

PLR 200537044: Defective or Just Misunderstood?

By Philip J. Kavesh

Several commentators have publicly stated or published various criticisms of the “Toggle” Trust (or as I call it, the “IRA Inheritance TrustSM”) that was the subject of favorable IRS Private Letter Ruling 200537044.

Permit me to begin by acknowledging that some of these criticisms of the Trust and PLR are well-taken, based upon the express language of the PLR and its limited disclosure of the facts underlying the ruling. Unfortunately, the final wording of the PLR (which I attempted to have fixed) turned out to be confusing, particularly its references to a “disclaimer”. Furthermore, there are several key facts not mentioned in the ruling regarding the language of the Trust and how the Trust Protector powers were exercised.

One criticism is that there must be a time limit on the right of the Trust Protector to “toggle switch” a conduit trust into an accumulation trust and to limit appointees (under powers of appointment) and remainder beneficiaries. Otherwise, the character of a trust could be switched back and forth after the Beneficiary Finalization Date (“BFD”). In the Trust document here, there was such a limit requiring the exercise on or before the BFD. Furthermore, the Trust Protector powers could, according to the Trust’s terms, be renounced *ab initio* to the date of death of the Trustor and, if the powers were exercised, such exercise was irrevocable and the power could not be used again. In this taxpayer case, the Trust Protector did, within 9 months of the Trustor’s death, not only exercise certain powers but also renounced *ab initio* any unexercised powers; plus, with respect to any exercised powers, renounced their further use (according to the Trust terms, these renunciations were binding upon all future Trust Protectors as well).

Another criticism that is correct, if given only the language of the PLR, is that, whether or not the “toggle switch” was pulled, the mere existence of the Trust Protector powers would negatively affect both conduit and accumulation trust status and therefore “the Trust was fatally defective”. As explained above, the elimination of these powers *ab initio*, or subsequent to exercise, cured this “defect”.

In order for the above described renunciations to be effective *ab initio*, the IRS felt that, despite the Trust language validating them, they had to be “treated as disclaimers” under state law. The IRS requested that we submit authority under applicable state law (of California), which we did, showing that a “renunciation” is treated the same way as a “disclaimer” so long as it meets certain requirements, mainly that it is in writing, irrevocable and made within 9 months of death.

Commentators have been confused about this “disclaimer” issue because the PLR seems to indicate that the *exercise* of the Trust Protector powers was also “treated as a disclaimer”. This was never asserted by the taxpayer nor discussed with the IRS prior to the final ruling. However, if we assume that the exercise does have to be treated as (or “like”) a disclaimer, there is ample IRS authority to do so. A Trustee/fiduciary has previously been permitted to limit the trust beneficiaries’ rights by a disclaimer - - which is clearly analogous to the case here. Furthermore, even if the Trust Protector exercise is not technically considered a disclaimer, it was permitted and effective *ab initio* according to the terms of the Trust itself, certainly a more conservative set of facts than in recent IRS rulings that have accepted court ordered reformations made far after death as effective retroactively to the date of death. Finally, all this can be rendered moot if the exercise occurs within 9 months of death and otherwise meets the requirements of IRC Section 2518 (as was the case here). In other words, this “disclaimer” question raised on the face of the PLR is for all intents and purposes a non-issue.

Hopefully, the above information and explanation has clearly addressed the negative comments you may read or hear from third parties less familiar with the Trust and the PLR, and will assist you in responding to any Trust “detractors”.