



E A S Y E S T A T E
P R O B A T E

ATTORNEY CLIENT PRIVILEGED INFORMATION

September 27, 2023

Benson Financial, LLC
c/o Paul Rosen, Esq.
1707 Post Oak Boulevard
Suite 483
Houston, Texas 77056

Re: Counter Legal Opinion on IRC Memo AM 2023-006

Dear Mr. Rosen:

Attached you will find the legal opinion you have asked my office to prepare in connection with the IRS internal memorandum AM 23-006 regarding the interpretation of IRC § 643(b) to a Non-Grantor, Irrevocable, Complex, Discretionary, Spendthrift Trust.

Should you or your office have any questions, please do not hesitate to contact me.

Very truly yours,

Steven E. Gurian, Esq., LLM



E A S Y E S T A T E P R O B A T E

Legal Opinion – 643b & Copyright Trust

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c/o Paul Rosen, Esq.
1707 Post Oak Boulevard
Suite 483
Houston, Texas 77056

Re: Counter Legal Opinion on IRC Memo AM 2023-006

Ladies and Gentlemen:

We have acted as counsel to Benson Financial, LLC, in connection with the above-referenced matter. Benson Financial, LLC, has requested that we deliver this opinion to you, and we understand that Benson Financial, LLC, will rely on this opinion.

BACKGROUND

Non-Grantor, Irrevocable, Complex, Discretionary, Spendthrift Trusts (hereinafter the “Trust”) were created as an asset protection and tax planning vehicle. A third-party settlor, acting on behalf of the taxpayer creates and funds the Trust, and the taxpayer is given the authority to add or remove trustees and beneficiaries. By designating the Trust as a non-grantor trust, the settlor of the Trust gives up control over any assets that are transferred to it. Consequently, these assets become creditor protected. Likewise, the spendthrift provision in the Trust adds an extra layer of protection by limiting the beneficiaries ability to transfer or assign their interest in the trust. The spendthrift provision also prevents creditors from attaching or taking Trust assets that are for the benefit of the beneficiary. From a tax standpoint, by structuring the Trust as a non-grantor Trust, the settlor does not pay tax on any income earned, but rather the trust pays tax as a legally distinct entity. However, when a non-grantor trust makes a distribution to a beneficiary, the taxable ordinary income is passed to the beneficiary and taxed on their personal income tax return.

IRC § 643(b) clearly and unambiguously states:

(b) Income

For purposes of this subpart and subparts B, C, and D, the term “income”, when not preceded by the words “taxable”, “distributable net”, “undistributed net”, or “gross”, means the amount of income of the estate or trust for the taxable year determined under the terms of the governing instrument and applicable local law. Items of gross income constituting extraordinary dividends or taxable stock

dividends which the fiduciary, acting in good faith, determines to be allocable to corpus under the terms of the governing instrument and applicable local law shall not be considered income.

A plain reading of IRC § 643(b) would remove extraordinary dividends or taxable stock dividends from the definition of “income” if a fiduciary has the sole and absolute authority to designate something as extraordinary dividends or taxable stock dividends, and that designation is paid to the corpus of the Trust and not subject to distribution. Such interpretation and classification of extraordinary dividends or taxable stock dividends as “non-income” would make the “income” under IRC § 643(b) non-taxable.

On August 18, 2023, the Office of Chief Counsel for the Internal Revenue Service released memorandum (Number: AM 2023-006) (hereinafter the “Memorandum”) which addressed the use of this Trust as an estate planning tool. The Memorandum states that the structure does not offer the tax benefits claimed. Specifically, the Memorandum states that any and all promotional materials on the Trust take IRC § 643(b) out of context and that IRC § 641 is not factored into any analysis concerning the taxation of the Trust.

We were asked to opine on the following matters with respect to IRC Memo AM 2023-006 and the application of IRC § 643(a) and (b) to Non-Grantor, Irrevocable, Complex, Discretionary, Spendthrift Trusts:

1. In the context of IRC § 643, is there a distinction between “distributable net income” and “taxable income?”
2. Whether the Trust will recognize income on its capital gains?
3. Whether the Trust will recognize income on extra ordinary dividends?

GENERAL QUALIFICATIONS AND ASSUMPTIONS

For purposes of this opinion we have examined the executed original, or a copy certified or otherwise authenticated to our satisfaction of only the documents listed on the attached **Exhibit “A”** (the “Documents”). With respect to the Documents we have assumed: (i) the genuineness of all signatures, and the incumbency, authority, legal right and power and legal capacity under all applicable laws and regulations, of the officers and other persons and entities signing each of said documents as or on behalf of the parties thereto; (ii) the authenticity of all documents submitted to us as originals; (iii) the conformity to authentic originals of all documents submitted to us as certified, conformed or photostatic copies; (iv) the due execution and delivery of all documents by all parties thereto (including those documents furnished to us in unexecuted form); and (v) that the aforesaid documents, in the forms thereof submitted to us for our review, have not been and will not be altered or amended in any respect material to our opinion. For the purposes of rendering our opinion, we have not reviewed any document other than the documents set forth above and we assume that there exists no provision of any such other document that bears upon or is inconsistent with our opinion. We have conducted no independent factual investigation of our own, but rather have relied solely upon the foregoing documents, the statements, representations and information set forth therein, and the additional matters recited or assumed herein, all of which we assume to be true, complete and accurate in all material respects. Notwithstanding anything to the contrary

set forth herein, we are not aware of any facts or circumstances that render our assumptions, false, misleading, or materially incorrect.

