



THE POWER OF SUBSTITUTION UNDER IRC SEC. 675(4)(C): FROM SOUP TO NUTS

The Swap Power in Usage in Grantor Trusts



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L. PAUL HOOD, JR., JD, LL.M., CFRE, FCEP PAUL@PAULHOODSERVICES.COM

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**The Power of Substitution Under IRC Sec. 675(4)(C): From Soup to Nuts:
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L. Paul Hood, Jr.¹

Appearances are deceitful, I know, but so long as they are, there's nothing like having them
deceive for us instead of against us.²

Introduction.

Much has been written about which of the so-called “defective” powers or rights are best for creation of an Intentionally Defective Grantor Trust (IDGT).³ This monograph is *not* about that subject; it is about the practical ramifications of *exercise* of the power of substitution under IRC Sec. 675(4)(C) (henceforward, Swap Power) and how to navigate the oft treacherous shoals and rapids of drafting for the Swap Power.

In my opinion, the vast majority of Swap Powers are *grossly inadequate* where the Swap Power is exercised because few scribes have thought about what happens if the Swap Power is *exercised*. As a result, the overwhelming majority of Swap Power clauses simply mirror IRC Sec. 675(4)(C), as amplified by Rev. Rul. 2008-22. The lesson from the five cases discussed in an upcoming section of the monograph is that failure to draft in anticipation of exercise is now a reasonably foreseeable risk of harm, for which scribes must address or face exposure for a malpractice claim.

Since 2015, we have had five public decisions of which I am aware involving the attempted exercise of the Swap Power where the trustee of the grantor trust resisted, causing the matter to wind up in a courtroom and ultimately in the various reporters, whether instigated by the trustee or by the grantor.⁴ The number of reported decisions concerning the Swap Power in this brief period of time signals problems that many practitioners don't point out to clients often enough, especially given that the Swap Power is one of the few IDGT powers that one can *expect* to exercise, particularly for basis harvesting purposes.

This monograph will review the five reported decisions and explore the practical meaning of exercise of the Swap Power and the aftermath. After a brief review of some common situations where exercise of

the Swap Power may be advisable or beneficial, I will review the statutory language of IRC Sec. 675(4)(C), briefly explore the recent public rulings involving the Swap Power, consider a panoply of perplexing problems around the exercise of a Swap Power, and give drafting suggestions. The Appendix contains an annotated Swap Power.⁵

Common Situations of Exercise of the Swap Power.

The Swap Power is one of the few grantor trust powers that can be exercised, even though it's effective upon mere **possession** of the Swap Power, even if the chances of its exercise are remote.⁶ Its exercise can be most beneficial in some situations. What follows are some of the common scenarios where exercise of the Swap Power can be helpful or beneficial:

- Where the values of the assets in an IDGT have **substantially appreciated**, the appreciation can be preserved through the exercise of a Swap Power, exchanging the IDGT assets for high basis assets, cash or a note.⁷
- Where the values of the assets in the grantor's hands have *declined* in value, exercise of the Swap Power can assist by transferring the assets to a new IDGT, thereby preserving basis against the fair market value reset for another taxable day.
- Where the grantor purchases or exchanges low basis IDGT assets shortly before death in exchange for higher basis assets, such as cash without imposition of an income tax.
- To substitute a life insurance policy for a more favorable policy.⁸
- To address changes in client goals or relations between the grantor and the IDGT trustee.⁹

History and Statutory Construction.

We begin, as we must, with the statutory law. IRC Sec. 675(4) provides in pertinent part "*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... (C) a power to reacquire the trust corpus by substituting other property of an equivalent value.”

The genesis of IRC Sec. 675(4)(C) is Sec. 39.22(a)-21(e)(1)(iv) of the so-called Clifford Regulations, which originally read that the Swap Power (or any other power of administration) could be held by the grantor or “any person *not having a substantial adverse interest in its exercise.*” Even though the italicized language was excised when Congress codified the Clifford Regulations in 1954, it is still prudent to avoid vouchsafing the Swap Power in the hands of anyone who has a substantial adverse interest in its exercise because of potential gift tax ramifications to such a person. Of course, exercise of the Swap Power would be a fully taxable event to the exerciser of the Swap Power because the trust wouldn’t be a grantor trust as to said exerciser.

The Swap Power must be exercisable in a ***non-fiduciary*** capacity.¹⁰ Literally, it says that the Swap Power can be held by *any* person, not just the grantor. Could you condition exercise of the Swap Power by requiring the approval of someone acting in a purely ***non-fiduciary*** capacity? IRC Sec. 675(4) doesn’t prohibit such, and I see no reason why one should not subject exercise of a Swap Power to a veto power held by a third party acting purely in a ***non-fiduciary*** capacity in appropriate situations?¹¹ The IRS has approved some jointly held Swap Powers,¹² even though I don’t recommend doing so for reasons that are discussed *infra*.

History of Grantor Trust Rules

In the beginning...

