The Joint and Survivor Grantor Trust and the S Election

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In this article, Montgomery and Montgomery explain why, following the death of the first spouse, a joint and survivor grantor trust remains an eligible S corporation shareholder for which no electing small business trust or qualified subchapter S trust election is required until after the death of the surviving spouse.

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I. The JSGT

The joint and survivor grantor trust (JSGT) is a non-foreign irrevocable trust jointly created by a married couple and funded by them with S corporation shares, subject to retained joint and survivor borrowing and substitution powers under section 675. Consider the following example.

A married couple, H and W, jointly and equally own[1] shares of an S corporation. They create a JSGT for the benefit of their child and transfer the S shares to that trust. By the express terms of the trust agreement, H and W jointly retain powers described in section 675[2] that qualify the trust as a permitted S corporation shareholder under section 1361(c)(1)(A)[3] and (2)(A)(i).[4] The jointly retained powers extend to the entire trust and are exercisable for the benefit of H, W, or both at any time while either of them is living.

II. JSGT Benefits

In addition to S corporation shareholder eligibility,[5] the JSGT may result in other tax benefits for H and W. If they sell appreciated assets to the trust, no taxable gain results from that sale, and the post-sale appreciation of the sold property will not be included in their estates for estate tax purposes. Also, if H and W annually pay the income tax on the JSGT's taxable income, their

[1]For example, when permitted by state law for the ownership of intangible property, H and W could own the S shares as joint tenants, tenants in common, tenancy by the entirety, or community property. *See infra* note 5.

[2]The trust agreement might provide, for example, that the trustee will, upon the demand by either H or W and without requiring the approval or consent of any person in a fiduciary capacity, transfer any trust assets in exchange for assets of equivalent value, or lend to H, W, or both any or all of the trust income and principal in exchange for a promissory note of equal value to the amount lent, bearing adequate interest but not adequate security. Those powers might be exercisable by H and/or W personally, or by an attorney-in-fact or other person who is not an adverse party described in section 675(2).

[3]Section 1361(c)(1)(A) ("For purposes of subsection (b)(1)(A), there shall be treated as one shareholder — (i) a husband and wife (and their estates), and (ii) all members of a family (and their estates).").

[4]Section 1361(c)(2)(A)(i) (describing an eligible S corporation shareholder as "a trust all of which is treated (under subpart E of part I of subchapter J of this chapter) as owned by an individual who is a citizen or resident of the United States"); reg. section 1.1361-1(e)(2) ("If husband and wife are owners of a subpart E trust, they will be treated as one individual."); and reg. section 1.1361-1(h)(3)(i)(A) ("If stock is held by a qualified subpart E trust, the deemed owner of the trust is treated as the shareholder.").

[5]LTR 8506060 (finding that a husband and wife who jointly transferred community property and separate property S corporation shares to a revocable trust are treated as one shareholder under section 1361(c)(2)(A)(i)); *see also* LTR 8505032 (community property); LTR 9017025 (community property); and LTR 8847019 (joint tenancy property).

estates will be further reduced for estate tax purposes to the extent of those payments.[6]

III. What if One of H or W Dies?

An issue that may directly affect the S election is whether upon the death of either H or W, any portion of the JSGT ceases to be an eligible S corporation shareholder described in section 1361(c)(2)(A)(i) and is instead described in section 1361(c)(2)(A)(ii) (a terminated grantor trust).[7] If so, an electing small business trust (ESBT)[8] or qualified subchapter S trust[9] election must effectively be made within the two-year period described in section 1361(c)(2)(A)(ii) for that portion of the JSGT to remain an eligible S corporation shareholder.[10]

On the other hand, if the surviving spouse continues as the 100 percent deemed owner[11] of the JSGT after the death of H or W, no portion will be a terminated grantor trust, and no ESBT or QSST election will be required until after the death of the survivor.

Put another way, if H is the first grantor to die, survived by W, is W then only a 50 percent deemed owner of the JSGT because she is the transferor of only 50 percent of its property, or is W the 100 percent deemed owner of the JSGT because the portion to which her retained powers described in section 675 then extend is 100 percent? To our knowledge, no case law answers this question. However, language in the regulations and section 675, interpreted according to customary canons of construction, supports the conclusion that W is the 100 percent deemed owner of the JSGT after the death of H because the portion to which her retained powers described in section 675 then extend is 100 percent. If so, no part of the JSGT will be a terminated grantor trust described in section 1361(c)(2)(A)(ii) upon H's death. In that event, all the benefits of the JSGT that existed when H was alive will continue undiminished until the death of W, including its continued eligibility as an S corporation shareholder for which no ESBT or QSST election is required until after W's death.

IV. The Section 675 Powers

Under section 675, a grantor is a deemed owner of a trust[12] if that grantor or a non-adverse party acting in a nonfiduciary capacity,[13] without the approval or consent of any person acting in a fiduciary capacity, has (1) the power to enable the grantor to reacquire the trust corpus[14] by substituting other property of equivalent value (substitution power)[15] or (2) the power to enable the grantor to borrow trust corpus or income, directly or indirectly, without adequate security (borrowing power).[16]

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[6] Julia Kagan, "Intentionally Defective Grantor Trust (IDGT)," Investopedia (Nov. 18, 2020).

[7] Section 1361(c)(2)(A)(ii) (describing an eligible S corporation shareholder as "a trust which was described in clause (i) immediately before the death of the deemed owner and which continues in existence after such death, but only for the 2-year period beginning on the day of the deemed owner's death").

[8] *See* section 1361(e)(1) and reg. section 1.641(c)-1.

[9] *See* section 1361(d)(3) and reg. section 1.1361-126.

[10] If a required ESBT or QSST election is not made within two months and 16 days after the end of the two-year period, per reg. section 1.1361-1(m)(2)(iv) and -1(j)(6)(iii)(C), the S election may be inadvertently terminated. If so, relief might be possible under section 1362(f) or Rev. Proc. 2013-30, 2013-36 I.R.B. 173 (providing simplified relief for late-filed elections made within three years and 75 days of the election effective date).

[11] "Deemed owner" is the phrase used in section 1361(c)(2)(A)(ii).

[12] Reg. section 1.675-1(a) (providing that the grantor is treated as the owner of any portion of a trust if, under the terms of the trust instrument or circumstances attendant on its operation, administrative control is exercisable primarily for the benefit of the grantor rather than the beneficiaries of the trust); reg. section 1.675-1(b) (providing that administrative controls considered exercisable primarily for the benefit of the grantor include (1) a power exercisable by the grantor, a non-adverse party, or both, which enables the grantor (in contrast to borrowers generally) to borrow the corpus or income of the trust, directly or indirectly, without adequate interest or adequate security; and (2) a power of administration exercisable in a nonfiduciary capacity by any non-adverse party, without the approval or consent of any person in a fiduciary capacity, to reacquire the trust corpus by substituting other property of an equivalent value).

[13] Section 672(a) (providing that the term "adverse party" means any person having a substantial beneficial interest in the trust that would be adversely affected by the exercise or non-exercise of the power that the person possesses regarding the trust); and section 672(b) (providing that the term "non-adverse party" means any person who is not an adverse party).

[14] Section 675(4)(C).

[15] Section 675(2) and (4)(C) indicates that the form of the originally transferred assets may change or be altered without affecting deemed owner status by their references to borrowing or reacquiring trust "corpus" rather than "the property originally transferred by the grantor." LTR 200842007 (Approving a substitution power enabling the grantor to "acquire any or all property constituting trust principal by substitution of other property of equivalent value" for a trust when the trustees have broad powers to "invest, dispose of, and otherwise deal with property in Trust, whether originally contributed to Trust, acquired by Trust or previously substituted into the Trust by Grantor, without the approval or consent of any other person.").

[16] Section 675(2). For example, the borrowing power might be exercised to enable W to pledge the S shares as security for a personal loan.

Many IRS private letter rulings conclude that a grantor is the deemed owner for income tax purposes when the grantor retains the substitution power and/or borrowing power over the trust.[17] Even though H and W are deemed owners of the JSGT for income tax purposes, neither the substitution power nor the borrowing power alone will likely cause the trust to be included in either of their estates for estate tax purposes.[18]

V. Grantor Trust Definitions

The conclusion that W continues as the 100 percent deemed owner of the JSGT after the death of H results from the language of regulations under section 671, as discussed below.

A. The Underlying Principle

Reg. section 1.671-2(b) provides:

> The principle underlying subpart E (section 671 and following), part I, subchapter J, chapter 1 of the Code, is in general that income of a trust over which the grantor or another person has retained substantial dominion or control should be taxed to the grantor.