We have also assumed that: (i) there has not been any mutual mistake of fact or misunderstanding, fraud, duress, or undue influence in connection with the transactions described herein; (ii) the conduct of the parties to the transactions that are the basis for your request for this opinion has complied with all applicable laws and any requirement of good faith, fair dealing, and conscionability in all respects material; (iii) you and your agents have acted in good faith and without notice of any facts or allegations that would be inconsistent, in any material respect, with the facts and assumptions contained, or the opinion as expressed, herein; (iv) the constitutionality or validity of a relevant statute, rule, regulation, or agency action is not in issue unless a reported decision has specifically addressed but not resolved, or has established, its unconstitutionality or invalidity; (v) other documents (aside from those executed in connection with the creation and administration of the Trusts) and court orders (pertaining to matters arising from or directly affecting the Trusts).

We have also assumed that the parties to the Documents have in all material respects complied and will comply at all times with their respective representations, warranties, covenants duties, and agreements contained in the Documents, and have not taken or made and will not take or make any actions or statements that are in any material respect inconsistent with or contradictory to such representations, warranties, covenants and agreements.

The law covered by the opinion expressed herein is limited to the Internal Revenue Code, Treasury Regulations, as well as the express provisions of the Trust (the “Opining Law”). Accordingly, we do not express any opinion as to any matter governed by any law other than the Opining Law.

We express no opinion as to any matter not specifically set forth herein. We express no opinion on whether a court of competent jurisdiction, including but not limited to the United States Tax Court, United States Courts of Appeals, and/or Supreme Court of the United States would or would not, enter an order or judgment in contravention to the opinions set forth herein. We cannot opine as to what action a court will take in the future when reviewing actions that have or have not occurred as of the date hereof. This opinion is expressly limited to the inquiries stated *supra*.

OPINIONS

A. Distributable Net Income and Taxable Income

It is our opinion that IRC § 643(a) modifies what is considered taxable income as defined in IRC § 63(a). Specifically, IRC § 643(a)(1) through (4) make modifications to what would otherwise be taxable income.

B. Taxation of Capital Gains

It is our opinion that the gains from the sale or exchange of a capital asset will be excluded from taxable income to the extent that such gains are allocated to the corpus of the Trust and are not paid, credited, or required to be distributed to any beneficiary during the taxable year. The

trusts provided in Exhibit “A” appear to comport with IRC § 643 and provide the fiduciary-trustee with the discretion for such an allocation, as would presumably, local law.

C. Taxation of Extraordinary Dividends

It is our opinion that extraordinary dividends or taxable stock dividends are excluded from gross income so long as the fiduciary-trustee does not pay or credit to any Trust beneficiary such dividends that are allocable to corpus under the terms of the governing instrument and local law. The trusts provided in Exhibit “A” appear to comport with IRC § 643 and provide the fiduciary-trustee with the discretion for such an allocation, as would presumably, local law.

ASSUMPTIONS OF FACT

A. Trustees

1. Each trustee has complied at all times and in all respects material with the provisions of Trust.
2. Each trustee has not and will not engage in any type of fraudulent activity in connection with the Trust.
3. Each trustee and their agents and/or representatives has not taken any action in contravention to the Trust.
4. Each trustee has filed a complete and accurate tax return.

B. Purposes of the Trust

1. That the Trust complies with IRC § 2511.
2. That the Trust is properly funded and complies with state law.
3. That the asset protection benefits of the Trust comport with local and state law.
4. That gross income generated by the Trust would constitute an extraordinary dividend as defined in IRC § 643(b).

LEGAL ANALYSIS

A. Discussion of the Law. The following discussion comprises of our analysis in reaching the opinion expressed herein and does not constitute an independent opinion as to any element of the analysis.

1. The Characterization of Distributable Net Income vs. Taxable Income within the Meaning of IRC§ 643

Under IRC § 61(a), the Internal Revenue Code defines gross income as follows:

(a) General definition - Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

(1) Compensation for services, including fees, commissions, fringe benefits, and similar items; (2) Gross income derived from business; (3) Gains derived from dealings in property; (4) Interest; (5) Rents; (6) Royalties; (7) Dividends; (8) Annuities; (9) Income from life insurance and endowment contracts; (10) Pensions; (11) Income from discharge of indebtedness; (12) Distributive share of partnership gross income; (13) Income in respect of a decedent; and (14) Income from an interest in an estate or trust.

Under IRC § 63(a), the Internal Revenue Code defines taxable income as follows:

(a) In general - Except as provided in subsection (b), for purposes of this subtitle, the term “taxable income” means **gross income** minus the deductions allowed by this chapter (other than the standard deduction). *[Emphasis Added]*.

Under IRC § 641(a), the Internal Revenue Code imposes tax on income of trusts and estates as follows:

(a) Application of tax - The tax imposed by section 1(e) shall apply to the taxable income of estates or of any kind of property held in trust [...].

