ltr. Rul. 200612002 (Mar. 24, 2006); I.R.S. Priv. Ltr. Rul. 200502014 (Jan. 14, 2005); Priv. Ltr. Rul. 200148028 (Nov. 30, 2001).

Again, these rulings are not binding and taxpayers cannot cite them as precedent. But it is likely that the I.R.S. would apply the same analysis to a WQST.

*C. Power to Revoke (I.R.C. § 676)*

Section 676 triggers grantor status if the settlor or a non-adverse party has the power at any time to revest property in the settlor.<sup>73</sup> As with § 674, requiring consent by a distribution committee before any distribution to the settlor or settlor's spouse occurs should prevent grantor status under this section.

*D. Impermissible Income (I.R.C. § 677)*

Section 677 triggers grantor status if trust income, without approval or consent of an adverse party or at the discretion the settlor or a nonadverse party, may be distributed to the settlor or the settlor's spouse, held or accumulated for future distribution to the settlor or the settlor's spouse, or applied to pay life insurance premiums on the life of the settlor or the settlor's spouse.<sup>74</sup> As with §§ 674 and 676, distribution committee consent should prevent this section from causing grantor status.

*E. Creditor Claims (Treas. Reg. § 1.677(a)-1(d))*

A trust will receive grantor trust status if, under state law, the grantor's creditors may satisfy claims against the settlor out of the trust's assets.<sup>75</sup> This will ensure grantor status of self-settled trusts in the vast majority of states that adhere to the traditional rule against self-settled spendthrift trusts. However, Wyoming permits such trusts in the form of WQSTs, which should prevent trust assets from being subject to creditor claims.<sup>76</sup> Accordingly, such trusts can avoid grantor trust status.

### III. MIGRATING A PREEXISTING COLORADO TRUST TO WYOMING

*A. Three Migration Methods*

What about trusts that have already been created pursuant to Colorado or some other state law? Colorado residents who want to take advantage of Wyoming's trust laws and remove application of Colorado tax on a trust's income have three primary options for moving a trust to Wyoming.

*1. Outright Distributions*

The current trustees could distribute all of the trust's income and principal to the beneficiaries and have the beneficiaries transfer the assets to new Wyoming trusts. If the trustee

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<sup>73</sup> I.R.C. § 676(a).

<sup>74</sup> *Id.* § 677(a).

<sup>75</sup> Treas. Reg. § 1.677(a)-1(d) (1971).

<sup>76</sup> See WYO. STAT. ANN. § 4-10-510(a).

has discretion to distribute income and principal, the trustee could use that authority to make outright distributions. Colorado courts have adopted the common law principle that the settlors and beneficiaries may consent to a trust's termination, even if it is irrevocable and all trust purposes remain unfulfilled.<sup>77</sup> A Colorado trust may also be terminated by court-approved settlement or a court order in response to unforeseen circumstances that thwart a trust's purposes, even if not all beneficiaries consent.<sup>78</sup> Of course, if the trust remains revocable, the settlor may also use procedures provided by the trust instrument to revoke or amend the trust.

This solution is somewhat cumbersome and contains inherent risks. If the trust was GST exempt or had a zero inclusion ratio, the new trusts will not retain that status. Such a procedure may also interfere with the goals of maintaining control over a family's wealth and business holdings. This method also requires that the trustees have absolute discretion to invade a trust's principal, which some trust instruments may not permit.

## 2. *Decanting*

In a more favorable option, Colorado trustees would exercise a special power of appointment to appoint the trust's assets to Wyoming trusts (often known as decanting). Some trust instruments may give the trustees such a power. If the instrument does not provide such a power, a trustee will have to rely on statutory or common law decanting. In 2009, the Statutory Revisions Subcommittee of the Colorado Bar Association Trust & Estate Section considered whether to recommend that the Colorado General Assembly amend the Colorado Probate Code to provide trustees with the power to distribute trust assets in further trust.<sup>79</sup> However, this legislation is still in its formative stages and has not been addressed by the legislature.