B. Grantor

Reg. section 1.671-2(e)(1) provides two methods by which a person may become a grantor:

> A grantor includes any person to the extent such person either [1] creates a trust or [2] directly or indirectly makes a gratuitous transfer . . . of property to a trust. . . . However, a person who creates a trust but makes no gratuitous transfers to a trust is not treated as an owner of any portion of a trust under sections 671 through 677 or 679. [Bracketed numbers added.]

C. Creator Grantor

Reg. section 1.671-2(e)(6), Example 1, provides:

> A creates and funds a trust, T, for the benefit of her children. B subsequently makes a gratuitous transfer to T. Under paragraph (e)(1) of this section, both A and B are grantors of T.

Reg. section 1.671-2(e)(1) and Example 1 of reg. section 1.671-2(e)(6) both distinguish grantors like H and W (creator grantors) from grantors who make gratuitous transfers only (transfer-only grantors). Because reg. section 1.671-2(e)(1) indicates that a person is a grantor "to the extent . . . such person . . . creates a trust," it follows that a creator grantor may, in the express terms of the trust agreement, define the extent to which that creator grantor retains substantial dominion or control over the entire trust, without regard to whether there may be other grantors of the trust. That principle is illustrated in reg. section 1.671-2(e)(6), Example 3, which provides:

> A, an attorney, creates a foreign trust, FT, on behalf of A's client, B, and transfers $100 to FT out of A's funds. A is reimbursed by B for the $100 transferred to FT. . . . Both A and B are treated as grantors of FT under paragraph (e)(1) of this section. In addition, B is treated as the owner of the entire trust under section 677. Because A is reimbursed for the $100 transferred to FT on behalf of B, A is not treated as transferring any property to FT. Therefore, A is not an owner of any portion of FT under sections 671 through 677 regardless of whether A retained any power over or interest in FT described in sections 673 through 677.

In Example 3, A, the creator grantor of FT, is acknowledged to be capable of retaining a power described in sections 673 through 677 over the entire trust, even though A is not treated as

[17] *See, e.g.*, LTR 201730018 (the grantor had the substitution power); LTR 200010036 (the non-adverse party had the substitution power); LTR 201507008 (the grantor had the borrowing power); LTR 200840025 (the non-adverse party had the borrowing power); and LTR 199942017 (the grantor had both the substitution power and the borrowing power).

[18] Rev. Rul. 2008-22, 2008-16 IRB 796 (ruling that a grantor's retained power, exercisable in a nonfiduciary capacity, to acquire trust property by substituting property of equivalent value will not alone cause the trust property to be includable in the grantor's gross estate under section 2036 or 2038, provided the trust agreement and local law prevent specified abuses of that power). *See also* LTR 200842007 (finding that under *Estate of Jordahl v. Commissioner*, 65 T.C. 92 (1975), *acq.*. 1977-1 C.B. 1, when property substituted is of equal value to the property replaced, no present taxable gift to the trust or inclusion for estate tax purposes results).

transferring any property to FT and there is another grantor of the trust (B, who is a transfer-only grantor).

D. Deemed Owner

Reg. section 1.671-3(a)(1) defines the deemed owner described in section 1361(c)(2)(A)(ii) as follows:

> When a grantor or another person is treated under subpart E (section 671 and following) as the owner of any portion of a trust, there are included in computing his tax liability those items of income, deduction, and credit against tax attributable to or included in that portion. For example: If a grantor or another person is treated as the owner of an entire trust (corpus as well as ordinary income), he takes into account in computing his income tax liability all items of income, deduction, and credit (including capital gains and losses) to which he would have been entitled had the trust not been in existence during the period he is treated as owner.

Because, after the death of H, W will be the deemed owner of both the corpus and ordinary income[19] of some fractional portion (concluded in this article to be 100 percent) of the JSGT, all the income tax attributes of that fractional portion must be allocated to W as though the trust does not exist.

E. Concurrent Deemed Owners

Trusts may have multiple grantors, each of whom individually is the person for whose benefit a retained grantor trust power may be exercised. Those multiple grantors may concurrently be "the grantor" described in section 675 and deemed owners as to their undivided fractional interests[20] of the trust that are subject to each grantor's control (concurrent deemed owners).[21] That principle is stated in reg. section 1.671-3(a)(3):

> If the portion of a trust treated as owned by a grantor . . . consists of an undivided fractional interest in the trust . . . a pro rata share of each item of income, deduction, and credit is normally allocated to the portion. . . . The numerator of this fraction is the amount which is subject to the control of the grantor or other person and the denominator is normally the fair market value of the trust corpus at the beginning of the taxable year in question.

The numerator of the concurrent deemed owner fraction defined in reg. section 1.671-3(a)(3) above is "the amount which is subject to the control of the grantor" rather than "the amount attributable to the transfer of the grantor." Because reg. section 1.671-2(b) (discussed in Section V.A above) equates "dominion or control"[22] with "section 671 and following," the concurrent deemed owner fraction of a trust as defined in reg. section 1.671-3(a)(3) includes the portion of the trust over which a grantor retains a power described in sections 673 through 677.

VI. The Required Calculations

The question of what happens when H or W dies may be answered by applying the numerator and denominator definitions of reg. section 1.671-3(a)(3) in conjunction with Example 7 of reg. section 1.671-2(e)(6), which provides:

> A, B's brother, creates a trust, T, for B's benefit and transfers $50,000 to T. The trustee invests the $50,000 in stock of Company X. C, B's uncle, purportedly sells property with a fair market value of $1,000,000 to T in exchange for the stock when it has appreciated to a fair market value of $100,000. Under paragraph (e)(2)(ii) of this section, the $900,000 excess value is a gratuitous transfer by C. Therefore, under paragraph (e)(1) of this

[19] *See supra* note 2.

[20] USLegal, "Undivided Interest Law and Legal Definition" ("An undivided interest is defined as an identical fractional or percentage interest or share in each right, benefit, and obligation with respect to the subject matter of a contract.").

[21] Financial Dictionary by Farlex, "Concurrent Ownership" (defining concurrent ownership as "ownership by two or more parties at the same time").

[22] "Dominion and control" is the phrase used in the last sentence of section 671.

section, A is a grantor with respect to the portion of the trust valued at $100,000, and C is a grantor of T with respect to the portion of the trust valued at $900,000. In addition, A or C or both will be treated as the owners of the respective portions of the trust of which each person is a grantor if A or C or both retain powers over or interests in such portions under sections 673 through 677.

The deemed owner fraction calculations required by the last two sentences may be illustrated by the following two variations of Example 7's facts.

A. Variation 1

A (the creator grantor) creates a trust, T, makes the first transfer of property to it, and retains for life a power described in sections 673 through 677 over the entire trust. C (the transfer-only grantor) then makes the second transfer of property to T and retains for life a power described in sections 673 through 677 over the portion of T attributable to C's transfer, such that A and C initially are then the equal concurrent deemed owners of the $900,000 portion of T. There are four possible combinations of deemed owner percentages, which change each time a concurrent deemed owner dies:

A = 55 percent (10 percent + 45 percent), and C = 45 percent.

- A = ($100,000/$1 million) + [($900,000/2)/$1 million].
- C = ($900,000/2)/$1 million.

If C dies before A, A = 100 percent, and C = 0 percent.

- A = ($100,000 + $900,000)/$1 million.
- C = $0/$1 million.

If A dies before C, A = 0 percent, and C = 90 percent.

- A = $0/$1 million.
- C = $900,000/$1 million.

If A and C both die, A = 0 percent, and C = 0 percent.

- A = $0/$1 million.
- C = $0/$1 million.

B. Variation 2

Instead of sole creator grantor A, there are two creator grantors (H and W) who jointly create T and make the first transfer of property to it. They also retain a joint and survivor power described in sections 673 through 677 that extends over the entire trust until the survivor's death, such that H and W initially are the equal concurrent deemed owners of the entire trust. C then makes the second transfer of property to T and retains for life a power described in sections 673 through 677 over the portion of T attributable to C's transfer, such that H, W, and C are then the equal concurrent deemed owners of the $900,000 portion of T. The deemed owner percentage combinations again change each time a concurrent deemed owner dies, as shown below.

H = 35 percent (5 percent + 30 percent), W = 35 percent (5 percent + 30 percent), and C = 30 percent.

- H = [($100,000/2)/$1 million] + [($900,000/3)/$1 million].
- W = [($100,000/2)/$1 million] + [($900,000/3)/$1 million].
- C = ($900,000/3)/$1 million.

If C dies before H and W, H = 50 percent, W = 50 percent, and C = 0 percent.

- H = ($100,000 + $900,000/2)/$1 million.
- W = ($100,000 + $900,000/2)/$1 million.
- C = $0/$1 million.

If both C and H die before W, H = 0 percent, W = 100 percent, and C = 0 percent.

- H = $0/$1 million.
- W = ($100,000 + $900,000)/$1 million.
- C = $0/$1 million.