IRC § 643(a) clearly and unambiguously states:

(a) Distributable net income

For purposes of this part, the term “distributable net income” means, with respect to any taxable year, the taxable income of the estate or trust **computed with the following modifications** —

(1) Deduction for distributions

No deduction shall be taken under sections 651 and 661 (relating to additional deductions).

(2) Deduction for personal exemption

No deduction shall be taken under section 642(b) (relating to deduction for personal exemptions).

(3) Capital gains and losses

Gains from the sale or exchange of capital assets shall be excluded to the extent that such gains are allocated to corpus and are not (A) paid, credited, or required to be distributed to any beneficiary during the taxable year, or (B) paid, permanently set aside, or to be used for the purposes specified in section 642(c). Losses from the sale or exchange of capital assets shall be excluded, except to the extent such losses are taken into account in determining the amount of gains from the sale or exchange of capital assets which are paid, credited, or required to be distributed to any beneficiary during the taxable year. The exclusion under section 1202 shall not be taken into account.

(4) Extraordinary dividends and taxable stock dividends

For purposes only of subpart B (relating to trusts which distribute current income only), **there shall be excluded those items of gross income constituting extraordinary dividends or taxable stock dividends which the fiduciary, acting in good faith, does not pay or credit to any beneficiary by reason of his determination that such dividends are allocable to corpus under the terms of the governing instrument and applicable local law.** [Emphasis Added].

A cursory overview of IRC § 61(a) would demonstrate that any revenue generated from the specified sources of income would be categorized as “gross income”. IRC § 63(a) goes on to state that “gross income” minus allowable deductions is categorized as “taxable income.” Under IRC § 643(a), Distributable Net Income is “taxable income,” *i.e.*, income that is taxable under IRC § 63(a), that is computed with **modifications** delineated in subsections (1) through (4). In other words, IRC § 643, *et. seq.*, modifies the definition, and therefore the method of calculation, of what would be considered taxable income. *See* Treas. Reg. § 1.643(a)-0 (defining taxable income (as defined in section IRC § 63) of the estate or trust, computed with the modifications set forth in §§ 1.643(a)–1 through 1.643(a)–7). Reading IRC § 643(a) in conjunction with Treas. Reg. § 1.643(a)-0 would demonstrate that what is considered taxable income under IRC § 63(a) is modified by the plain language of IRC § 643(a)(1) through (4).

Because IRC § 643(a) is clear and unambiguous, it must be afforded its plain and obvious meaning. *See CRI-Leslie, LLC v. Comm'r of Internal Revenue*, 147 T.C. 217, 224 (2016), *aff'd*, 882 F.3d 1026 (11th Cir. 2018)(holding that a court will interpret a statute according to its plain meaning). It is therefore our opinion that IRC § 643(a) reasonably modifies taxable income as defined in IRC § 63(a), by virtue of subsections (1) through (4). Therefore, the assessment made in the Memorandum with respect to IRC § 643(a) not acting as a modifier of IRC § 63(a) is inaccurate and incomplete at best, as the Memorandum fails to properly analyze the entirety of IRC § 643(a). Further, the Memorandum’s analysis with respect to IRC § 643(b) is also incomplete.

IRC § 643(b) clearly and unambiguously states:

(b) Income

For purposes of this subpart and subparts B, C, and D, the term “income”, when not preceded by the words “taxable”, “distributable net”, “undistributed net”, or “gross”, means the amount of income of the estate or trust for the taxable year determined under the terms of the governing instrument and applicable local law. **Items of gross income constituting extraordinary dividends or taxable stock dividends which the fiduciary, acting in good faith, determines to be allocable to corpus under the terms of the governing instrument and applicable local law shall not be considered income.** [*Emphasis Added*].

The Memorandum fails to address the fact that both subsections (a) and (b) both modify the meaning of “taxable income”. IRC § 643(b) specifically states that unless the words “taxable”, “distributable net”, “undistributed net”, or “gross”, precede the word “taxable”, then “income” would mean the amount of income of the estate or trust for the taxable year determined under the terms of the governing instrument and applicable local law. *See also* Treas. Reg. § 1.643(b)-1. Clearly, there is a modification of what constitutes “income” under IRC § 643(b) as well.

2. Taxation of Capital Gains

IRC § 643(a)(3) clearly and unambiguously states:

(3) Capital gains and losses

Gains from the sale or exchange of capital assets shall be excluded to the extent that such gains are allocated to corpus and are not (A) paid, credited, or required to be distributed to any beneficiary during the taxable year, or (B) paid, permanently set aside, or to be used for the purposes specified in section 642(c). Losses from the sale or exchange of capital assets shall be excluded, except to the extent such losses are taken into account in determining the amount of gains from the sale or exchange of capital assets which are paid, credited, or required to be distributed to any beneficiary during the taxable year. The exclusion under section 1202 shall not be taken into account.