While Colorado may not have a statute permitting trust decanting, such statutes arguably codify a trustee's common law power to appoint assets in further trust.<sup>80</sup> This argument derives from two principles. First, a trustee who has a discretionary power to invade a trust's corpus possesses a limited power of appointment.<sup>81</sup> Second, the donee of a limited power of appointment may use that power to create a lesser estate in favor of the power's objects (the beneficiaries) if the instrument does not reflect a contrary intent on the part of the donor.<sup>82</sup>

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<sup>77</sup> *In re Green Valley Financial Holdings*, 32 P.3d 643, 646 (Colo. Ct. App. 2001) (citing RESTATEMENT (SECOND) OF TRUSTS § 338(1) & cmt. a (1959)).

<sup>78</sup> *Saunders v. Muratori*, 251 P.3d 550, 553 (Colo. Ct. App. 2010) (citing *Conn. Bank & Trust Co. v. Coffin*, 563 A.2d 1323, 1336–38 (Conn. 1989); RESTATEMENT (THIRD) OF TRUSTS § 66(1)).

<sup>79</sup> Statutory Revisions Committee, Proposed Decanting Statute (Sept. 16, 2010), [http://www.cobar.org/repository/Inside\\_Bar/TrustEstate/Proposed%20Decanting%20Statute%20w%20Comments%2009%2009%2010.doc](http://www.cobar.org/repository/Inside_Bar/TrustEstate/Proposed%20Decanting%20Statute%20w%20Comments%2009%2009%2010.doc).

<sup>80</sup> See, e.g., Rashad Wareh, *Trust Remodeling*, TRUSTS & ESTATES, Aug. 2007, at 20; Joel E. Smith, Annotation, *Power to Appoint Realty in Fee or Personalty Absolutely as Including Power to Appoint Lesser Estate or Interest*, 94 A.L.R.3d 895, § 3[a] (1994); SCOTT ON TRUSTS § 17.2 (4th ed. 2001).

<sup>81</sup> See RESTATEMENT (SECOND) OF PROP.: DONATIVE TRANSFERS § 11.1 cmt. d (1986).

<sup>82</sup> See *id.* § 19.3; *In re Hart's Will*, 262 A.D. 190, 194 (N.Y. Sup. Ct. 1941) (holding that, in the absence of words to the contrary, a party with the power to appoint a fee may appoint a lesser estate).

Scholars typically cite three cases in support of this argument.<sup>83</sup> Common law decanting remains uncertain in most states<sup>84</sup> and individuals should conduct more research and seek court approval before attempting to decant in the absence of a statute or authorization by the trust instrument.

### 3. *Appointing a Wyoming Trustee*

A more widely available option for migrating a preexisting trust to Wyoming is to have the Colorado trustee resign and appoint a Wyoming trust company as trustee. This may require that the trust instrument provide some method of removing and appointing trustees. But in many circumstances, the process of appointing a Wyoming trustee to administer a trust should not be efficient and require minimal court involvement:

[A]cceptance and change of trusteeship, and other aspects of the administration of a trust shall proceed expeditiously consistent with the terms of the trust, free of judicial intervention and without order, approval, or other action of any court, subject to the jurisdiction of the court as invoked by interested parties or as otherwise exercised as provided by law.<sup>85</sup>

Colorado law permits the currently serving trustee to resign as trustee if doing so does not pose undue detriment to the trust's administration.<sup>86</sup> Colorado courts also have the equitable authority to remove a trustee at their reasonable discretion if the trustee's continued authority would be detrimental to the beneficiaries' interests.<sup>87</sup> If a trust has no trustee, courts have the common law power to appoint a new one.<sup>88</sup> Petitioning a court to involuntarily remove a trustee of a testamentary trust may be more difficult unless the trustee has abused its discretion.<sup>89</sup> If the trust instrument provides a method for appointing a new trustee following a vacancy, that method should be followed.

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<sup>83</sup> See *Phipps v. Palm Beach Trust Co.*, 196 So. 299 (Fla. 1940); *In re Spencer's Estate*, 232 N.W.2d 491 (Iowa 1975); *Wiedenmayer v. Johnson*, 254 A.2d 534 (N.J. Super. Ct. App. Div. 1969).

<sup>84</sup> Richard B. Covey & Dan T. Hastings, *Recent Developments in Transfer and Income Taxation of Trusts and Estates and State Trust and Estate Law*, 43 HECKERLING INST. ON EST. PLAN. ¶ 101.3[B] (2009).

<sup>85</sup> COLO. REV. STAT. § 15-16-201(2).