The federal income tax became effective in 1913. The federal estate tax was enacted in 1916, but the federal gift tax wasn’t enacted for good until 1932 (originally enacted in 1924 but repealed in 1926). The fact that the rules were drafted at different times is why the string provisions of the federal estate tax and the income tax grantor trust provisions were crafted without coordination. They were addressing different

situations, many on the fly as crafty taxpayers tried novel approaches to split income with persons in lower marginal tax brackets.

First grantor trust rules arrive on the scene.

When the income tax rates increased exponentially to finance World War I, taxpayers resorted to using trusts to split income because trusts had the run up the same income tax brackets as individuals. Initially, taxpayers used revocable trusts, but they finally lost a case on revocable trusts, so they switched to short term reversionary trusts, which the IRS continued to fight with mixed success. The first income tax grantor trust rules appeared in the Revenue Act of 1924.¹³ The Swap Power was not included in the original grantor trust rules. It is paramount to remember that the grantor trust powers were supposed to be bad, and the “punishment” was that the grantor was taxed on the trust’s income.

Thanks for nothing, Supreme Court!

Things continued to fester in this area in IRS audits and the courts . In 1940, the United States Supreme Court decided *Helvering v. Clifford*,¹⁴ a case involving the use of a short term reversionary trust that complied perfectly with the then existing grantor trust rules. Instead of providing some much needed guidance in a murky area by merely relying upon the statute, the Supreme Court sadly yet predictably chose the path of intellectual sloth and resorted to the favorite test of a lazy court: facts and circumstances. This only increased the amount of darkness and litigation in this area as neither taxpayers nor the IRS were really sure of the rules, so many taxpayers simply played the audit lottery. To its credit, in the aftermath of the really less than satisfying *Clifford* decision, the Treasury Department began work on some regulations intending to give bright line guidance in this area.

Clifford Regulations restore order somewhat, but Congress finally acts.

In 1945, Treasury promulgated regulations expanding on Sec. 22 of the Internal Revenue Code of 1939 as interpreted by the U.S. Supreme Court in *Clifford*, which became known as the Clifford Regulations. The Clifford Regulations were amended in 1947, but these amendments did not pertain to the Swap Power

provision. The Clifford Regulations had three primary focuses: (1) short-term reversionary trusts, (2) where the grantor had the power to determine or control beneficial enjoyment of income or corpus, and (3) administrative controls. The Swap Power provision pertains to the third category.

Even though the subject trust in *Clifford* had a five year term, the Clifford Regulations set two bright line tests: (a) a trust that reverted within ten years, irrespective of additional rights or powers, and (b) a trust that reverted within 15 years, where the grantor also held other rights, powers or administrative controls, e.g., a right of substitution similar, but **not** identical, to the Swap Power provision. In the 15 year reversionary trust, the grantor's right of substitution caused grantor trust status where the grantor possessed a power of substitution, *irrespective* of whether equivalent value is returned to the trust.¹⁵ Query whether the right to take trust property by substituting property of lesser value made the gift incomplete?

For trusts that lasted longer than 15 years, the Clifford Regulations included the following language that made a trust a grantor trust thereunder: "...and a power to reacquire the trust corpus by substituting other property of an *equivalent value*." [Emphasis added]¹⁶ This is the genesis of the Swap Power.

Unfortunately, the courts kept muddying up the waters, so Congress stepped in and enacted subpart E of subchapter J of the Internal Revenue Code of 1954 when it replaced the 1939 code in 1954. Congress retained much of the Clifford Regulations. However, it made a significant change to the language in what would become the Swap Power in IRC Sec. 675(4)(C).

Congress kept the Swap Power as a tainted grantor trust power, requiring that the substitution be of "an equivalent value." This is the only place in the Internal Revenue Codes of 1954 and 1986 where this term appears. Query the potential for shenanigans where the swap must be of ***equivalent value*** such that it was deemed to be a tainted grantor trust power. This may have been a solution in search of a problem, which ironically has become a primary go-to "defective" power. Or, given the number of reported rulings

and decisions in this area, did Congress show that it understood human dynamics of greed back in 1954 very well?

Treas. Reg. Sec. 1.671-1(a)(3) provides “If certain administrative powers over the trust exist under which the grantor **can or does** benefit (section 675).” [Emphasis added] Note that the IRS is still suspicious of administrative powers that it feels that taxpayers can benefit themselves. Query how a grantor benefits if the grantor is forced to substitute property of equivalent value, and the trustee of the grantor trust serves as a protection mechanism. This is what the Tax Court observed in *Jordahl Est. v. Comr.* Yet this language is a vestige of the Clifford Regulations because the power of substitution thereunder permitted even bad deals to be foisted upon the trustee.

What does “reacquire” mean?