The Memorandum states that the Trust will recognize income on its capital gains and dividends, except to the extent those amounts are distributed or deemed to be distributed to its beneficiaries. Looking at IRC § 643(a)(3) as a whole, the assessment made in the Memorandum is correct. Gains from the sale of a capital asset are excluded to the extent that such gains are allocated to corpus and are not paid, credited, or required to be distributed to the beneficiary during the taxable year, or paid, permanently set aside, or to be used for the purposes specified in section 642(c). Treas. Reg. § 1.643(a)-3 expounds further by stating that gains from the sale or exchange of capital assets are ordinarily excluded from distributable net income and are not ordinarily

considered as paid, credited, or required to be distributed to any beneficiary except as provided for in § 1.643(a)–6 and paragraph (b) of this section which addresses income from foreign trusts and certain sales of capital assets.

Treas. Reg. § 1.643(a)-3(b) clearly and unambiguously states:

(b) Capital gains included in distributable net income. Gains from the sale or exchange of capital assets **are included in distributable net income to the extent they are, pursuant to the terms of the governing instrument and applicable local law, or pursuant to a reasonable and impartial exercise of discretion by the fiduciary** (in accordance with a power granted to the fiduciary by applicable local law or by the governing instrument if not prohibited by applicable local law)—

(1) **Allocated to income** (but if income under the state statute is defined as, or consists of, a unitrust amount, a discretionary power to allocate gains to income must also be exercised consistently and the amount so allocated may not be greater than the excess of the unitrust amount over the amount of distributable net income determined without regard to this subparagraph § 1.643(a)–3(b));

(2) **Allocated to corpus but treated consistently by the fiduciary on the trust’s books, records, and tax returns as part of a distribution to a beneficiary;** or

(3) **Allocated to corpus but actually distributed to the beneficiary or utilized by the fiduciary in determining the amount that is distributed or required to be distributed to a beneficiary.** *[Emphasis Added]*.

Subsections (1) through (3) describe the only three instances (with its own set of limitations) where capital gains **would** be included in distributable net income. Because IRC § 643(a) modifies taxable income as defined in IRC § 63(a), by virtue of subsections (1) through (4), it is reasonable to infer that gain from the sale or exchange of a capital asset is likewise excluded from taxable income.

3. Taxation of Extraordinary Dividends¹

IRC § 643(a)(4) clearly and unambiguously states:

(4) Extraordinary dividends and taxable stock dividends

For purposes only of subpart B (relating to trusts which distribute current income only), **there shall be excluded those items of gross income constituting extraordinary dividends or taxable stock dividends which the fiduciary, acting in good faith, does not pay or credit to any beneficiary by reason of his determination that such dividends are allocable to corpus under the terms of the governing instrument and applicable local law.** [*Emphasis Added*].

The plain language of IRC § 643(a)(4) excludes extraordinary dividends and taxable stock dividends from gross income so long as the fiduciary-trustee does not pay or credit to any Trust beneficiary such dividends that are allocable to corpus under the terms of the governing instrument and local law.

The Memorandum also addresses IRC § 643(b) which clearly and unambiguously states:

(b) Income

For purposes of this subpart and subparts B, C, and D, the term “income”, when not preceded by the words “taxable”, “distributable net”, “undistributed net”, or “gross”, means the amount of income of the estate or trust for the taxable year determined under the terms of the governing instrument and applicable local law. **Items of gross income constituting extraordinary dividends or taxable stock dividends which the fiduciary, acting in good faith, determines to be allocable to corpus under the terms of the governing instrument and applicable local law shall not be considered income.** [*Emphasis Added*].

A plain reading of the pertinent portions of IRC § 643(b) at issue would demonstrate that gross income that is characterized as extraordinary dividends or taxable stock dividends would not be considered income. As stated *supra*, IRC § 61(a) delineates 14 classes of income which are subject to taxation by virtue of IRC § 63(a) (minus deductions). Therefore, if IRC § 643(b) explicitly removes extraordinary dividends or taxable stock dividends from income as defined in IRC § 61(a), it therefore would not be subject to tax under IRC § 63(a), assuming that certain conditions precedent are met. *See also* Treas. Reg. § 1.643(b)-2 (“Extraordinary dividends or taxable stock dividends which the fiduciary, acting in good faith, determines to be allocable to

¹ Although the focus of this opinion is the taxation of a complex trust, under Treas. Reg. § 1.643(a)-4 “a trust which qualifies under subpart B (section 651 and following) as a “simple trust,” there are excluded from distributable net income extraordinary dividends or taxable stock dividends which are not distributed or credited to a beneficiary because the fiduciary in good faith determines that under the terms of the governing instrument and applicable local law such dividends are allocable to corpus.”

corpus under the terms of the governing instrument and applicable local law are not considered “income” for purposes of subpart A, B, C, or D, part I, subchapter J, chapter 1 of the Code. See section 643(a)(4), § 1.643(a)–4, § 1.643(d)–2, section 665(e), paragraph (b) of § 1.665(e)–1, and paragraph (b) of § 1.665(e)–1A for the treatment of such items in the computation of distributable net income”).

B. Qualifications in the Application of Law

In expressing our opinion, we note the following considerations presented by the facts of this case. First, each trustee has and will observe all applicable statutory formalities and requirements of the Trust in all material respects as well as all tax reporting requirements.