<sup>86</sup> *Stell v. Boulder Cty. Dep't of Soc. Servs.*, 92 P.3d 910, 915 (Colo. 2004) (citing *In re White*, 484 A.2d 763, 766 (Pa. 1984); GEORGE T. BOGERT, TRUSTS § 31 (6th ed. 1987)).

<sup>87</sup> *In re Malone's Estate*, 597 P.2d 1049, 1050 (Colo. Ct. App. 1979) (citing RESTATEMENT (SECOND) OF TRUSTS § 107(a) & cmt. a (1959)) (holding hostility between trustees and beneficiaries sufficient to remove a trustee, regardless of the merits of the underlying dispute); *Johnson v. El Paso Cattle Co.*, 725 P.2d 1180, 1183 (Colo. Ct. App.) (holding a Colorado court had discretion to remove a trustee for failure to register a trust); COLO. REV. STAT. § 15-16-201(1)(a) (giving Colorado probate courts exclusive jurisdiction in proceedings initiated by interested parties to appoint and remove trustees).

<sup>88</sup> See RESTATEMENT (SECOND) OF TRUSTS § 108(b).

<sup>89</sup> See *In re Estate of Klarner*, 113 P.3d 150, 157 (Colo. 2005) ("Generally, the court will not remove a testamentary trustee absent a demonstrated abuse of power.").

B. *Applying Wyoming Substantive Law to a Preexisting Colorado Trust*

Wyoming's substantive law will apply to the trust once its administration has been moved to Wyoming. At common law,<sup>90</sup> in the absence of a contrary designation in a trust's governing instrument, questions of the administration of a living trust holding movables are typically governed by the law of the state with the most substantial relationship to the trust.<sup>91</sup> Without a contrary designation, questions of the administration of a testamentary trust will typically be governed by the law of the state where the settlor was domiciled at death or the local law of another state where the trust is to be administered.<sup>92</sup> Such common law conflict of law rules often allow the law governing trust administration to be changed by having the trust be administered in a more favorable state.

Wyoming's modified version of the Uniform Trust Code significantly eases the process of changing a trust's governing law. If a Wyoming trust company accepts trusteeship of the trust and administration occurs in Wyoming, the trust's new situs will be in Wyoming.<sup>93</sup> Wyoming law will then govern questions of administration and construction if the governing instrument does not provide otherwise.<sup>94</sup> The law of administration will be the state with the most significant relationship to the trust, a consideration in which the trust's place of administration is the most important factor.<sup>95</sup> The location of the trust's assets is a secondary factor and the location of the settlor and beneficiaries is the least important factor.<sup>96</sup>

Preexisting trusts that designate a governing law often pose problems for migrating trusts, particularly if the trusts have become irrevocable. Wyoming law addresses this problem by allowing courts to "modify the administrative terms of a trust if continuation of the trust on its existing terms would be impracticable or wasteful or impair the trust's administration."<sup>97</sup> Additionally, "the law of the jurisdiction designated in the terms of the trust may be changed to the principal place of administration by a court with subject matter jurisdiction."<sup>98</sup> This latter provision is unique to Wyoming and unavailable in other Uniform Trust Code jurisdictions.

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<sup>90</sup> Common law and equitable principles supplement the Colorado Probate Code unless they have been displaced by statute. COLO. REV. STAT. § 15-10-103.

<sup>91</sup> RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 272(b) (1971).

<sup>92</sup> *Id.* § 271(b).

<sup>93</sup> WYO. STAT. ANN. §§ 4-10-108, -202 (2010).

<sup>94</sup> *Id.* § 4-10-107(a).

<sup>95</sup> *Id.* § 4-10-107(a)(ii).

<sup>96</sup> *Id.*

<sup>97</sup> *Id.* § 4-10-413. This provision exists in the uniform version of the Uniform Trust Code. UNIF. TRUST CODE § 412(b) cmt.

<sup>98</sup> WYO. STAT. ANN. § 4-10-107(b).