Because the final result of Variation 2 is the same even if there is no grantor C, the answer to the question of what happens when H or W dies is this: After the death of H, W is the 100 percent deemed owner of the JSGT until her death because the portion to which her retained powers described in section 675 then extend is 100 percent.

VII. Tax Court Interpretation

Although the italicized language below is dictum (that is, not necessary to the Tax Court's decisions), it is consistent with the language of section 1.671-2(b) and -3(a)(3):

> When the grantor of a trust retains any of the powers described in sections 673 through 677, he is treated, for income tax purposes, *as the "owner" of that portion of the trust over which the power extends*.[23] [Emphasis added.]

This language shows that the Tax Court interprets deemed ownership of a trust to be in proportion to a grantor's retained power described in sections 673 through 677 over the trust (rather than simply in proportion to that grantor's transfer of property to the trust).

VIII. IRS Interpretation

The result in LTR 9304017 is consistent with the conclusion of this article. The private letter ruling considers a scenario in which two parents, C and D, jointly create and fund trusts A and B for the benefit of each of their children. S corporation shares are transferred to the trusts. The parents retain a joint and survivor section 674 power over the trusts (like the section 675 powers that H and W retained over the JSGT) that can be exercised by the trustee (a non-adverse party) to appoint additional trust beneficiaries. Because the joint and survivor retained power extends to the entirety of trusts A and B for as long as one of C or D is living, C, D, or both are the 100 percent deemed owners of trusts A and B until the death of the survivor (the same final result as Variation 2). Thus, trusts A and B qualify as S corporation shareholders for which no QSST elections are required until after the second death. The letter ruling concludes:

> After the deaths of C and D, Trust A, Trust B, and any separate share trust created thereunder will be considered a qualified subchapter S trust under section 1361(d)(3) of the Code, provided that each beneficiary is a citizen or resident of the United States and that a valid election is made by or on the behalf of the respective beneficiary under section 1361(d)(2).

IX. State Law

Although the allocation of all items of income, deduction, and credit against tax that result from the application of section 675(2) and (4)(C) is a matter of federal law, the interpretation of federal statutory phrases related to the retained substitution power or borrowing power might involve a reference to state property law.[24] For example, under Washington law, each spouse has an undivided and equal interest in each community property asset.[25] If H and W are Washington residents who jointly own the S shares as their community property before the transfer of those shares to the JSGT, either H or W independently has complete and sole management control over all the S shares, including the unilateral power to transfer title to any or all of them.[26] Thus, under Washington property law, either the substitution power (the power to reacquire the trust corpus) or the borrowing power (the power to borrow trust corpus[27]) alone appears sufficient to make W, after the death of H, the 100 percent deemed owner of the entire JSGT until her death.

X. The Canons of Construction

When a court answers the "What if one of H or W dies?" question for the first time, the interrelated statutory and regulatory language will be interpreted according to customary canons of construction.

[23] *Dick H. McKenzie Family Estate*, T.C. Memo. 1984-9, at 9; and *Luman v. Commissioner*, 79 T.C. 846, 853 (1982).

[24] *C.f., Estate of Brickert v. Commissioner*, 37 T.C. 57 (1961).

[25] *In re Estate of Patton*, 494 P.2d 238 (1972).

[26] Wash. Rev. Code section 26.16.030 ("Community property defined — Management and control," which provides that "either spouse . . . acting alone, may manage and control community property, with a like power of disposition as the acting spouse or domestic partner has over his or her separate property, except . . . neither person shall give community property without the . . . implied consent of the other.").

[27] Section 675(2) is similar to section 674 in that no reference to state law is likely necessary to construe the section 675(2) statutory phrase "borrow trust corpus." *See* LTR 9304017 (concerning the retained power to add descendants as additional trust beneficiaries).

A. Substitution Power Language

Section 675(4)(C) defines the substitution power as follows:

> The grantor shall be treated as the owner of *any portion* of a trust in respect of which — (4) A power of administration is exercisable in a nonfiduciary capacity by any person without the approval or consent of any person in a fiduciary capacity. For purposes of this paragraph, the term "power of administration" means any one or more of the following powers: . . . (C) *a power to reacquire the trust corpus by substituting other property of an equivalent value*. [Emphasis added.]

B. Borrowing Power Language

Section 675(2) defines the borrowing power:

> The grantor shall be treated as the owner of *any portion* of a trust in respect of which — A power exercisable by the grantor or a nonadverse party, or both, *enables the grantor to borrow the corpus or income*, directly or indirectly, without adequate interest or without adequate security. [Emphasis added.]

C. Powers of Spouses Language

Section 672(e) provides:

> For purposes of this subpart, a grantor shall be treated as holding any power or interest held by — (A) any individual who was the spouse of the grantor at the time of the creation of such power or interest.

D. Applicable Canons

1. Plain meaning canon; *expressio unius* canon.

Courts have stated that statutes are to be construed according to the plain meaning of their unambiguous language, "unless this leads to an unreasonable result or a result contrary to legislative intent" (the plain meaning canon),[28] and that "Congress' intent is found in the words it has chosen to use."[29] Further, courts "cannot insert into statutes terms or provisions which are obviously not there."[30]

The *expressio unius* canon is defined as "the expression of the one is the exclusion of the other."[31] The meaning of that maxim, the Court of Federal Claims has explained, is that "if Congress includes certain related items in a statute but does not include other items in the same category, it intentionally excludes those other items."[32] And the Supreme Court has observed that "where Congress includes particular language in one section of a statute but omits it in another . . . it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion."[33]

For example, to construe section 675(2) to mean that after the death of H, W is merely a 50 percent deemed owner of the JSGT because she is the transferor of only 50 percent of its property requires reading into section 675(2) the bracketed added language below — words that "are obviously not there"[34]:

> The grantor [*who directly or indirectly transfers property to a trust*] shall be treated

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[28] *United States v. Crabtree*, 565 F.3d 887, 889 (4th Cir. 2009) (quoting *Sigmon Coal Co. v. Apfel*, 226 F.3d 291, 304 (4th Cir. 2000)); *Secretary of Labor v. Twentymile Coal Co.*, 411 F.3d 256, 260-261 (D.C. Cir. 2005) ("To read the regulation's use of the term [in this way] would lead to absurd results. . . . This Court will not adopt an interpretation of a statute or regulation when such an interpretation would render the particular law meaningless."); *Long Island Care at Home Ltd. v. Coke*, 551 U.S. 158, 170 (2007) (invoking the canon that the specific governs the general); and *Fabi Construction Co. v. Secretary of Labor*, 508 F.3d 1077, 1087 (D.C. Cir. 2007) (relying on *noscitur a sociis* as part of determination that the plain meaning of "form work" precludes the agency's interpretation of the regulation).

[29] *Harbison v. Bell*, 556 U.S. 180, 198 (2009) (Thomas, J., concurring).

[30] *In re Matter of Adoption of Chaney*, 887 P.2d 1061, 1065 (1995); *see also Commissioner v. Asphalt Products Co.*, 482 U.S. 117, 121 (1987). In *Asphalt Products*, the Supreme Court held that a taxpayer underpaid his taxes by $7,000 but was found to have negligently underpaid by only $700. The taxpayer argued that the statute imposing a penalty for underpayment of taxes should be read to require payment in an amount equal to 5 percent of the amount of the underpayment attributable to negligence. The Court, however, refused to add the "attributable to" qualifier to the express statutory language that simply required payment in "an amount equal to 5 percent of the underpayment," even though this led to an arguably less equitable result.

[31] *Ventas Inc. v. United States*, 381 F.3d 1156, 1161 (Fed. Cir. 2004).

[32] *Sunoco Inc. v. United States*, 129 Fed. Cl. 322 (2016).

[33] *Keene Corp. v. United States*, 508 U.S. 200, 208 (1993) (quoting *Russello v. United States*, 464 U.S. 16, 23 (1983)).

[34] *Chaney*, 887 P.2d at 1065.

> as the owner of [*the portion of such trust attributable to such property*] in respect of which — A power exercisable by the grantor or a nonadverse party, or both, enables the grantor to borrow the corpus or income, directly or indirectly, without adequate interest or without adequate security. [Emphasized bracketed language added.]

The hypothetical implied bracketed language would violate the plain meaning canon, the *expressio unius* canon, or both because those words, which are not included in section 675(2), are included in section 679(a)(1), which reads:

> A United States person *who directly or indirectly transfers property to a* foreign *trust* . . . shall be treated as the owner for his taxable year of *the portion of such trust attributable to such property.* [Emphasis added.]