In reaching our opinion herein, we have relied upon concepts from the Trust, the Internal Revenue Code, Treasury Regulations, statutory authorities, cases, and secondary sources discussed herein which involve general principles regarding the taxation of the Trust. While we believe that the general principles applicable in the context of the analysis proffered are supported by the Documents and law, we caution that a court addressing the issues presented for legal analysis in this opinion would rule on the issues of the taxation of the Trust based upon the particular facts and circumstances before it, and might, therefore, reach a different result based on those facts. The foregoing opinion is therefore a reasoned opinion based upon an analysis of the Documents, the Internal Revenue Code, Treasury Regulations, and case law decided under the laws of various jurisdictions that we believe would be applicable by analogy to the factual patterns set forth herein. Thus, the opinion expressed herein is not a guaranty as to what a particular court or regulatory committee actually would hold, but is an opinion as to the decision a court or regulatory committee would reach assuming that the issues were properly presented to a court or regulatory committee, and assuming that the a court or regulatory committee were to follow existing precedent as to legal and equitable principles applicable in any future litigation regarding the taxation of the Trust.

In this regard, we further note that legal opinions on matters involving the Opining Law unavoidably have inherent limitations that generally do not exist in respect of other issues on which opinions of third parties typically are provided. These inherent limitations exist primarily because of: (i) the pervasive equity powers of courts properly exercising jurisdiction, (ii) the overriding goal of reorganization to which other legal rights and policies may be subordinated, (iii) the potential relevance of the exercise of judicial discretion, as evidenced by the fact that courts have accorded different degrees of significance to a variety of factual elements, (iv) facts and circumstances arising in the future that are different from those assumed herein, and (v) the nature of the trust administration and taxation of trusts and estates in general. Accordingly, the conclusions reached herein must be considered in light of these broad statutory and equitable powers of a court or regulatory committee. Consequently, we render no opinion or advice of counsel as to the interplay of the issues opined on herein with the judicial or regulatory process with respect to the Trust generally, or strategic factors or circumstances that might affect the outcome of any litigation regarding the taxation of the Trust and related matters.

This opinion is rendered pursuant to your request and is solely for your use, and may only be relied upon by you, your successors or assigns (including any trustee or any substitute or successor trustee), and may not be relied upon for any other purpose or relied upon by, or furnished or quoted to, any other Person for any purpose. This opinion speaks only on the date hereof and

is based on our understandings and assumptions as to present facts, and on our review of the above-referenced documents and the application of state and federal law as the same exist on the date hereof, and we undertake no obligation to update or supplement this opinion after the date hereof for the benefit of any Person (including any Person granted reliance in the preceding sentence) with respect to any facts or circumstances that may hereafter come to our attention or any changes in facts or law that may hereafter occur or take effect.

Very truly yours,

A handwritten signature in blue ink, appearing to be 'SE' with a stylized flourish.

Steven E. Gurian, Esq., LL.M

EXHIBIT “A”

1. IRC Memo AM 2023-006;
2. Benson and Associates Legal Opinion dated June 3, 2002;
3. Myers and Associates Legal Opinion dated May 6, 2003;
4. Paul B. Rosen Legal Opinion dated June 12, 2019;
5. Benson Financial, LLC – Internal Revenue Code and Legal Compliance: Non-Grantor, Irrevocable, Complex, Discretionary, Spendthrift Trust;
6. 2010 IRS Nationwide Tax Forum;
7. Copyright Master’s Trust 2012 Business Trust; and
8. Master’s Irrevocable Spendthrift Trust Agreement.

**Office of Chief Counsel
Internal Revenue Service
memorandum**

Number: AM 2023-006

Release Date: 8/18/2023

CC:PSI:B01:DHChulani

POSTU-105921-22

Third Party Communication: None

Date of Communication: Not Applicable

UILC: 643.01-00, 643.01-04, 643.02-00

date: August 09, 2023

to: Janice B. Geier
Associate Area Counsel, Portland
(Small Business/Self-Employed)

Sheila R. Pattison
Associate Area Counsel, Austin
(Small Business/Self-Employed)

from: Holly Porter
Associate Chief Counsel
(Passthroughs & Special Industries)

subject: "Non-grantor, irrevocable, complex, discretionary, spendthrift trust"

This memorandum may not be used or cited as precedent.

SUMMARY: This memorandum discusses a marketed trust structure which mistakenly interprets § 643 of the Internal Revenue Code (the "Code") to remove certain trust income from current taxation. CC:PSI first discovered promotional material relating to the structure in March 2021, and subsequently informed SB/SE Division Counsel. This memorandum describes the structure and explains why it does not provide the claimed benefit. While we have reviewed the promoters' materials, we have not reviewed specific taxpayers' documents in relation to the structure. Therefore, this is a general discussion which does not rely on any facts unique to specific taxpayers and we do not include any taxpayer identifying information. Our legal conclusions are based on the summarized materials and may change if a particular case offers different facts.