This word was a vestige of the Clifford Regulations. Query: Does it effectively restrict use of the Swap Power to any person who **contributed** to the trust? Not according to the IRS.¹⁷ In my opinion, this is a correct reading of the Swap Power provision (or indeed any such power of administration) because even under the Clifford Regulations provision, the Swap Power can expressly be held by any person **not** holding a substantial adverse interest. Thus, IRC Sec. 675(4)(C) is **broader** than its counterpart in the Clifford Regulations.

What does the term “equivalent value” mean?

IRC Sec. 675(4)(C) contains the sole use of the term “equivalent value” in the Internal Revenue Code of 1986. Again, the genesis of this term is the Clifford Regulations. While I assume that this means equivalent fair market value,¹⁸ the IRS has never confirmed that, so I recommend using the equivalent value as per IRC Sec. 675(4)(C), but providing that equivalent value can **never** be less than fair market value as finally determined for federal estate and gift tax purposes in order to avoid a gift on the swap if there is a difference between equivalent value and fair market value, as indeed there could be if fair value is the proper standard of value for exercises of the Swap Power.¹⁹

State Court Recent Jurisprudence.

In this section of the monograph, I will discuss five recent cases of attempted and contested exercises of a Swap Power.

*In re Matter of Condiotti.*²⁰

The grantor established an irrevocable grantor trust for his minor son in 2000. He appointed his wife as trustee of the trust. MidFirst Bank was later appointed as a co-trustee. The Swap Power clause read as follows:

Notwithstanding any other provision of this instrument . . . to the contrary, [the] settlor, acting in a nonfiduciary capacity and without the approval or consent of any person acting in a fiduciary capacity, reserves the power to reacquire the trust corpus by substituting other property of an equivalent value.

In October 2011, the grantor sent a notification to the trustees, stating that he had decided to exercise the Swap Power. The grantor offered in substitution a nine year interest only with a balloon payment of principal promissory note at the then applicable federal rate of 1.27% for the full value of the trust's corpus, valued at approximately \$9,500,000. The trustees replied that the grantor could not do what he had proposed because he had failed to provide equivalent value.

First, the trustees contended that the grantor was not actually invoking the substitution power; he was, instead, attempting to invoke the loan power that the trust instrument expressly denied him. Second, focusing on the language in the provision creating the Swap Power, they asserted that the property that the grantor proposed to substitute — the promissory note — was not of “equivalent value” to the trust's corpus.

The grantor threatened to sue the trustees. They responded by filing a petition with the probate court requesting instructions. At issue was the proper valuation method to be applied to the promissory note

that the grantor proffered in substitution for the assets of the grantor trust. The grantor asserted that, as the note offered in this case met all of the requirements under the Internal Revenue Code, it should be determined to be property of “equivalent value,” and the trustees should be required to accept the note under the Swap Power of the grantor trust.

The Trustees urged the probate court to use a fair market value standard of value, valuing the property proffered to be swapped into the grantor trust based upon what a willing buyer would pay a willing seller. Given the limited market for promissory notes, the comparatively low interest rate of the note offered by the grantor, and the fact that the note was unsecured, the Trustees argued that the promissory note that the grantor intended to use as substituted property was not of equivalent value and was in fact fairly valued at about half the value of the trust corpus.

In a written order, the probate court agreed with both of the trustees’ contentions. It instructed the trustees that they could “properly reject” the promissory note because it was “not of equivalent value to the corpus of the trust and pursuant to their discretionary authority to make loans.” The appellate court affirmed, but only on the ground that the settlor’s proposed transaction was an attempt to exercise the loan power, not the Swap Power, so the trustees could properly reject it. The appellate court did not address the trial court’s alternative holding that, even if the proposed transaction were an exercise of the substitution power, the promissory note was not of “equivalent value” to the trust’s corpus.

Comments: Remember that the grantor named his wife as initial sole trustee, and she turned down the swap demand as co-trustee. I am not sure whether the Condiotti marriage was still extant when this litigation ensued. However, it’s highly likely that if it was, things were very tense at home!

The probate court teed the case up as a matter of national first impression. However, the appellate court made it an unpublished decision because it sidestepped both the Swap Power and valuation issues and decided the matter on the loan issue alone. The probate court opinion in this matter is worth reading

because it talks about the fair market value standard of value of the note versus a minimum applicable federal rate note being valued at face value.

[In re Dino Rigoni Intentional Grantor Trust for the Benefit of Christopher Rajzer,](#)²¹

Rigoni owned approximately 551 acres of farmland in Michigan. In 2001, Rigoni created an estate plan to convey that property to the Rajzers (his daughter and son-in-law) while minimizing tax consequences. To that end, Rigoni created a limited liability company named Rigoni Investments, LLC, of which he was initially the sole owner.

Rigoni also created a revocable living trust for himself (the “Rigoni trust”) and transferred 100% of the ownership interest in Rigoni Investments to that trust. Rigoni then conveyed his farmland to Rigoni Investments. Rigoni then created an “intentionally defective grantor trust” for each of the Rajzers. The trusts each contained a Swap Power clause permitting Rigoni to substitute property of “equivalent value” for the trust property.