The inclusion of the above-italicized words in section 679(a)(1) shows that they were excluded from section 675(4)(C) and (2) intentionally, so the plain meaning canon and the *expressio unius* canon prohibit reading them into section 675(4)(C) and (2).[35]

2. Harmonious reading canon.

Related statutes are to be read as a harmonious whole whenever reasonable, with separate parts being interpreted within their broader statutory context in a way that "renders them compatible, not contradictory."[36]

When read together, section 1361(c)(1)A (treating married couples as a single shareholder for S corporation purposes), section 1361(c)(2)(A)(i) (treating a wholly owned grantor trust as an eligible S corporation shareholder), and section 1362(f) (providing liberal relief for inadvertently invalid or terminated S elections) indicate a general congressional intent favoring the simplification and validity of S elections. Thus, reading into section 675(4)(C) and (2) the implied bracketed words — which would illogically strain the meaning of the statute's other express words to convert a portion of the JSGT into a terminated grantor trust after the death of H — would also violate the harmonious reading canon. Doing so would inevitably lead to more inadvertently terminated S elections and unnecessarily increase the number of requests for relief under section 1362(f), a result that is contradictory to the general congressional intent favoring the simplification and validity of S elections.

3. Singular-plural canon.

The presumptive rule of statutory construction is that the singular includes the plural, and vice versa.[37] Drawing inferences from section 675's use of the phrase "the grantor" instead of "a grantor" (for example, by construing "the grantor" to mean that "a grantor" like W cannot, after H's death, be the deemed owner of the portion of the JSGT that is attributable to H's transfer of property) violates the singular-plural canon. That would contradict the language referring to W interchangeably as both *a* grantor of the JSGT in section 672(e)(1) (H is the other grantor) and *the* grantor in section 672(e)(1)(A) (H is "the spouse of the grantor at the time of the creation of such power or interest").

XI. Conclusion

No terminated grantor trust results until after the second death. As creator grantors, H and W jointly retained the section 675 substitution and borrowing powers extending over the entire JSGT until the death of the survivor of them. After H's

[35] Reading those nonexistent words into section 675(4)(C) and (2) would require a corresponding construction of reg. section 1.671-2(e)(1), in violation of the similar "superfluous canon," which requires specific provisions to be construed to avoid rendering superfluous any of their words. If a creator grantor may only be the deemed owner under section 675(4)(C) and (2) of the portion of the trust attributable to property transferred to the trust by that grantor, there would be no purpose to the distinction made in reg. section 1.671-2(e)(1) between a creator grantor and a transfer-only grantor. *Corley v. United States*, 556 U.S. 303, 314 (2009) (quoting *Hibbs v. Winn*, 542 U.S. 88, 101 (2004)) ("a statute should be construed [to give effect] to all its provisions, so that no part will be inoperative or superfluous, void or insignificant").

[36] Antonin Scalia and Bryan A. Garner, *Reading Law: The Interpretation of Legal Texts* (2012); and William N. Eskridge Jr. et al., *Cases and Materials on Legislation and Regulation: Statutes and the Creation of Public Policy* (2014).

[37] The Dictionary Act, ch. 388 (1947), as amended, 1 U.S.C. sections 1-6, has definitions of common terms used in federal statutes (*e.g.*, "person," "vessel," and "vehicle"). These definitions govern in all federal statutes unless the context indicates otherwise. The Dictionary Act provides that "unless the context indicates otherwise . . . words importing the singular include and apply to several persons, parties, or things; words importing the plural include the singular." 1 U.S.C. section 1.

death, W is "the grantor" described in section 675 for whose sole benefit the substitution and/or borrowing powers may then be exercised. Despite the death of H, the express language of section 675 makes W the deemed owner of "any portion" of the trust to which her retained substitution and borrowing powers extend. W is therefore the deemed owner of 100 percent of the trust after H's death because the entirety of the trust remains "subject to the control of the grantor" within the meaning of reg. section 1.671-3(a)(3).

The language in the regulations and section 675, interpreted according to customary canons of construction, supports this logical conclusion: After the death of H survived by W, no portion of the JSGT is a terminated grantor trust, and it continues as an eligible S corporation shareholder described in section 1361(c)(2)(A)(i) to the same extent as when both H and W were living.

However, a protective ESBT election is still advisable. Until there is case law holding that W will be the 100 percent deemed owner of the JSGT after the death of H, it is still wise, as a precaution, to plan for the alternative result. To best defend the S election, it is prudent to make a protective ESBT election at the inception of the JSGT.[38] Reg. section 1.641(c)-1(a) allows, and Example iv of reg. section 1.1361-1(m)(8) describes,[39] a grantor trust for which the trustee makes a valid unconditional[40] protective ESBT election at inception, even though it will not be taxed as an ESBT until after the grantor's death. The protective ESBT election is expressly allowed for a wholly owned grantor trust, like the JSGT.[41]

If an unconditional protective ESBT election effective as of the inception date is timely filed, the regulations suggest that the JSGT will be insulated from a retroactive disallowance of deemed owner status that otherwise might invalidate the S election. ■

[38] The protective QSST election described in reg. section 1.1361-1(j)(6)(iv) is not available for the JSGT.

[39] Reg. section 1.1361-1(m)(8), Example iv ("Subpart E trust continuing after grantor's death. On January 1, 2003, M transfers stock in X, an S corporation, and other assets to Trust. Under the terms of Trust, the trustee of Trust has complete discretion to distribute the income or principal to M during M's lifetime and to M's children upon M's death. During M's life, M is treated as the owner of Trust under section 677. The trustee of Trust makes a valid election to treat Trust as an ESBT effective January 1, 2003. On March 28, 2004, M dies. Under applicable local law, Trust does not terminate on M's death. Trust continues to be an ESBT after M's death, and no additional ESBT election needs to be filed for Trust after M's death.").

[40] A trustee may not make a conditional protective ESBT election that applies only if the trust fails to qualify as an S shareholder under another provision. *See* preamble to T.D. 8994 ("A conditional ESBT election should not be allowed because the ESBT election must have a fixed effective date."). If a trustee attempts that conditional election and the trust does not independently qualify as an S shareholder under one of the other categories of permissible trusts, the invalid protective election will not prevent the loss of S corporation status. Reg. section 1.1361-1(m)(2)(v) (first and second sentences). In that case, another ESBT election will be required after some portion of the trust becomes a terminated grantor trust.

[41] Reg. section 1.1361-1(m)(2)(v) ("In addition, a trust that qualifies as an ESBT may make an ESBT election notwithstanding that the trust is a wholly-owned grantor trust.").

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Grantors Cannot Override The Grantor Trust Rules

To the Editor:

We write to point out an error in the March 28 article by Alan L. Montgomery and Ryan L. Montgomery, "The Joint and Survivor Grantor Trust and the S Election."

In their article, the authors say:

> Language in the regulations and section 675, interpreted according to customary canons of construction, supports the conclusion that W is the 100 percent deemed owner of the JSGT [joint and survivor grantor trust] after the death of H because the portion to which her retained powers described in section 675 then extend is 100 percent.

This statement is, we respectfully suggest, wrong.

The grantor trust rules create two distinct sets of rules. Sections 671 through 677 and 679 deem a trust's grantor to be the owner of the trust assets for income tax purposes, while section 678 deems someone other than the trust's grantor to be the owner of the trust assets for income tax purposes. These rules are quite different.

The grantor of a trust is deemed to own its assets if she retains (or is deemed to have retained through the grantor's spouse) any of a wide assortment of powers or interests, including the right to reacquire trust assets by substituting assets of equivalent value, which the authors discuss. Indeed, in general, the grantor is deemed to be the owner of the trust (or its assets) if some non-adverse party (other than the grantor) has such a section 675 power of substitution. Under section 678, a person other than a grantor is deemed to own the trust assets only if (a) he has a power, exercisable solely by himself, to vest the corpus or the income in himself; or (b) he had such a power and partially released it or modified it, retaining a power or interest which, were this person the grantor of the trust, would have caused him to be taxed as the owner of the trust assets under sections 671 through 677.

Which of these sets of rules applies depends on whether the person in question is a "grantor" of the trust and the extent to which that grantor makes one or more gratuitous transfers to the trust. As the article correctly states, a "grantor" is any person who creates a trust or makes a direct or indirect gratuitous transfer of property to a trust.[1] One can, however, be deemed to own the trust assets as a grantor only to the extent that she contributed assets to the trust.

Reg. section 1.671-2(e)(6), Example 3, on which the authors rely, actually confirms this point. In that example, the attorney who nominally creates a trust for the client is a grantor, but the attorney is not deemed to own any portion of the trust assets because he had not made a gratuitous transfer to the trust.

This approach is also confirmed by reg. section 1.671-3, which discusses the portion of a trust that is deemed owned by each of multiple grantors. Multiple grantors of a grantor trust will each own a share of the whole trust. The portion deemed owned by each grantor is based first on what part of the trust is attributable to the contributions by each grantor. Only then does the existence of a grantor trust power become relevant. Thus, two spouses who create a grantor trust and fund it solely with property owned jointly in equal shares will each own half the trust. The transfer to the trust destroys the state law joint ownership.