Consequently, even the settlors and beneficiaries of irrevocable trusts with instruments that designate Colorado as the place of administration can take advantage of Wyoming law. First, the trustee of the Colorado trust should resign and a Wyoming trust company should be appointed to administer the trust in Wyoming. If possible, the settlor, beneficiaries, trustees, and trust protectors should enter into a binding nonjudicial settlement agreement confirming the transfer of the trust's principal place of administration.<sup>99</sup> Moving the trust's place of administration to Wyoming will provide Wyoming courts with personal and subject matter jurisdiction over the trust.<sup>100</sup> A Wyoming trust company can then petition a Wyoming court to modify any problematic terms and change the trust's place of administration to Wyoming if doing so is necessary. If the parties to the trust wish to convert the trust to a WQST, they may do so by nonjudicial settlement agreement without the involvement of a court.<sup>101</sup>

#### IV. WING DISTRIBUTION COMMITTEES AFTER THE 2007 I.R.S. RELEASE

##### A. *Background*

A distribution from a WING should not be treated as a completed gift because the members of the distribution committee each have substantial, adverse interests in the trust property and, thus, do not hold general powers of appointment over the trust assets. Several I.R.S. Private Letter Rulings appear to confirm this result.<sup>102</sup> But in a 2007 release, the I.R.S. raised the possibility that the PLRs may conflict with two Revenue Rulings that determined that distribution committee members hold general powers of appointment for estate tax purposes because the members are replaced if they resign or die.<sup>103</sup> Nonetheless, WINGs remain distinguishable from the Revenue Rulings in question as set forth below.

##### B. *Revenue Rulings 76-504 and 77-158*

In 1976, the I.R.S. considered the estate tax consequences of a trust in which a decedent-trustee and two other cotrustees held general powers of appointment.<sup>104</sup> The Service noted that a

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<sup>99</sup> See *id.* § 4-10-111(d)(v).

<sup>100</sup> See *id.* §§ 4-10-202(a) (providing that fiduciaries of trusts moving their principal place of administration submit to the jurisdiction of Wyoming courts), 4-10-202(b) (providing that beneficiaries of trusts principally administered in Wyoming are subject to Wyoming jurisdiction regarding trust matters), 4-10-203(a) (providing that district courts have jurisdiction over Wyoming proceedings brought by a trustee or beneficiary regarding trust administration).

<sup>101</sup> *Id.* § 4-10-111(c)(vii).

<sup>102</sup> See Priv. Ltr. Rul. 200612002 (Mar. 24, 2006); Priv. Ltr. Rul. 200502014 (Jan. 14, 2005); Priv. Ltr. Rul. 200247013 (Aug. 14, 2002); Priv. Ltr. Rul. 200148028 (Nov. 30, 2001).

<sup>103</sup> Int. Rev. Serv., *Chief Counsel Seeking Comment on Gift Tax Consequences of Trusts Employing Distribution Committee*, IR-2007-127 (July 9, 2007) (citing Rev. Rul. 77-158 (1977); Rev. Rul. 76-503 (1976)); see also Priv. Ltr. Rul. Priv. Ltr. Rul. 200715005 (Jan. 3, 2007) (holding a deceased distribution committee member's power jointly passes to the surviving member and the donor's son); Priv. Ltr. Rul. 2007290025 (Apr. 10, 2007); Priv. Ltr. Rul. 200731019 (May 1, 2007).

<sup>104</sup> Rev. Rul. 76-503, 1976-2 C.B. 275.

decedent's gross estate includes the value of all property over which the decedent holds a general power of appointment at the time of the decedent's death.<sup>105</sup> The Service also cited the definition of a general power of appointment and Treasury Regulations providing that a power will not be deemed a general power of appointment if it must be exercised with the consent of someone who has a substantial adverse interest in the property.<sup>106</sup> If three individuals have a joint power to appoint power among a group of people including themselves and, upon the death of one power-holder, the joint power passes to the surviving power-holders, the surviving power-holders will be considered to have substantial adverse interests.<sup>107</sup> But if the power does not pass to the surviving power-holders and the survivors must share the power with the decedent's replacement, the survivors will not be considered to have substantial, adverse interests.<sup>108</sup> This situation removes the power-holders' ability to profit by refusing to exercise the power in the decedent's favor during the decedent's lifetime, making their interests non-adverse.<sup>109</sup> Thus, the decedent-trustee possessed a general power of appointment because the coholders lacked substantial, adverse interests in the property and one-third of the value of the trust would be included in the decedent's gross estate.<sup>110</sup>

The I.R.S. reached an identical result in a case with similar facts, but in which the trustees had to act by a majority, rather than unanimous, vote.<sup>111</sup> Again, the surviving trustees were in no better position to exercise the power of appointment after one trustee's death. Thus, the cotrustees' interests were not adverse. The cotrustees held general powers of appointment that would cause the property subject to the power to be included in their gross estates.