The Rigoni trust then sold a 20% membership interest in Rigoni Investments to each of the Rajzer trusts. As consideration for the membership interests, the Rajzer grantor trusts each tendered a promissory note in the amount of \$185,416. Rigoni also created a second limited liability company called Rigoni Asset Management, LLC (“RAM”). The Rigoni trust transferred a 1% interest in Rigoni Investments to RAM, and RAM was appointed as the initial manager of Rigoni Investments. Later in 2001, the Rigoni trust gifted another 10% interest in Rigoni investments to each of the Rajzer grantor trusts.

In April of 2011, Rigoni, through counsel, sent a letter to the original trustee of the Rajzer grantor trusts, ordering the trustee, pursuant to the substitution clause, to substitute the promissory notes each trust for the 20% membership interest in Rigoni Investments that each trust had purchased. The original trustee responded that the language of the trust required substitution of property of equivalent value and that

he believed that Rigoni had failed to offer property that met that criterion. Rigoni also informed the Rajzers that their lease would expire at the end of 2011 and would not be renewed.

In January of 2012, Rigoni again attempted to exercise his right under the substitution clause, this time by ordering the trustee (now successor trustee Purkey) to substitute the promissory notes of each trust for the full 30% of interest in Rigoni Investments owned by each trust. Purkey responded in the same fashion as had the original trustee, stating that Rigoni had failed to offer property of equivalent value for substitution.

In April of 2012, Rigoni filed a petition with the trial court, seeking to have the court compel the trustee to allow the substitution of property in the trusts. In June of 2012, Purkey filed a petition requesting that the trial court determine the “equivalent value” of a 60% interest in Rigoni Investments. The two petitions were consolidated, and the matter was set for a bench trial. At trial, the principal issue was the valuation of the two 30% interests in Rigoni Investments.

Rigoni presented his expert on valuation, who opined that the fair market value of 60% of Rigoni Investments was \$248,000. The trustee also offered the testimony of an expert in business valuation, who valued the 60% interest in Rigoni Investments at \$2,388,000. This figure represents 60% of the appraised value of the farmland held by Rigoni Investments (\$3,980,000), to which valuation the parties stipulated.

Rigoni’s appraiser reached this conclusion by applying a “discounted cash flow” approach to value. Rather than value the underlying asset held by Rigoni Investments (the farmland), he determined the present value of the income stream received by Rigoni Investments, i.e., income from leasing the property. Rigoni’s appraiser then used the offer from the Rajzers to lease the farmland in 2012 for \$125,000, as well as average agricultural and land leasing rates from a Michigan State University report as a basis for determining an income stream for 2012 through 2021. He then applied substantial discounts for lack of marketability (19%) and minority shareholder status (32%).

The trustee also offered the testimony of an expert in business valuation. His expert valued the 60% interest in Rigoni Investments at \$2,388,000. This figure represents 60% of the appraised value of the farmland held by Rigoni Investments (\$3,980,000), to which valuation the parties stipulated. The trustee's appraiser testified that he had considered multiple methods of valuation, and he concluded that the best method of valuation was the market value of the assets held by Rigoni Investments. The trustee's appraiser based his conclusion in part on Internal Revenue Service Revenue Ruling 59-60, Sec. 5(b).

The trustee's appraiser further testified that he found it inappropriate to apply discounts for lack of marketability and minority shareholder status in this case. He opined that the fair market value standard with discounts presumes a willing buyer and willing seller, and that in this case Christopher Rajzer was not a willing seller, which affected his analysis similarly to cases involving minority shareholder oppression.

The trustee's appraiser also opined that Rigoni's appraiser's use of the discounted cash flow method of valuation was inappropriate in this instance because his method did not capture the value of the entire entity of Rigoni Investments, only its cash flow. The trustee's appraiser stated that, in his opinion, "equivalent value to me means a [sic] asset that has similar characteristics in terms of risk and opportunities for rate of return." He further opined that the substitution of the promissory notes for the Rajzer trusts' shares in Rigoni Investments would not provide the same risk or rate of return.

Following the bench trial and post-trial briefing, the trial court issued an opinion and order containing findings of fact. As to Issues I and II (interpretation of trust language), the trial court ruled that Rigoni's substitution right was "inextricably linked" with the requirement that he substitute property of equivalent value, and that "the reacquisition of Trust Assets by Dino Rigoni be contemporaneous with the replacement of those assets with property of equivalent value as agreed upon by the Trustee." As to issues III and IV (the valuation of the membership interests held by the Rajzer trusts), the trial court found the

trustee's appraiser's method of valuation to be correct, and that the value of the 60% membership interest was \$2,388,000.00.

On appeal, Rigoni challenged the trial court's interpretation of the Swap Power clause and the valuation of the 60% membership interest in Rigoni Investments. The Swap Power was as follows:

As Grantor, I [Dino Rigoni] do hereby retain the power and right, exercisable only for my personal benefit and only in a non-fiduciary capacity, to reacquire trust assets by substituting property of an equivalent value without the approval or consent of the Trustee or any person acting in a fiduciary capacity. The Trustee shall comply with my written expressed intentions concerning the exercise of this power.