The grantors can, as the authors write, determine by agreement how the trust's beneficial enjoyment and control shall be shared. They cannot, however, determine by agreement who the grantor of a particular part of the trust is for purposes of the grantor trust rules; that's determined on the basis of their relative contributions.

The authors' position is contrary to the regulations defining the portion of a trust deemed

[1] Reg. section 1.671-2(e).

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owned by multiple grantors and, were it correct, section 678 would be immaterial.

Kindest regards,

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Pioneer Wealth Partners LLC
Coauthor, *Blattmachr on Income Taxation of Estates and Trusts* (2018)

F. Ladson Boyle
University of South Carolina School of Law
Coauthor, *Blattmachr on Income Taxation of Estates and Trusts* (2018)

Howard M. Zaritsky
Coauthor, *Federal Income Taxation of Estates and Trusts* (2001)
Apr. 15, 2022 ■

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Authors' Response to Blattmachr, Boyle, and Zaritsky

To the Editor:

Although we agree with its title "Grantors Cannot Override the Grantor Trust Rules," we respectfully disagree with the rest of the April 25 letter to the editor[1] by Jonathan G. Blattmachr, F. Ladson Boyle, and Howard M. Zaritsky about our March 28 article "The Joint and Survivor Grantor Trust and the S Election."[2]

The authors of the letter are well-known commentators, and we're pleased they read our article. However, their letter contradicts clear language in section 675 and the regulations, and cites no authority[3] (which, to our knowledge, does not exist) to support this incorrect statement:

> One can, however, be deemed to own the trust assets as a grantor only to the extent that she contributed assets[4] to the trust.[5]

The errors in the above statement resulting from the misinterpretation of the regulations (including most importantly the misreading of the definition of "grantor") are described in footnotes 3 through 5, but its more fundamental flaw is that the authority of greatest weight, section 675, contains no language that even remotely resembles it. Rather, the above statement takes the language from section 679(a)(1), which expressly defines its deemed ownership to be proportionate to the property transferred by a grantor to the foreign trust,[6] and implies it into all the other grantor trust sections. No such language is contained within section 675(2) and (4)(C), which characterize deemed ownership solely in terms of the powers retained by a grantor over "any portion of a trust." That statutory phrase, which plainly has only one meaning, disproves the statement quoted above, since "any portion of a trust" obviously may be larger (or smaller) than the portion attributable to property transferred to the trust by that grantor.

Reg. section 1.671-2(b) and -3(a)(3) similarly contain no references or limitations relating to the portion of the trust attributable to property transferred to the trust by a grantor. The letter mischaracterizes reg. section 1.671-3(a)(3) as follows:

> This approach is also confirmed by reg. section 1.671-3, which discusses the portion of a trust that is deemed owned by each of multiple grantors. Multiple grantors of a grantor trust will each own a share of the whole trust. The portion deemed owned by each grantor is based first on what part of the trust is attributable to the contributions by each grantor. Only then does the existence of a grantor trust power become relevant.

The above statement requires two separate calculations to determine the deemed owner fraction, but the actual reg. section 1.671-3(a)(3) language requires only one calculation. Just like

[1] Jonathan G. Blattmachr, F. Ladson Boyle, and Howard M. Zaritsky, "Grantors Cannot Override the Grantor Trust Rules," *Tax Notes Federal*, Apr. 25, 2022, p. 619.

[2] Alan L. Montgomery and Ryan L. Montgomery, "The Joint and Survivor Grantor Trust and the S Election," *Tax Notes Federal*, Mar. 28, 2022, p. 1815.

[3] Although the letter to the editor cites to reg. section 1.671-2(e)(1), its description of the definition of "grantor" omits the phrase "to the extent" and the word "either." ("A grantor includes any person *to the extent* such person *either* [1] creates a trust, *or* [2] directly or indirectly makes a gratuitous transfer . . . of property to a trust. . . ." (emphasis and bracketed numbers added)).

[4] This statement is not valid for a "creator-grantor" (the first alternative "grantor" definition in reg. section 1.671-2(e)(1)). The definition of "creator-grantor" is disconnected (by "either" and "or") from the "makes a gratuitous transfer" language contained within the second alternative "transfer-only grantor" definition.

[5] Reg. section 1.671-2(e)(1) prevents a "straw person" trust creator (for example, one who transfers no property to the trust and is nominally named as the trust creator in furtherance of an abusive trust scheme) from being treated as a deemed owner (". . . a person who creates a trust but makes no gratuitous transfers to a trust is not treated as an owner of any portion of a trust. . . ."). However, that straw person is still a "creator-grantor" (*see* reg. section 1.671-2(e)(6), Example 3). Because W (the creator-grantor who transfers 50 percent of the trust property in our article) is not a straw person, she is the deemed owner of "any portion of a trust" to which her retained section 675 powers extend, without regard to whether that portion is attributable to her transfer of property to the trust. *See* reg. section 1.671-2(b) and -3(a)(3).

[6] Section 679(a)(1) provides: "A United States person who directly or indirectly transfers property to a foreign trust . . . shall be treated as the owner for his taxable year of the portion of such trust attributable to such property."

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section 675, the actual language characterizes deemed ownership solely in terms of the control retained by a grantor over the trust, with no mention of the portion of the trust attributable to property transferred to the trust by that grantor:

> If the portion of a trust treated as owned by a grantor . . . consists of an undivided fractional interest in the trust . . . a pro rata share of each item of income, deduction, and credit is normally allocated to the portion. . . . *The numerator of this fraction is the amount which is subject to the control of the grantor or other person and the denominator is normally the fair market value of the trust corpus* at the beginning of the taxable year in question. [Emphasis added.]

The following nonexistent "two-calculations" language, which is attributed to reg. section 1.671-3(a)(3) in the letter to the editor but not found there, is imaginary:

> The portion deemed owned by each grantor is based first on what part of the trust is attributable to the contributions by each grantor. Only then does the existence of a grantor trust power become relevant.[7]

That imaginary two-calculations language is bootstrapped into the last sentence of the letter, giving the misleading impression that its invalid conclusion is based on the actual language of reg. section 1.671-3(a)(3):

> The authors' position is contrary to the regulations defining the portion of a trust deemed owned by multiple grantors and, were it correct, section 678 would be immaterial.

The only valid part of the above conclusion in the letter to the editor is that section 678 is indeed immaterial to our creator-grantor W, who is the deemed owner of the entire trust under section 675.

We invite readers to compare our article with the letter by Blattmachr, Boyle, and Zaritsky, and decide for themselves which of them accurately applies the statutory and regulatory language to the facts of the particular case described in the article. Although the opinions in the letter come from well-known tax professionals, tax return preparers may not rely on its misstatements of law to avoid preparer penalties and liability for unnecessary S corporation complications and lost income and estate tax savings. Their letter contradicts section 675 and ignores the reg. section 1.671-2(e)(1) "creator-grantor" and "transfer-only grantor" distinction (see footnotes 3 through 5). That imaginary and nonsensical two-calculations language, which is misleadingly attributed to reg. section 1.671-3 to try to justify an invalid conclusion, is not in fact there. Reg. section 1.6662-4(d)(3)(iii) lists, in declining order of relative importance, the authority that may be considered "substantial authority for the tax treatment of an item." At the top of that list are:

> Applicable provisions of the Internal Revenue Code and other statutory provisions; proposed, temporary and final regulations construing such statutes.

Excluded from the list are opinions of tax professionals:

> Conclusions reached in treatises, legal periodicals, legal opinions, or opinions rendered by tax professionals are not authority. The authorities underlying such expressions of opinion where applicable to the facts of a particular case, however, may give rise to substantial authority for the tax treatment of an item.

Alan L. Montgomery

Ryan L. Montgomery

Kara Kalenius Novak

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Apr. 26, 2022

[7]This statement is nonsense. If creator-grantors H and W jointly and severally retain identical mirror-image section 675 powers over the entire trust, and H transfers $800 of property and W transfers $200 of property, its first sentence means that H is $800/$1,000 = 80 percent and W is $200/$1,000 = 20 percent. Under the reg. section 1.671-3(a)(3) definitions of "numerator" and "denominator," its second sentence still means the same thing as shown in our article: H is $500/$1,000 = 50 percent, W is $500/$1,000 = 50 percent, and after H's death W is $1,000/$1,000 = 100 percent. Their second sentence negates their first sentence.

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Invitation Accepted: Weighing In on the Grantor Trust Rules

To the Editor:

I accepted the invitation of Alan L. Montgomery and Ryan L. Montgomery (the "Authors") in their response letter published on May 2, 2022, also written by Kara Kalenius Novak and Kaitlyn Kelly Perez.[1] The invitation was to compare the Authors' March 28 article[2] to the April 25 letter[3] by Jonathan G. Blattmachr, F. Ladson Boyle, and Howard M. Zaritsky (the "Dissenters").