### C. 2007 I.R.S. Release

The 2007 I.R.S. release expressed concern that the above two revenue rulings conflict with the PLRs that appear to authorize WING distribution committees.<sup>112</sup> The PLRs suggest that the committee members do not hold general powers of appointment over the trust assets for gift tax purposes because each member has a substantial, adverse interest in the trust. In contrast, the Revenue Rulings suggest that the members hold general powers of appointment over the trust assets for estate tax purposes because members can be replaced at death. If the revenue rulings were applied consistently, the members of the distribution committee arguably possess general powers of appointment, which would subject distributions to gift tax.

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<sup>105</sup> *Id.* (citing I.R.C. § 2041(a)(2)).

<sup>106</sup> *Id.* (citing I.R.C. § 2041(b)(1); Treas. Reg. § 20.2041-3(c)(2)).

<sup>107</sup> *Id.* (citing Treas. Reg. § 20241-3(c)(2)).

<sup>108</sup> *Id.* (citing Treas. Reg. § 20241-3(c)(3)).

<sup>109</sup> *Id.*

<sup>110</sup> *Id.*

<sup>111</sup> Rev. Rul. 77-158, 1977-1 C.B. 285.

<sup>112</sup> Int. Rev. Serv., *Chief Counsel Seeking Comment on Gift Tax Consequences of Trusts Employing Distribution Committee*, IR-2007-127 (July 9, 2007). The I.R.S. did not directly cite the WING-favorable PLRs, but clearly refers to them.

The release noted a possible means of distinguishing the PLRs from the revenue rulings. A settlor's retention of a testamentary special power of appointment renders the gift incomplete, which should prevent the committee members from holding general powers of appointment. But the 2007 release also cited possible contrary authority from a Treasury Regulation example and a Revenue Ruling.<sup>113</sup> Such contrary authority may be inapplicable to the PLRs in question.<sup>114</sup> The Treasury Regulation example illustrates transition rules applicable to powers of appointment created before October 22, 1941 or after October 21, 1941 and may not illustrate when powers are deemed to exist.<sup>115</sup> Further, Revenue Ruling 67-370 applies to interests in property under I.R.C. § 2033, which are different from powers of appointment.<sup>116</sup>

*D. Responses to the 2007 Notice*

The Office of the Associate Chief Counsel, Passthroughs & Special Industries requested comments regarding whether distribution committee members possess general powers of appointment before taking action regarding the PLRs. The I.R.S. has accepted comments but has not made a final determination. The ABA Section of Real Property, Trust and Estate Law (ABA Section) wrote a response arguing that the PLRs were not inconsistent with the revenue rulings and that no member of a distribution committee holds a general power of appointment.<sup>117</sup> If the members must exercise their powers of appointment with the settlor's consent, the members cannot have general powers of appointment.<sup>118</sup> But the PLRs consider distribution committees that may act with the consent of each other, but without the settlor's consent. Yet such members still lack general powers of appointment because they may only act in conjunction with other members who have substantial, adverse interests in the trust assets.<sup>119</sup> The ABA Section argued that Treasury Regulations section 25.2514-3(b)(2) does not require succession to power upon the death of a fellow power-holder in order for a power-holder to have an adverse interest. The Regulations merely provide a way for power-holders to be adverse if they succeed to power upon the death of a fellow power-holder. If the regulations were intended to require that an adverse power-holder succeed to power on the death of a fellow power-holder, they would have said so. In fact, the regulations only require that a power holder have an additional economic interest in

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<sup>113</sup> *Id.* (citing Treas. Reg. § 25.2514-1(e) ex. 1 (providing that a power of appointment created by a living instrument is treated as a power created on the date the instrument takes effect and not as created at a future date); Rev. Rule. 67-370, 1967-2 C.B. 324 (“A defeasible remainder interest in trust which is subject to termination at the will of another is an interest in property within the meaning of [I.R.C. § 2033], and the value of such interest is includible in the remainderman's gross estate if the interest was not terminated prior to his death.”)).