In affirming the trial court on all issues, the appellate court observed:

Rigoni essentially argues that the plain language of the clause required the trustee to effect a substitution of property upon his command, and if necessary seek additional value in a later proceeding. We disagree.

In fact, Rigoni's argument would substantially rewrite the substitution clause by essentially causing it to read, "I may substitute any property for trust assets; if the trustee determines that the value of the property substituted was not equivalent, it may seek additional value afterwards." We decline to rewrite the unambiguous language of the substitution clause in such a fashion.

Nothing in the language of the substitution clause requires the trustee to accept any tender of property as substitution for trust assets; rather, the substitution clause prohibits the trustee from declining to comply with Rigoni's substitution of equivalent value property. A necessary precondition to that substitution is that equivalent value be

established: Rigoni may reacquire “trust assets by substituting property of an equivalent value.” (Emphasis added.) Once Rigoni has tendered property of equivalent value, the trustee lacks the discretion to deny the substitution. The trustee, however, still possessed the power and duty to determine whether the attempted substitution complied with the requirements of the substitution clause. [Emphasis added]

Comments: Another unpublished opinion. Wow. The equities strongly militated in favor of the beneficiaries of the grantor trusts because it appeared clear beyond cavil that the grantor was trying to pull some shenanigans, using, probably impermissibly, his position as the sole member of the LLC that was the manager of Rigoni Investments.

You have to wonder about Rigoni’s appraiser. Didn’t it bother him that the asset approach indication of value of the interest was *ten times larger* than the value indication computed using his discounted cash flow method? Yet, he stuck to his guns and gave his client the low value that he sought, but yet couldn’t keep. Additionally, I don’t know whether Rigoni’s appraiser valued a combined 60% LLC interest or two 30% interests in Rigoni Investments? If the former, I question the size of the discount for lack of control, which was 32% and was too high even had he been valuing two 30% interests, although his discount for lack of marketability was perhaps a tad bit low.

No one mentioned it, but did Rigoni’s derivative fiduciary duty as the sole member of the LLC that served as manager of Rigoni Investments *trump* his Swap Power, which is supposed to be exercised in a *non-fiduciary* capacity? I wonder if Rigoni was trying to take advantage of some naïve people who were just simple country farmers with the labyrinthine entity structure, much of which was unnecessary in my opinion for estate planning purposes.

Rigoni’s position on how the Swap Power procedure operated was fanciful. It would have imposed a system similar in many respects to eminent domain proceedings, where the governing body that has

expropriation authority simply exercises eminent domain, tenders some lowball number and forces the shafted property owner to sue for the remaining fair market value and damages. Thankfully, both courts got it right in this instance in my opinion.

[Benson v. Rosenthal.](#)²²

The grantor established various trusts for the benefit of his adopted daughter and two grandchildren. He created three trusts in 2009, three trusts in 2012, a Grantor Retained Annuity Trust in 2012, and another Grantor Retained Annuity Trust in 2014. Notwithstanding the dispute at issue, these trusts hold ownership interests in various entities that in turn own valuable property, including significant non-voting interests in the New Orleans Saints and Pelicans major league professional sports franchises, the New Orleans Fox television affiliate, automobile dealerships, and the Benson Tower and Champions Square development.

In January of 2015, weary of a battle between his daughter and her children with his third wife over the ownership and operation of the two professional sports franchises, and desirous of putting his third wife in control of the sports franchises, the grantor exercised his Swap Power and sent correspondence to the trustee, stating his intention to exchange the trust assets for promissory notes of equivalent value. This correspondence was sent to the trustee on January 12, 2015 but intended to make the exchange effective as of January 1, 2015.

With the January 12 correspondence, the grantor included a preliminary schedule of values of the trust assets, a Notice of Exchange of trust assets, and blank promissory notes containing a valuation adjustment clause that would operate to adjust the notes automatically to a later-determined appraised value. The transfer also included certain real estate and the forgiveness of nearly \$100 million of indebtedness owed to the grantor by some of the trusts.

The trustee refused to execute the documents required to complete the exchange, stating that such an exchange requires a simultaneous transfer of property. He also stated that an unsecured promissory note

is “not an appropriate trust investment” and that he must “make his own independent verification that the assets to be exchanged are of equivalent value [with the trust assets]” before the exchange could occur.

On January 24, 2015, the grantor supplemented his exchange request with additional documents, including certifications of the values of each trust signed by the grantor, collateral assignments granting the trusts security interests, and seven promissory notes for values based on the most recent valuations available. These promissory notes also contained valuation adjustment clauses. The grantor’s supplements failed to assuage the trustee’s concerns, and he again rejected the exchange, stating that there had “not yet been an exchange of assets of equivalent value.”