The Authors argue a peculiar view that one can be a grantor of an entire trust for purposes of the grantor trust rules found in sections 671 to 677 by creating a trust and retaining certain powers listed in section 675 over all the trust assets, even if the creator did not contribute all the assets to the trust. Indeed, the Authors argue that this is true if the creator (or co-creator) contributed as little as 5 percent of the trust assets (and presumably made any contribution). In contrast, the Dissenters say, "one can, however, be deemed to own the trust assets as a grantor only to the extent that she contributed assets to the trust." The Authors say the Dissenters' letter "cites no authority [which, to the Authors' knowledge, does not exist] to support this incorrect statement."

One does not have to look far to find authority in support of the Dissenters' statement. Sections 673 to 677 all begin, "General Rule. The grantor shall be treated as the owner of any portion of a trust." That language stating when the grantor trust rules apply to a grantor has been in the Internal Revenue Code at least since the code was recodified in 1954. It has long been established under the common law of trusts and for federal tax purposes that a "person who furnishes the consideration for the creation of a trust is the settlor, even though in form the trust is created by another."[4]

"The settlor is sometimes called the 'trustor,' or particularly in tax contexts the 'grantor.'"[5] That only a person who furnished the consideration could be taxed under the grantor trust rules is clear enough that reg. section 1.671-2, which has the "applicable principles" for the grantor trust rules, did not define "grantor" from the time it was adopted in 1956 until, prompted by an unrelated statutory change, it was amended in 1999 and 2000, as is discussed below. Further, a careful review of reg. section 1.671-2 shows that every use of the words "grantor" and "owner" therein is consistent with the Dissenters' statement.

In contrast to this widespread understanding of who the grantor trust rules apply to, the Authors ground their argument on reg. section 1.671-2(e)(1), which they assert provides "two methods by which a person may become a grantor." They quote that regulation as follows:

> A grantor includes any person to the extent such person either [1] creates a trust or [2] directly or indirectly makes a gratuitous transfer . . . of property to a trust. . . . However, a person who creates a trust but makes no gratuitous transfers to a trust is not treated as an owner of any portion of a trust under sections 671 through 677 or 679.

The portion of the regulation above, as quoted by the Authors, is not remarkable. Given that it is a basic concept of the common law of trusts that the creation of a trust requires a contribution of property, one might even ask how the clause identified by the Authors as [1] adds anything to the clause identified as [2].

A review of the history of that regulation provides the answer. Subsection (e) was added to

[1] Montgomery et al., "Authors' Response to Blattmachr, Boyle, and Zaritsky," *Tax Notes Federal*, May 2, 2022, p. 751.

[2] Montgomery and Montgomery, "The Joint and Survivor Grantor Trust and the S Election," *Tax Notes Federal*, Mar. 28, 2022, p. 1815.

[3] Blattmachr, Boyle, and Zaritsky, "Grantors Cannot Override the Grantor Trust Rules," *Tax Notes Federal*, Apr. 25, 2022, p. 619.

[4] *Lehman v. Commissioner*, 109 F.2d 99, 100 (2d Cir. 1940).

[5] *Restatement of the Law of Trusts* 3d (2001), section 3, cmt. a.

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reg. section 1.671-2 in 1999 as a temporary regulation that was finalized without change in 2000.[6] This addition was done primarily in response to the foreign trust rules in sections 672(f) and 643(h) that were amended in 1996.[7] Those 1996 changes also included an amendment to section 6048(a)(1) that required "the responsible party" to provide written notice of certain "reportable events" to the secretary. Congress included within the definition of a "responsible party" both (1) the grantor in the case of the creation of an *inter vivos* trust and (2) the transferor in the case of a reportable event.[8] Thus, Congress was imprecise in equating the creator of an *inter vivos* trust, even one who made no contribution to the trust, with being a "grantor"; however, the damage was limited to a reporting requirement in section 6048 and did not infect the grantor trust rules found in sections 671 to 679.

Unfortunately, Treasury picked up Congress's imprecise language in section 6048 and carried it into the regulations under section 672. In Part 2 of its Explanation of Provisions and Revisions in T.D. 8831, Treasury noted that it had previously, in 1997, issued proposed regulations under that section that defined a grantor "to include any person to the extent such person either (i) creates a trust or (ii) directly or indirectly makes a gratuitous transfer to a trust. Commenters questioned why a nominal creator who has made no transfer to a trust should be treated as a grantor and asked for an explanation of the tax significance of such treatment." Treasury answered the commenters:

> Treating a nominal creator as a grantor ensures that someone will be responsible for reporting the creation of a foreign trust by a U.S. person even if the trust is not immediately funded. See section 6048(a)(3)(A)(i) and (a)(4)(A). At the same time, Treasury and the IRS believe that an accommodation grantor, such as an attorney who creates a trust on behalf of a client, (although a grantor) should not be treated as an owner of the trust. Accordingly, the temporary regulations provide that a person who either creates a trust, or funds a trust with an amount that is directly repaid to such person within a reasonable period of time, but who makes no other transfers to the trust that constitute gratuitous transfers, will not be treated as an owner of any portion of the trust under sections 671 through 677 or 679.

Language omitted by the Authors from their quotation of reg. section 1.671-2(e)(1) included "if a person creates or funds a trust on behalf of another person, both persons are treated as grantors of the trust (See section 6048 for reporting requirements that apply to grantors of foreign trusts.)."

The Authors take this imprecise use of the term "grantor" and erect a wobbly structure on it, including making up their own unique terms to distinguish between two different kinds of grantors, whom they named "creator grantor" and "transfer-only grantor." Neither of those terms occurs in the grantor trust tax law, nor do they have any corollary to any similar terms. The Authors then take these terms and read distinctions into the regulations that are not there.[9] Similarly, the Authors take what T.D. 8831 called an "accommodation grantor" and the simple concept that such a "grantor" who did not make her own contribution to the trust should not be treated as an owner of the trust for grantor trust purposes and remake it into their "straw person" rule.[10] They give as an example of their rule "one who transfers no property to the trust and is nominally named as the trust creator in furtherance of an abusive trust scheme." There is no basis for the Authors' assertion that one who

[6] *See* T.D. 8831 and T.D. 8890.

[7] T.D. 8831 Summary.

[8] Section 6048(a)(4).

[9] *See, e.g.*, their discussion of examples 1 and 3 of reg. section 1.674-2(e)(6).

[10] In footnote 5 of their response, the Authors say, "Reg. section 1.671-2(e)(1) prevents a 'straw person' trust creator (for example, one who transfers no property to the trust and is nominally named as the trust creator in furtherance of an abusive trust scheme) from being treated as a deemed owner ('. . . a person who creates a trust but makes no gratuitous transfers to a trust is not treated as an owner of any portion of a trust. . . .'). However, that straw person is still a 'creator grantor' (see reg. section 1.671-2(e)(6), Example 3)." Of course, Example 3 does not say anything about a "creator grantor." It does say that an accommodation grantor is not an owner for grantor trust purposes but is a responsible party for purposes of section 6048.

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nominally creates a trust funded by another is doing so "in furtherance of an abusive trust scheme."

The Authors also make much of the fact that the "numerator of the concurrent deemed owner fraction defined in reg. section 1.671-3(a)(3) above is 'the amount which is subject to the control of the grantor' rather than 'the amount attributable to the transfer of the grantor.'" They draw this distinction based on their strained reading of reg. section 1.671-2(b); however, the latter regulation was first adopted in 1999 and the former regulation was adopted in 1956, so it is not persuasive that grantor trust treatment as provided in language adopted in a 1956 regulation relies on a definition of grantor introduced in 1999.

Further, the Authors' reliance on a 1982 Tax Court memorandum decision and a private letter ruling from 1993 cannot be viewed as an interpretation of a definition of grantor introduced into the regulations in 1999. Finally, comparing the language of section 675, which was in the Internal Revenue Code when it was enacted in 1954, to section 679, which was added in 1976, and concluding that Congress, per the Authors' cited *expressio unius* canon, meant for the word "grantor" not to have its common meaning in section 675 is doubtful.[11] The Authors' wobbly structure topples under scrutiny.

The Authors in their response call the Dissenters' "two-calculations" language "imaginary." But the clear language of sections 673 to 677 shows that there are two elements to the application of the grantor trust rules. As noted above, these sections all begin with "the grantor shall be treated as the owner of any portion of a trust." Under the common law meaning of grantor, these sections only apply to the extent that the taxpayer contributed to the trust, which is the first element. Then the specific provisions of sections 673 to 677 specify the second element, which provides when the grantor is treated as the owner of the contributed portion of the trust for federal income tax purposes.