<sup>114</sup> N.Y. STATE BAR ASS'N TAX SECTION, REPORT RESPONDING TO IR-2007-127, REQUEST FOR COMMENTS REGARDING GENERAL POWERS OF APPOINTMENT UNDER IRC SECTION 2514, REPORT NO. 1134, at 25 (Oct. 11, 2007).

<sup>115</sup> *Id.*

<sup>116</sup> *Id.*

<sup>117</sup> COMMENTS OF THE AM. BAR ASS'N REAL PROP., TR. & EST. LAW SECTION, INCOMPLETE GIFT RESPONSE (Sept. 26, 2007).

<sup>118</sup> *Id.* (citing I.R.C. § 2514(c)(3)(A)).

<sup>119</sup> *Id.* (citing I.R.C. § 2514(c)(3)(B); Treas. Reg. § 25.2514(b)(2), (3)).

the trust that would be negatively impacted by agreeing to a distribution of any amount to the other party in order to be adverse. Such an interest need not be in the form of succession to power on the death of a fellow power-holder.

According to the ABA Section,

We construe the revenue rulings as providing that, in the case of a dynasty type trust, if a trustee with the unanimous consent of the other trustees (Rev. Rul. 76-503) or with the consent of a majority of the other trustees (in Rev. Rul. 77-158), has a power to distribute property in his or her favor, and also has the power to designate a family member as successor trustee or, in the absence of such a designation, a successor trustee who is a family member will be appointed, then the trustee will be deemed to possess a general power of appointment over a proportionate share of the trust.<sup>120</sup>

Four considerations arguably make this interpretation of the revenue rulings consistent with (and distinguishable from) the PLRs. First, the revenue rulings involved dynasty trusts, in which the only possibility for beneficial enjoyment would come from current distributions. In contrast, the PLR trusts were not dynasty trusts intended to benefit an entire family during the RAP period. Second, the revenue ruling trustees (or oldest living descendants) could appoint relatives as successor trustees, which left little opportunity for any trustee to gain economic advantage by withholding distributions. In contrast, the committee members in the PLRs did not have discretion to appoint relatives to act as successor trustees. Third, unlike the revenue ruling trustees, each surviving committee member under the PLRs had the power to appoint assets to himself or herself with the settlor's consent. Fourth, unlike in the revenue rulings, the surviving committee members were the default takers of a testamentary power of appointment and, after the death of other members of the committee, had the power to appoint trust assets to themselves with the consent of the successor member or settlor.

The ABA Section also made the argument, noted by the 2007 notice, that the settlor's incomplete gift to the trust prevents the distribution committee members from holding general powers of appointment. First, distributions to the settlor will not be treated as gifts because no completed gift occurs regarding property subject to a taxpayer's power of amendment unless distributed to a person "other than the donor."<sup>121</sup> Second, "no one may be deemed to have a general power until the transfer of the property subject to the power is complete for gift and estate tax purposes."<sup>122</sup>

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<sup>120</sup> *Id.*

<sup>121</sup> *Id.* (citing Treas. Reg. § 25.2511-2(f)).

<sup>122</sup> *Id.* The ABA Section argued that this is a fundamental principle of gift and estate taxation and that it is consistent with apparently inconsistent authority. *Id.* (distinguishing Rev. Rul. 67-370, 1967-1 C.B. 324; *Johnstone v. Comm'r*, 76 F.2d 55 (9th Cir. 1935); Priv. Ltr. Rul. 200101012; Priv. Ltr. Rul. 200210051; Priv. Ltr. Rul. 200403094; Priv. Ltr. Rul. 200604028).

Finally, the ABA Section requested additional guidance regarding situations similar to the PLRs and argued that, if the I.R.S. concludes that distribution committee members hold general powers of appointment, such determination be applied prospectively pursuant to I.R.C. § 7805(b).<sup>123</sup>

*E. Distinguishing WINGs from Adverse Revenue Rulings*

Even if the favorable PLRs are not distinguishable from Revenue Rulings 76-504 and 77-158, WINGs should still be distinguishable from the powers of appointment held by the Revenue Ruling trustees in the Revenue Rulings because a WING beneficiary can never serve as trustee. According to the Revenue Rulings, the trustees were beneficiaries and deemed to hold general powers of appointment because there were no substantial interests in the trust property adverse to the exercise of the power in favor each other. If the surviving trustees would jointly succeed to the power of a dying or retiring trustee, those trustees would have substantial adverse interests by virtue of the fact that they would have an incentive to deny giving each other permission to appoint property because that would reduce the amount of property they would hold a power over after another trustee resigns or dies. But if the trustees must share their powers with each others' successor trustees, no such incentive exists because they would have no greater power over the property than they did before the trustee resigned or died. Consequently, such trustees were held to have general powers of appointment and the value of dying trustee's proportional share of the property was included in that trustee's estate at death.