On August 24, 2015, after filing suit to force the trustee to go forward with the swap, the grantor again supplemented the Notice of Exchange in accordance with the valuation adjustment clauses included in the promissory notes. The grantor had retained Empire Valuation Consultants (“Empire”) to conduct a valuation of the assets that he sought to remove from the trusts as of December 31, 2014. Empire’s services had been used in the valuation of assets of the trusts on prior occasions and had been relied upon by the trustee. Based on Empire’s updated valuation of the trust assets, the grantor delivered to the trustee thirteen new promissory notes of specific values and collateral assignments securing each of those notes. The trustee again rejected the grantor’s exchange.

The trustee sought a judgment holding either that (1) the grantor’s attempted substitution was, in fact, a request for a loan, which the trustee had the discretion to deny, or that (2) the grantor’s purported substitution did not occur on January 1, 2015 and occurred, at the earliest, on August 24, 2015, if the grantor can prove that he exchanged property of equivalent value.

With respect to the loan argument, the district court was not persuaded by the trustee’s citing of *In re Condiotti* because the promissory note in that instance was unsecured, whereas the grantor’s promissory

notes were secured adequately and based upon an appraisal by a qualified appraiser. Based upon that, the district court denied the trustee's motion to dismiss on the pleadings. With respect to the efficacy of the Swap Power exercise, the district court again sided with the grantor, concluding: "*The trusts grant [the grantor] the unilateral power to substitute assets, and while the trustee must ensure equivalent value, he does not have the power to prevent such an exchange.*"

Disagreeing with *In re Condiotti* on this point:

...This Court does not read the Substitution Provisions of these trusts as requiring a contemporaneous exchange. The trusts merely require that when a grantor unilaterally effects a substitution, he is bound to offer equivalent value in exchange.

Applying this interpretation to the facts at hand, this Court holds that if the attempted exchange was a substitution, it was effective on January 24, 2015. It is on that date that Plaintiff provided the trustee with a certification of value of the substituted property, as required by the 2009 Trusts, and promissory notes purporting to be of equivalent value, as required by all trusts.

Comments: While I get that valuation takes time, the conclusion that the trustee's remedy is to sue for additional value, like eminent domain, seems inconsistent with the words substitute or exchange, both of which connote a *simultaneous* transfer. The grantor selected the assets to swap out of the trust, not the trustee.

That the grantor selected subjectively valued assets that take time to appraise should not be held against the trustee. The burden of proving equivalent value must rest with the grantor, not the trustee having to prove a negative, i.e., that the proposed swap is not of equivalent value. In my opinion, the district court's conclusion on this point could end up as a slippery slope. However, this case lays out what is in my opinion the proper way that a grantor should prepare and present a swap.

[Schinazi v. Eden.](#)²³

The grantor established the Trust on August 23, 2005, naming Eden as Trustee and his daughter as the primary beneficiary. The Trust agreement authorized the grantor to deposit property into the Trust, and he retained a Swap Power. Two days after creating the Trust, the grantor and RFS & Associates, LLC, a corporation in which Schinazi held a controlling interest and served as manager, formed a limited partnership known as RFS Partners, L.P. The partnership agreement named RFS & Associates as "General Partner," designated the grantor as "Limited Partner," and set forth procedures for transferring partnership interests.

Over six years later, on January 2, 2012, the grantor sent the trustee a promissory note in the amount of \$58,290,000, stating that he was "exercising [his] asset substitution right [under the Trust agreement] by substituting [the] Promissory Note for the limited partnership interest owned by the Trust in RFS Partners, L.P." The grantor asked the trustee to acknowledge in writing that he was now "the sole owner of all interest formerly owned by the Trust in the Partnership."

The trustee refused to sign the acknowledgment, asserting that the promissory note did not constitute a substituted asset of equivalent value, as required by the Trust agreement. Despite this refusal, the grantor informed the trustee on September 11, 2012, that "the Trust's balance sheet consists of" the \$58,290,000 promissory note, rather than an interest in RFS Partners. The trustee sued the grantor and RFS & Associates in November 2012, seeking a declaratory judgment regarding which party—the Trustee or the grantor—owned the RFS Partners interest that the grantor sought to reacquire in January 2012.

The trustee also asserted claims for failure to tender assets of equivalent value, breach of fiduciary duty, litigation expenses under applicable state law, and punitive damages. Finding that the Trust still owned the partnership interest, the trial court granted summary judgment to the trustee on the declaratory judgment claim, but awarded the grantor summary judgment on the trustee's remaining allegations. Both

parties appealed. In reversing the trial court's grant of summary judgment to the grantor on the trustee's claim for breach of fiduciary duty, the appellate court noted:

Furthermore, the record raises questions about the adequacy of the promissory note [the grantor] tendered in exchange for the transfer. Some evidence indicates that the value of the partnership interest increased just days after the tender, when Pharmasset—a company in which RFS Partners owned significant stock—was purchased by another entity.