For simplicity, this memorandum is limited to rebutting the promoters' misinterpretation of § 643. We do not address whether some or all of these structures could be recharacterized as grantor trusts under § 671, and, if needed, will issue a supplemental memorandum on that question. Similarly, we do not address the statements in the promoters' materials that appear to advise taxpayers to treat certain taxable trust

distributions as deductible payments of trust expenses or the treatment of sales to the trust. In addition, we do not discuss the following questions:

1. The gift, estate, or generation-skipping transfer (GST) tax consequences of the structure. Specifically, we do not address whether transfers to or from the trust are “taxable gifts” as defined in § 2511.
2. The trust’s purported “asset protection” benefits, including whether state or federal courts will find that the terms of the trust provide protection from the claims of creditors including claims pertaining to federal tax debts.
3. Whether any of the gross income described in this structure constitutes an “extraordinary dividend” under § 643(b).
4. Whether, in any particular case, the existence of the trust might be challenged as a threshold matter under “sham trust” principles. We assume, solely for the sake of this memorandum, that the taxpayers are observing the formalities of their trust instruments and other relevant documents and contracts. To the extent that they are not, such that their control over the property transferred to the trust does not really change, the trust might be disregarded, with all the claimed tax benefits dependent on the trust’s validity being vitiated. See Zmuda v. Commissioner, 731 F.2d 1417 (1984), and Markosian v. Commissioner, 73 T.C. 1235 (1980), for the factors used to determine that a trust arrangement is a sham.
5. Whether the transaction in general or any particular instance of it might fall into any of the categories of “reportable transactions” provided in Treas. Reg. § 1.6011-4, such as a “confidential transaction” or “transaction with contractual protection.”

DESCRIPTION OF STRUCTURE: The structure claims to provide significant tax and asset protection advantages to individual taxpayers (described herein as the “Taxpayer”). The structure is being promoted by a combination of attorneys, accountants, enrolled agents, and unlicensed tax advisors. The promotional materials consist primarily of a series of presentations (some of which can be found on various social media platforms), informational websites, short documents, and short legal opinions. The materials state that the trust being offered complies with Scott on Trusts, the Uniform Trust Code, the Restatement of Trusts (Third), and the Code. Some materials specifically note that the trust is “section 643 compliant”. The materials describe the trust by its purported characteristics, typically a combination of the terms “non-grantor,” “irrevocable,” “discretionary,” “complex” (or “complex with simple provision”), “section 643,” and “spendthrift.”¹ In many variations, promotional materials refer to the trust structure as a “Non-Grantor, Irrevocable, Complex, Discretionary, Spendthrift Trust”. While there is some inconsistency among the materials, the basic form and mechanics of the structure are described here.

¹ In some iterations of the promotional materials, the trust is additionally described as “copyrighted.” This appears to be a reference to a specific model or form of trust instrument that is being sold or licensed, and not a tax or legal characteristic of the trust.

Formation and oversight

A third-party settlor, acting on behalf of Taxpayer, creates and nominally funds a trust with legal documents that are provided by the promoter. Taxpayer is appointed the “Compliance Overseer” with power to add and remove trustees and change beneficiaries of the trust. The promotional materials are inconsistent as to whether Taxpayer, a third-party, or both serve as trustee. In the case of a third-party serving as trustee, it is unclear whether the third-party would be an independent trustee.

Taxpayer is not a named beneficiary of the trust. In some variations, Taxpayer’s spouse and/or children are specifically named as beneficiaries but are subject to change by the Taxpayer. The trust instrument gives the trustee sole discretion to make distributions of income or principal to beneficiaries (“discretionary distributions”). It is unclear whether the Taxpayer, serving in the role of Compliance Overseer, is given a power to direct the trustee to make or withhold discretionary distributions to beneficiaries. The trust is a self-styled “spendthrift” trust or “spendthrift trust organization.” There are no provisions that allow any party to revoke the trust by distributing trust assets back to the donor in termination of the trust.

An accompanying letter described as a legal opinion (“legal opinion letter”) states that the trust is in “in compliance with the IRC” and thereby must obtain an Employer Identification Number (EIN) and file Form 1041, “U.S. Income Tax Return for Estates and Trusts” (in addition to any other filing requirements) annually as a complex trust. A subsequently dated legal opinion letter from the same source notes that the trust is “not subject to turn over orders by any court. This limits the liability of Beneficiaries and Trustees of the Trust. It also makes the corpus of the Trust unreachable by creditors.”

Funding

The trust is primarily funded by Taxpayer selling assets to the trust in exchange for a promissory note (styled as a “demand note” in certain materials).² The promotional materials do not discuss issues relating to the trust’s initial capital, creditworthiness, or ability to make payments on the promissory note. Nor do the materials outline requirements related to the terms of the note, such as having a defined period for repayment. Certain materials do discuss the requirement for debt instruments of the trust to charge adequate interest (not specifically in relation to the demand note).

Certain materials claim that the sale of assets to the trust is a non-taxable event, noting that the trust’s purchase price is the “book value” of the assets rather than their fair market value, such that the trust retains Taxpayer’s basis in the assets. Further, there is a presumption that any of the Taxpayer’s business assets (including real estate, equipment, or intangible property) sold to the trust will be leased back to Taxpayer or an

² Examples of assets appropriate for funding the trust by ‘sale’ include equipment, real estate, computers, websites, handbooks, copyrights, trademarks, and proprietary operating systems.

entity owned or controlled by Taxpayer. A few variations recommend that (1) Taxpayer transfer up to a 90% interest in a limited liability company ("LLC") (or another type of business entity) owned by Taxpayer to the trust, (2) the Taxpayer will cause the LLC to sell certain assets (including intellectual property (IP)) to the trust, and (3) Taxpayer will cause the LLC to lease back those assets and IP from the trust for a payment that is approximately equal to 70% of the monthly income of the LLC.