The power held by a member of a WING distribution committee is different for several reasons. First, a WING is often drafted to intentionally not constitute a completed gift, and the entire value of the WING will be included in the grantor's estate in any event.<sup>124</sup> In contrast, the problematic Revenue Rulings did not involve incomplete gifts. Because the WING property will be included in the grantor's estate, there should be no risk that a separate distribution committee member could have estate inclusion.<sup>125</sup> As long as the transfer to the WING is considered an incomplete gift by the trust's settlor for estate tax purposes, it should not be possible for a distribution committee member to hold a general power of appointment over the WING property.<sup>126</sup> Second, the trustees of the Revenue Rulings were beneficiaries and trustees of the same trust. Wyoming law prohibits someone from being both the settlor beneficiary and trustee of a WQST (the kind of trust utilized in creating a WING).<sup>127</sup> A transfer to a WQST requires a transfer of property from a settlor to a qualified trustee.<sup>128</sup> A "qualified trustee" means

- (A) A natural person who is a resident of this state; or

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<sup>123</sup> *Id.*

<sup>124</sup> *See* I.R.C. §§ 2036(a), 2038; Treas. Reg. § 25.211-2(c), (f).

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<sup>127</sup> WYO. STAT. ANN. §§ 4-10-512(a); 4-10-103(a)(xxxv).

<sup>128</sup> *Id.* § 4-10-512(a); *see also id.* § 4-10-510(a) (requiring the trustee of a WQST be a qualified trustee).

- (B) A person authorized by the law of this state to act as a trustee or a regulated financial institution which:
  - (I) Maintains or arranges for custody in this state of some or all of the qualified trust property;
  - (II) Maintains records for the qualified spendthrift trust on an exclusive or nonexclusive basis;
  - (III) Prepares or arranges for the preparation of fiduciary income tax returns for the qualified spendthrift trust; or
  - (IV) Otherwise materially participates in the administration of the qualified spendthrift trust.<sup>129</sup>

Settlors and unauthorized financial institutions may not act as qualified trustees of a WQST.<sup>130</sup> This prevents the situation that arose in Revenue Rulings 76-504 and 77-158 because the settlor cannot be the qualified trustee of the WING.

*F. A Possible Interim Solution*

There may be ways to avoid the problem pending resolution by the General Counsel's Office, such as "by appointing a three-member power of appointment committee in which a member who ceases to act is not replaced."<sup>131</sup> The ABA Section noted that the problematic Revenue Rulings did not address situations in which no successor trustee is appointed

[F]or example if the resigning or deceased trustee fails to designate a successor and has no adult descendants, in which case the remaining trustees alone would possess the power. In such a situation . . . we think the example contained in Treas. Reg. § 25.2514-3(b)(2) . . . would mean that the deceased trustee would not be treated as holding a general power of appointment at death."<sup>132</sup>

A structure in which the members of a WING distribution committee are not replaced upon death, incapacity, or resignation should sidestep the problem posed by the 2007 Notice. The members will not be treated as possessing general powers of appointment because they will have adverse interests in the trust, creating an incentive to deny lifetime distributions.

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<sup>129</sup> *Id.* § 4-10-103(a)(xxxv)(A)-(B).

<sup>130</sup> *Id.* § 4-10-103(a)(xxxv)(C).

<sup>131</sup> Richard W. Nenno & John E. Sullivan, III, *Planning and Defending Domestic Asset Protection Trusts*, SP 040 ALI-ABA 705 (2009).

<sup>132</sup> COMMENTS OF THE AM. BAR ASS'N REAL PROP., TR. & EST. LAW SECTION, INCOMPLETE GIFT RESPONSE (Sept. 26, 2007).