This purchase was not finalized until January 12, 2012, but had been announced several months before the grantor tendered the note. Material questions of fact, therefore, remain regarding breach.

Comments: The grantor appears to have been engaged in some questionable insider shenanigans relative to the trust's interests before a favorable buyout of some shares in a pharmaceutical company based on some inside information. While the opinion doesn't provide much detail on the description of the note tendered in the swap, the mere fact that valuation was questioned probably means that the note was unsecured and may not have borne an adequate rate of interest to compensate the trustee for the risk of taking the note.

[Manatt v. Manatt.](#)²⁴

On September 20, 2017, purporting to exercise his Swap Power under the BJM Trust, the grantor acted to substitute the 53.57 shares of Manaco stock for money, at a rate of \$83,000 per share. The sum of money was reduced by the outstanding promissory note debt created by the original sale of the stock to the trust, leaving a balance of \$2,326,947.25. Two days later, however, the trustee of the grantor trust sent a letter to the grantor's attorney, indicating that, as trustee of BJM Trust, he "rejected" the substitution, challenging that it did not constitute equivalent value. Four days later, the trustee sent the grantor a

second letter, informing the grantor that he had arranged to pay off the promissory note holding the 48.21 shares of Manaco stock in the grantor trust and had transferred the payoff amount to Brad, thereby creating the appearance that the trustee of the grantor trust was the outright owner of the stock.

The grantor brought a declaratory judgment action against the trustee of the grantor trust. The complaint sought a declaratory judgment ordering the trustee to sign and deliver 53.57 shares of Manaco stock; accept the substitution tendered on September 20, 2017; order the trustee to execute and deliver all instruments and documents necessary to effectuate the exchange of assets; and award the grantor all legal and equitable remedies to fully restore him to his property.

The grantor filed a motion for judgment on the pleadings asking the court to determine the rightful ownership of the stock held in the grantor trust. The grantor argued this is a legal question, which depends on whether Erik, as trustee of the grantor trust, has the legal authority to stop Brad, as grantor of the trust, from changing the kinds of assets held in the trust by asserting the new assets are not as valuable as the old assets. The grantor asserted that the court could decide this question based on the unambiguous language of the trust documents. Quoting *Benson v. Rosenthal*,²⁵ the grantor argued that under the plain language of the Swap Power of the trust, as grantor he retained “the unilateral power to substitute assets, and while the trustee must ensure equivalent value, he does not have the power to prevent such an exchange.”

As to the merits of the motion, the trustee of the grantor trust asserted that the grantor trust was structured as an intentionally defective grantor trust (IDGT), and, therefore, it had to comply with various terms. Erik argued that as trustee, he has the fiduciary duty to ensure compliance with the Swap Power. Citing Revenue Ruling 2008–22, the trustee of the grantor trust further asserted that his fiduciary duty requires that he be assured the substituted asset is of equivalent value.

According to the trustee, in June 2017, the grantor valued shares of Manaco stock held by grantor's children at \$133,000 per share and, therefore, a value of \$83,000 per share under the purported substitution of assets on September 20, 2017, was not an equivalent value. The trustee concludes that because compliance with that term is required, the letter regarding substitution of assets was merely an offer, which the trustee summarily rejected. Moreover, the trustee notes that he has now paid off the promissory note and owns the shares outright.

The Swap Power read as follows:

10.14 Power to Exchange Assets. During my lifetime, I, acting alone in my individual and not in any fiduciary capacity, shall have the power, with respect to any trust created under this instrument, to reacquire trust assets by substituting other property having an equivalent value herewith; provided, however, that this substitution power cannot be exercised in a manner that can shift benefits among the trust beneficiaries as provided in Rev. Rul. 2008–22. Neither the consent of the trustee nor the consent of any other person shall be required. The power described in this paragraph may be exercised by an agent appointed under a durable power of attorney or through any other means, whose actions shall be conclusive and binding.

In all events, the trustee shall satisfy himself or herself that the properties acquired and substituted pursuant to this paragraph are, in fact, of equivalent value; and, further the trustee shall ensure that this substitution power is exercised in a manner that cannot shift benefits among the trust beneficiaries as such phrase is used in Rev. Rul. 2008–22.

By written instrument delivered to the trustee, I (or an agent appointed under a durable power of attorney) may irrevocably release the power under this paragraph 10.14; and on the first to occur of (a) my death, (b) the expiration of the term beginning on September

1, 2012 and ending on August 31, 2027 and (c) the release of my power pursuant to this paragraph 10.14, my power under this paragraph 10.14 shall terminate and have no further legal force or effect under this instrument. [Emphasis added]

The parties do not dispute that the Swap Power gives the grantor the power to substitute assets nor did they contest that the trustee has a fiduciary duty to satisfy himself that the properties acquired and substituted are of equivalent value. Rather, the dispute is in regard to **the timing of the trustee's duty**. The grantor contends that a challenge regarding the value of the substituted asset does not prevent the substitution from occurring. The trustee contends that the valuation of the substituted asset must occur before substitution takes effect.