Before the imprecise use of the term "grantor" was introduced into the regulations in 1999, there was no question but that the amount subject to grantor trust treatment was the portion of the amount attributable to the transfer of the grantor over which the grantor had control. Thus, the Authors create a false dichotomy when they say that the "numerator of the concurrent deemed owner fraction defined in reg. section 1.671-3(a)(3) above is 'the amount which is subject to the control of the grantor' rather than 'the amount attributable to the transfer of the grantor.'" However, the proper determination of the numerator requires an evaluation of both portions.

Finally, the Authors, in their invitation to the reader to decide for themselves, suggest that their analysis of the statutory and regulatory language can be limited to the facts of the particular case described in the article. But there is no limiting principle to their analysis. If they are right, when the surviving spouse is deemed to be the 100 percent owner of the joint and survivor grantor trust, she is responsible for 100 percent of the income tax arising from that trust's assets. Perhaps the surviving spouse is OK with that tax liability. But what of A, who created the trust in Example 7 of reg. section 1.671-2(e)(6), if A holds a distribution power over the trust for his brother B's benefit? A might have been willing to bear the burden of being liable for the income tax on $100,000, but is A willing, and able, to bear the burden of being liable for the income tax on the entire $1 million, when 90 percent of it was contributed by Uncle C?

Likewise, if the Authors were correct, the problem of funding a large beneficiary defective inheritor's trust (a BDIT) is not a problem at all. The technique initially has the beneficiary fund the BDIT with $5,000, which becomes a grantor trust under section 678 when the beneficiary lets a withdrawal power lapse. The BDIT is structured to be outside of the beneficiary's taxable estate, and the lapse of a $5,000 withdrawal right does not cause estate inclusion. The problem has always been how to get substantial additional assets into the BDIT without ruining the exclusive

[11] In their footnote 35, the Authors argue that if their reading of the law is not correct, "there would be no purpose to the distinction made in reg. section 1.671-2(e)(1) between a creator grantor and a transfer-only grantor." But as set forth above previously, the distinction between (1) what the common law has called a grantor and (2) what the regulations also call a grantor, but who has only created a trust without making a contribution to it, is because Treasury wanted to call attention to section 6048's reporting requirements that are imposed on both the latter and the former.

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grantor trust status as to the beneficiary and without using excessive amounts of leverage. But if the Authors are correct in their reading of the law, if the beneficiary holds a swap power under section 675, other family members can put an unlimited amount into the BDIT while the beneficiary continues to be the grantor of 100 percent of the BDIT. But as explained above, such is not the law.

Philip M. Lindquist
Lindquist Eisenberg LLP
July 18, 2022 ■

Pillar 2: Down but Not Out

To the Editor:

I write regarding the excellent article by Heydon Wardell-Burrus.[1] What must be puzzling to many readers is that this article (and many other articles in *Tax Notes* and elsewhere) assumes that pillar 2 will in fact be implemented, while recent news reports cast doubt on whether that is the case. The collapse of negotiations over a limited Build Back Better Act (H.R. 5376) in the United States indicates that no pillar 2 legislation is likely to be enacted this year, and if the Republicans take over either the House or the Senate in November, it will not be possible to enact any legislation embodying pillar 2 until 2025 at the earliest. Also, the opposition of Hungary has for now stopped the EU from adopting a directive embodying pillar 2.

As frequently noted, pillar 2 can be implemented without the United States, although that will have negative consequences for U.S. multinationals (especially if there is no foreign tax credit for "extraterritorial" foreign taxes under the new regulations).[2] But it is hard to see how pillar 2 can be implemented without the EU, because if it is implemented by neither the United States nor the EU, then most of the world's multinationals will not be covered by the income inclusion rule, which would mean that source countries will have no incentive to enact either the undertaxed payments rule or the qualified minimum domestic top-up tax (QMDTT). That outcome would mean that there will be no global minimum tax and no limit to tax competition (the two goals of pillar 2).

However, pillar 2 is not "dead on arrival" even if the Hungarian opposition cannot be overcome, because the EU is not needed. It is enough if the members of the EU that are part of the G-20 (France, Germany, and Italy) adopt pillar 2, which can be implemented by each country unilaterally. That outcome seems very likely because the larger EU economies were the drivers of pillar 2 in the first place. In that case, it is also plausible that

[1] Wardell-Burrus, "Can Pillar 2 Be Leveraged to Save Pillar 1?" *Tax Notes Int'l*, July 18, 2022, p. 317.

[2] *See*, *e.g.*, Reuven S. Avi-Yonah and Mohanad Salaimi, "Minimum Taxation in the United States in the Context of GloBE," *Intertax* (July 2022).

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Authors Respond to Philip M. Lindquist's 'Two Calculations' Theories

To the Editor:

In his July 25 letter to the editor,[1] Philip M. Lindquist agrees with the Jonathan Blattmachr, Ladson Boyle, and Howard Zaritsky April 25 letter to the editor[2] about our March 28 article "The Joint and Survivor Grantor Trust and the S Election."[3] We responded to the Blattmachr, Boyle, and Zaritsky letter on May 2.[4]

Referring to W (the creator-grantor[5] in our article who transferred only 50 percent of the trust property but retained section 675 powers over 100 percent of the trust), Lindquist's letter states (as did the Blattmachr, Boyle, and Zaritsky letter) that two calculations are required to determine W's deemed owner percentage, even though only a single calculation for each grantor is required by reg. section 1.671-3(a)(3) for trusts that have multiple grantors.[6] Since there is no language in sections 673 through 677, or in any of the regulations construing them, that requires the two calculations, Lindquist instead contends it is based on a "widespread understanding of who the grantor trust rules apply to" found in the common law, about which there exists "no question":

> Under the common law meaning of grantor, these sections [referring to sections 673 to 677] only apply to the extent that the taxpayer contributed to the trust,[7] which is the first element.[8] Then the specific provisions to section 673 to 677 specify the second element, which provides when the grantor is treated as the owner of the contributed portion of the trust[9] for federal income tax purposes. Before the imprecise use of the term "grantor" was introduced into the regulations in 1999, there was no question but that the amount subject to grantor trust treatment was the portion of the amount attributable to the transfer of the grantor over which the grantor had control.

Not only does Lindquist cite no common law that supports his "widespread understanding" theory,[10] but the Tax Court disagrees in *Gould*[11] that there exists any such widely understood and uniformly applied common law grantor definition for purposes of sections 671 through 677:

> Before the regulations were promulgated, there existed no definition of "grantor" for

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[1] Philip M. Lindquist, "Invitation Accepted: Weighing In on the Grantor Trust Rules," *Tax Notes Federal*, July 25, 2022, p. 567.

[2] Jonathan G. Blattmachr, F. Ladson Boyle, and Howard M. Zaritsky, "Grantors Cannot Override the Grantor Trust Rules," *Tax Notes Federal*, Apr. 25, 2022, p. 619.

[3] Alan L. Montgomery and Ryan L. Montgomery, "The Joint and Survivor Grantor Trust and the S Election," *Tax Notes Federal*, Mar. 28, 2022, p. 1815.

[4] Montgomery and Montgomery, "Authors' Response to Blattmachr, Boyle, and Zaritsky," *Tax Notes Federal*, May 2, 2022, p. 751.

[5] Reg. section 1.671-2(e)(1) provides, "A grantor includes any person *to the extent* such person *either* [1] creates a trust, *or* [2] directly or indirectly makes a gratuitous transfer . . . of property to a trust." (Emphasis and bracketed numbers added.) Put differently, the regulation's plain language definition of grantor creates two types of potential grantors: (1) any person to the extent such person creates a trust, or (2) any person to the extent such person makes a gratuitous transfer, which is confirmed by the preamble to T.D. 8831, cited and discussed by Lindquist, and separates the two types of grantors with a "(i)" and a "(ii)."

[6] Reg. section 1.671-2(e)(1) and -3(a)(3) contains no requirement to first determine the portion of the trust attributable to property transferred by a creator-grantor before determining the portion subject to the control of that grantor.

[7] Lindquist cites no common law cases that say that. Regardless, this statement is not valid for a "creator-grantor" (the first alternative grantor definition in reg. section 1.671-2(e)(1)). The definition of creator-grantor is disconnected (by "either" and ", or") from the "makes a gratuitous transfer" language in the second alternative, "transfer-only grantor" definition.

[8] There is no "first element" for a creator-grantor. Reg. section 1.671-2(e)(1) only prevents a "straw person" trust creator (for example, one who transfers no property to the trust and is nominally named as the trust creator in furtherance of an abusive trust scheme) from being treated as a deemed owner. *Cf. CIM Trust v. Commissioner*, T.C. Memo. 2001-172 ("Kimmey was a straw man who acted only in form as the grantor of the trust."). Though not a deemed owner, a straw person trust creator is still a grantor under reg. section 1.671-2(e)(1) and (6), Example 3.