Income earned by the trust

The promotional materials claim that almost none of the income generated by the trust is subject to current federal income tax if the trustee allocates such income to corpus and refrains from making distributions to beneficiaries. The legal basis for these assertions regarding federal income taxation rely on § 643 of the Code.

To support the assertion that all income from the sale or exchange of capital assets ("capital gains") is excluded from federal income tax, the materials quote § 643(a)(3), without context (emphasis in original):

"IRC Section 643(a)(3) Capital Gains and Losses – gains from the sale or exchange of capital assets shall be EXCLUDED to the extent that such gains are allocated to corpus and not (A) paid, credited, or required to be distributed to any beneficiary during the taxable year . . ."

Next, the materials claim that the trustee may characterize any remaining trust income as an "extraordinary dividend", which the materials claim is not subject to current taxation so long as the trustee allocates such income to corpus. The materials find support for this claim in § 643(a)(4):

"if a fiduciary has the sole and absolute authority to designate something as extraordinary dividends or taxable stock dividends, and that designation is paid to the corpus of the trust and not subject to distribution, then it is not income to the trust according to Rule 643 [sic]."³

The accompanying legal opinion letters do not expound on this assertion, claiming only that the trust structure "provides the exclusion of extraordinary dividends and taxable stock dividends from items of gross income because the structure allows the Trustee to allocate these dividends to the corpus of the Trust." Another memorandum styled as a legal opinion letter simply states, "[c]apital gains, extraordinary dividends and taxable

³ Several promoters rely on a private letter ruling issued by this office as support for their claim that extraordinary dividends described in § 643(a)(4) are not subject to current taxation. Some materials refer to this ruling as "Private Letter Ruling # PLR-133314-14 issued May 8, 2015" or "IRS Private Letter Ruling 133314-14" See PLR 201519012. This private letter ruling held that a certain distribution that a trust received from an LLC pursuant to a settlement agreement is considered an extraordinary dividend "excluded from the definition of "income" *within the meaning of § 643(b)* (emphasis added)."

stock dividends when allocated by the trustee to the corpus of the trust in good faith are not taxable income to the trust.” That memorandum subsequently quotes from § 643 without explanation or context.

LAW:

Section 61(a) of the Code provides that, except as otherwise provided, “gross income” means all income from whatever source derived.

Section 63(a) generally defines the term “taxable income” as gross income minus the deductions allowed by Chapter 1 of the Code.

Section 641(a) generally provides that the tax imposed by § 1(e) applies to the taxable income of estates or of any kind of property held in trust including income which, at the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

Section 641(b) provides, in part, that the taxable income of a trust shall be computed in the same manner as in the case of an individual, except as otherwise provided in this part [§§ 641 through 685]. The tax shall be computed on such taxable income and shall be paid by the fiduciary.

Section 643(a) defines the term “distributable net income”, for purposes of this part [§§ 641-685] as meaning, with respect to any taxable year, the taxable income of the estate or trust computed with certain modifications listed in §§ 643(a)(1) through (7).

Section 643(a)(3) provides that gains from the sale or exchange of capital assets shall be excluded [from “distributable net income”] to the extent that such gains are allocated to corpus and are not (A) paid, credited, or required to be distributed to any beneficiary during the taxable year, or (B) paid, permanently set aside, or to be used for the purposes specified in § 642(c).

Section 643(a)(4) provides that for purposes only of subpart B [§§ 651 and 652] (relating to trusts which are required to distribute current income only (i.e., “simple” trusts)) there shall be excluded [from “distributable net income”] those items of gross income constituting extraordinary dividends or taxable stock dividends which the fiduciary, acting in good faith, does not pay or credit to any beneficiary by reason of his determination that such dividends are allocable to corpus under the terms of the governing instrument and applicable local law.

Section 643(b) provides that for purposes of subparts A, B, C, and D [§§ 641-668], the term “income,” when not preceded by the words “taxable,” “distributable net,” “undistributed net,” or “gross,” means the amount of the income of the estate or trust for the taxable year determined under the terms of the governing instrument and applicable local law. Items of gross income constituting extraordinary dividends or taxable stock dividends which the fiduciary, acting in good faith, determines to be allocable to corpus

under the terms of the governing instrument and applicable local law shall not be considered income.

Section 1.643(a)-0 of the Income Tax Regulations provides that the term “distributable net income” has no application except in the taxation of estates and trusts and their beneficiaries. It limits the deductions allowable to estates and trusts for amounts paid, credited or required to be distributed to beneficiaries and is used to determine how much of an amount paid, credited, or required to be distributed to a beneficiary will be includible in that beneficiary’s gross income. It is also used to determine the character of distributions to the beneficiaries. Distributable net income means for any taxable year, the taxable income (as defined in § 63) of the estate or trust, computed with the modifications described in §§ 643(a)(1) through (7) and the regulations thereunder.

Section 651 provides in the case of any trust the terms of which provide that all of its income is required to be distributed currently, and do not provide that any amounts are to be paid, permanently set aside, or used for the purposes specified in § 642(c), there shall be allowed as a deduction in computing the taxable income of the trust the amount of the income for the taxable year which is required to be distributed currently.