[9] Only the "second element" applies to W, the creator-grantor who transferred 50 percent of the trust property in our article. Since she is not a "straw person" who transferred no property to the trust as described in the previous footnote, she is the deemed owner of "any portion of a trust" to which her retained section 675 powers extend, without regard to whether that portion is attributable to her transfer of property to the trust. *See* section 675(2), section 675(4)(C), reg. section 1.671-2(e)(1), -2(b), and -3(a)(3).

[10] Lindquist, *supra* note 1, at n.1, does not support his "widespread understanding" theory because the *Lehman* case (*Lehman v. Commissioner*, 109 F.2d 99 (2d Cir. 1940)) is a reciprocal trusts estate tax inclusion case, rather than a grantor trust income tax case. Neither does the citation to the *Restatement of the Law of Trusts* 3d (2001), section 3, cmt. a, support his "widespread understanding" theory, since it does not discuss any grantor trust income tax cases. Neither does the nominal creator discussion in T.D. 8831, since H and W, as described in our article, are not nominal (*i.e.*, "in name only") settlors who transferred no property to the trust.

[11] *Gould v. Commissioner*, 139 T.C. 418 (2012).

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> purposes of sections 671-677. This Court had defined a settlor of a trust (*i.e.*, grantor) generally as one who furnishes the major portion of consideration for the trust's creation. *See, e.g., Bixby v. Commissioner*, 58 T.C. 757, 791 (1972); *Smith v. Commissioner*, 56 T.C. 263, 290 (1971).

If so, the reg. section 1.671-2(e)(1) grantor definitions are the only such definitions of general application for purposes of sections 671 through 677.[12] We found no decisions citing reg. section 1.671-2(e)(1) that contain any language suggesting that its grantor definitions are not binding as written for purposes of sections 671 through 677 or that any two-calculations requirement for creator-grantors like W is implicated by reg. section 1.671-2(e)(1), reg. section 1.671-3(a)(3), or any other regulation construing section 675.[13]

Lindquist alternatively claims that Congress must have been mistaken when it incorporated the section 675 phrase "the grantor" into section 6048(a)(4)(A),[14] in which case the reg. section 1.671-2(e)(1) grantor definitions are essentially invalid.[15]

Under the tax reporting circumstances described in our article, the tax return preparer may not disregard the express terms of section 675 and the regulations construing it, unless a reasonable legal basis for doing so is disclosed on the return.[16] Lindquist's common law "widespread understanding" theory as to why return preparers may ignore the reg. section 1.671-2(e)(1) creator-grantor and transfer-only grantor distinction is of little value for penalty exception purposes if there are no citations to any relevant legal authority for the preparer to disclose on the return. Relying on his alternate theory that reg. section 1.671-2(e)(1) is invalid because Congress was wrong to incorporate the phrase "the grantor" into section 6048(a)(4)(A) is presumptuous and unlikely to be a good-faith challenge to a regulation that conforms to the language Congress chose to use.

Disregarding unambiguous statutory and regulatory language in reliance on the personal opinions found in the Blattmachr, Boyle, and Zaritsky and Lindquist letters, for which there is no authority in section 675, or in the related regulations or in judicial decisions that construe them, will significantly increase the return preparer's risks of incurring penalties and liability for unnecessary S corporation complications and lost income and estate tax savings. On the other hand, there are no such risks if the return preparer first refers to the reg. section 1.6662-4(d)(3)(iii) list of what does[17] and does not[18] constitute "authority," and then applies the language that is actually in sections 675(2) and 4(C), reg. section 1.671-2(b), reg. section 1.671-2(e)(1), reg. section 1.671-3(a)(1), and reg. section 1.671-3(a)(3) to the facts of the particular case.

The Blattmachr, Boyle, and Zaritsky and Lindquist "two calculations" theory appears to be a mistaken assumption unsupported by any

[12] Indeed, immediately before defining the term "grantor," reg. section 1.671-2(e) indicates that its grantor definition applies for all grantor trust purposes ("for purposes of part I of subchapter J, chapter 1 of the Internal Revenue Code, a grantor includes any person to the extent. . .").

[13] *See Close v. Commissioner*, T.C. Memo. 2014-25, 31-32 ("For purposes of the grantor trust provisions, *see* secs. 671-679, a grantor includes any person to the extent that person either creates a trust or gratuitously transfers property, directly or indirectly, to a trust, *see* sec. 1.671-2(e)(1), Income Tax Regs. . . . The grantor of the trust is taxed on the income of the trust under the grantor trust provisions if any of the following conditions are met: . . . certain administrative powers are exercisable by the grantor or a nonadverse party, [fn. ref. omitted] *see* sec. 675.").

[14] Lindquist states: "Thus, Congress was imprecise [in section 6048] in equating the creator of an *inter vivos* trust, even one who made no contribution to the trust, with being a 'grantor.'"

[15] Lindquist states: "Unfortunately, Treasury picked up Congress's imprecise language in section 6048 and carried it into the regulations under section 672."

[16] Under reg. section 1.6662-3(c)(1), disclosure on the return may avoid the penalty if "in case of a position contrary to a regulation, the position represents a good faith challenge to the validity of the regulation. This disclosure exception does not apply, however, in the case of a position that does not have a reasonable basis."

[17] "Applicable provisions of the Internal Revenue Code and other statutory provisions; proposed, temporary and final regulations construing such statutes" are the authority of greatest weight in determining whether a reporting position is supported by substantial authority. *See* reg. section 1.6662-4(d)(3)(iii).

[18] "Conclusions reached in treatises, legal periodicals, legal opinions, or opinions rendered by tax professionals are not authority. The authorities underlying such expressions of opinion where applicable to the facts of a particular case, however, may give rise to substantial authority for the tax treatment of an item." Reg. section 1.6662-4(d)(3)(iii).

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identifiable authority. They articulate no compelling reasons[19] to expect the courts to agree with them on the facts assumed[20] for our article.[21] The best practice is for tax professionals to adhere to the express language of section 675 and the regulations that construe it, rather than to the unsupported opinions of other tax professionals who choose not to believe that language.

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July 26, 2022

[19]Lindquist's BDIT discussion is not relevant to the conclusions of our article, since the beneficiary in his example is a transfer-only grantor. His statement that "there is no limiting principle to their analysis" overlooks that any contrived or insubstantial transfer of property, made for the primary purpose of tax avoidance, generally "can be ignored . . . on the familiar tax principle that substance predominates over form." *Schulz v. Commissioner*, 686 F.2d 490, 496 (fn. ref. omitted); *CIM Trust v. Commissioner*, *supra* note 8 ("the primary purpose of the Morrows in establishing the trust was to avoid employment tax").

[20]The substance-over-form doctrine does not apply to the facts assumed in our article. W's 50 percent transfer is not contrived or insubstantial, and although there may be incidental tax benefits in some (but certainly not all) instances, the primary non-tax-avoidance purpose of the joint and survivor grantor trust is the continuation of S corporation shareholder eligibility under section 1361(c)(2)(A)(i) until after the death of the surviving grantor.

[21]*See* the "Canons of Construction" discussion in our article, *supra* note 3.

The Harvard Clinic Did Not Create *Boechler*

To the Editor:

This letter is in response to Jasper L. Cummings, Jr.'s, special report, "The Supreme Court's 2021 Term in Tax,"[1] in which he takes to task the Supreme Court's opinion in *Boechler*.[2] We disagree with many of his conclusions and descriptions of the legal arguments, but we feel no need to respond to those, as we have filed several amicus briefs in *Boechler* (at the Eighth Circuit and the Supreme Court) that dispel the inaccuracies on those legal points. However, we feel compelled to respond to inaccurate statements he made concerning how the *Boechler* case came about. In substance, without using the word, Mr. Cummings has accused us of barratry. But, clinics and the Center for Taxpayer Rights (of which Nina Olson is executive director) did not officiously conspire to create *Boechler* to generate a Supreme Court test case.

Mr. Cummings stated:

> The taxpayer in *Boechler* is a one-woman professional corporation law firm with an active practice in asbestos litigation. The case history indicates that it intentionally refused to file Forms W-2 (or to refile or prove prior filing) after the IRS offered multiple chances to file late; the penalty at issue was for that intentional refusal to file.

Boechler's lawyer in the Tax Court (No. 18578-17L) was and is only David Clark Thompson, another North Dakota solo practitioner who is not a tax lawyer. In his Tax Court response to the IRS's motion to dismiss the case, he noted that there is no dispute that Boechler withheld and remitted to the IRS taxes paid on all corporate compensation and sent copies of the Forms W-2 to the IRS. The only dispute is about whether the corporation also sent copies of the Forms W-2 to the Social Security Administration. We understand from Mr. Thompson that he has been showing proof of

[1]Cummings, "The Supreme Court's 2021 Term in Tax," *Tax Notes Federal*, July 4, 2022, p. 33.

[2]*Boechler PC v. Commissioner*, 142 S. Ct. 1493 (2022).

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