Section 651(b) provides, in part, that if the amount of income required to be distributed currently exceeds the distributable net income of the trust for the taxable year, the deduction shall be limited to the amount of the distributable net income.

Section 661(a) provides that in any taxable year a deduction is allowed in computing the taxable income of a trust (other than a trust to which subpart B applies), for the sum of (1) the amount of income for such taxable year required to be distributed currently, and (2) any other amounts properly paid or credited or required to be distributed for such taxable year, but such deduction shall not exceed the distributable net income of the estate or trust.

ANALYSIS:

Contrary to the claims of the promoters, the trust will recognize income on its capital gains and dividends, except to the extent those amounts are distributed or deemed to be distributed to its beneficiaries.

The promotional materials support their claims about the tax benefits of their structure by reading subsections of § 643 out of context. The materials do not address § 641 which provides the basic rule that the trust’s taxable income is computed as it is for individuals, with certain modifications. Instead, the materials look to § 643(a) for guidance as to the definition of “taxable income”. In so doing, the materials fail to consider the beginning of that section, which expressly states that the section defines “distributable net income” rather than “taxable income.”

A non-grantor trust is considered a separate taxable entity for income tax purposes. A non-grantor trust computes its gross income in much the same manner as an individual. Most deductions and credits allowed to individuals are also allowed to estates and trusts. However, there is one primary distinction. A trust is allowed an income distribution deduction for distributions to beneficiaries. See §§ 651 and 661. A trust's deduction for distributions to beneficiaries is limited to the lesser of (1) amounts that the trust properly pays or credits to beneficiaries during the taxable year (or amounts that are required to be paid or credited to the beneficiaries during the taxable year under the trust instrument if not actually distributed) or (2) the "distributable net income" of the trust.

Section 643 defines the concept of the "distributable net income" (or "DNI") of the trust. DNI not only limits the amount that the trust can deduct for distributions to beneficiaries, but it also determines the amount on which the beneficiaries can be taxed as a result of those distributions. See §§ 652 and 662. The income distribution deduction of the trust coupled with the gross income inclusion to beneficiaries ensures the income of the trust is taxed either to the entity or to the beneficiaries, but not to both.

Under § 643(a), DNI is calculated by making certain modifications to the trust's taxable income. Some of these modifications include subtracting certain items of gross income from DNI that may not be distributable to beneficiaries who are entitled to receive trust "income". This, in turn, depends on the economic rights of trust beneficiaries determined under the trust instrument and applicable local law for the taxable year at issue. As background, a trustee apportions items of gross income or tax-exempt receipts of the trust between two different classes of beneficiaries, a class that is entitled to trust "income" as defined under the trust instrument and applicable local law (i.e., the "accounting income" of the trust), and a class of beneficiaries (sometimes referred to as "remainder beneficiaries") entitled to certain amounts of gross income allocated to trust "corpus" or "principal". Gross income that is allocated to trust principal can be accumulated by the trust for distribution in subsequent taxable years or at the time of the trust's termination. Gross income that is allocated to trust income is either distributed to beneficiaries in the current taxable year or, depending on the terms of the trust instrument, can be accumulated by the trust for distribution in subsequent taxable years.

If a trust excludes all capital gains and extraordinary dividends from income within the meaning of § 643(b), that simply means that the trust will subtract those capital gains and extraordinary dividends from DNI under § 643(a), so long as those amounts are not actually distributed to the beneficiaries. In turn, subtracting those amounts from DNI simply means that trust has a lower threshold for the deduction that it can take for distributions to beneficiaries authorized by § 651 (for simple trusts) or § 661 (for complex trusts). If a non-grantor trust does not make (and is not required to make) any distributions to its beneficiaries, then it is not entitled to any "income distribution deduction". Therefore, all of the income attributable to capital gains and extraordinary dividends must be reported by the non-grantor trust as income on Form 1041.

The promoters of this structure mistakenly assume that income in § 643(b) refers to the taxable income of the trust. However, the first sentence of § 643(b) provides that, within the parts of the Code encompassing §§ 641 through 668, any references to “income” without preface refers to the accounting income of the trust rather than another concept of income such as “taxable income”. References to other types of income will be denoted by their full name, such as “distributable net income” or “taxable income”. See e.g., § 641 describing rules related to the computation of “taxable income”.

RECOMMENDATION:

In each case using this structure, as a threshold matter, the trust's income tax returns should be examined to ensure that (a) the trust is reporting all of its taxable income, including capital gains and any income that is described as an extraordinary dividend, and (b) ensure that the trust is disallowed any deduction claimed with respect to such income solely because the trustee, acting in good faith, has allocated such income to the corpus of the trust.⁴

Please call Jennifer N. Keeney or Darshan H. Chulani at (202) 317-6850 if you have any further questions.

⁴ Certain promotional materials include a description of tax reporting used in this structure as shown on the Form 1041. This sample Form 1041 reflects that capital gains and other amounts of gross income characterized as extraordinary dividends are included as part of the trust's “total income”, however, the sample Form 1041 shows that the trust claims a deduction on line 15a (other deductions not subject to 2% floor) in an amount that corresponds to the amount included in income. These promotional materials suggest that, in some variations, a statement is included with the return to explain this deduction.