In the *Benson* case, on which the grantor relied, the court found that the plain language of the substitution provision allowed the grantor unilateral power to substitute assets without the approval of anyone. In that case, the grantor substituted secured promissory notes and other assets for various trust assets, including approximately \$100,000,000 in debt relief.

The trustee challenged the substitution and refused to execute the documents required to complete the exchange, arguing, *inter alia*, that as trustee, he had to “make his own independent verification that the assets to be exchanged are of equivalent value [with the trust assets] before the exchange could occur.” Reasoning the dispute was a matter of trust interpretation, the court found that the grantor’s intent was unambiguous based on the plain language of the provision. The district court noted:

Under [the trustee’s] interpretation of the provision, the trustee’s duty to ensure the substituted asset is of equivalent value becomes a condition precedent to the substitution of assets.

This interpretation contradicts the plain language of the Swap Power, which allows that the grantor, “during [his] lifetime” and “acting alone in [his] individual and not in any

fiduciary capacity,” can reacquire trust assets by substituting other property of equivalent value, and in doing so, “[n]either the consent of the trustee nor the consent of any other person shall be required.” [Emphasis added]

Ruling in favor of the grantor, the district court reasoned:

A plain language reading of the substitution provision, read together with the other provisions in the BJM Trust, compels the conclusion that [the grantor] had the unilateral right of substituting the assets. [The Trustee’s] fiduciary duty to determine whether the substitution of assets was of equivalent value did not abridge, delay, or block [the grantor’s] right of substitution.

...

Having concluded [the grantor] had the unilateral power to substitute assets, the Court finds [the grantor’s] reacquisition of assets was legally effective on September 20, 2017, making [the grantor] the true and lawful owner of the assets he reacquired. On the current record, however, the Court is unable to order [the trustee] to deliver the 53.57 shares of Manaco stock as it is unclear that [the trustee] has possession of those shares. [The trustee] stated in answer to the complaint that he has no control over the shares. At the hearing, it was disclosed that [the trustee] sold the shares to family members. Because there is a dispute regarding who is in possession of the shares, the remainder of the relief [the trustee] requests is outside the scope of this motion for judgment on the pleadings and cannot be granted at present.

Comments: The *Manatt* trustee-beneficiary’s shocking pre-decision act to transfer the shares at issue before the court had a chance to rule at least temporarily thwarted the grantor’s right to take possession of the subject shares after the ruling. The potential for questionable self-help here underscores the reason

why I believe that, notwithstanding the *Benson* and *Manatt* decisions, the exchange must be ***simultaneous*** in nature, and the only way that this can happen is to use promissory notes that have an adjustment clause **to increase or decrease the amount passing to** the trustee of the grantor trust in the exercise of the Swap Power.

I disagree with part of the *Manatt* court's interpretation of the subject Swap Power, the second paragraph of which reads as follows:

In all events, the trustee shall satisfy himself or herself that the properties acquired and substituted pursuant to this paragraph are, in fact, of equivalent value; and, further the trustee shall ensure that this substitution power is exercised in a manner that cannot shift benefits among the trust beneficiaries as such phrase is used in Rev. Rul. 2008-22.

[Emphasis added]

The court seized on the fact that the words acquired and substituted were ***past tense*** usages, presupposing that the substitution had already taken place. However, the subject Swap Power expressly references Rev. Rul. 2008-22, which expressly requires a trustee who is not satisfied that he has received equivalent value from the grantor (or third party exerciser of the Swap Power) has a duty to resist and oppose any attempted substitution of assets worth less than the value of trust's assets sought to be swapped out of the grantor trust. The above paragraph is different from any of the other four Swap Powers in the other cases, but the *Manatt* court seems to have glossed over it. I interpret that paragraph as allowing the trustee to hold up finalization of exercise of the Swap Power until the trustee is satisfied that he has received equivalent value.

To allow the grantor of a trust to unilaterally substitute property in and out of the trust with no possible stopping by the trustee wastes time and is contrary in my opinion to the inherent fiduciary duty that the settlor owes to the trust on formation. I submit that if a grantor who formed the trust has the unilateral

ability to simply substitute property without it being tested for equivalence in value, the underpinning requirement of an irrevocable trust may be missing. Query whether it is still a trust where the grantor retains the unchecked power prior to the swap to substitute assets that may well be worth *less* than the value of the assets being substituted into the grantor trust.

A Panoply of Swap Power Imponderables.

In this last section of the monograph, I address a number of issues that arise around the exercise of a Swap Power.

The Trustee's Defender v. Guardian Roles

Traditional notions of fiduciary duty and the very essence of the trust mandate that while the grantor's Swap Power be respected, the grantor should have to first meet some minimum good faith burden of going forward, not of the least of the Swap Power training wheels. If the grantor doesn't present enough evidence to meet his burden of moving forward, the trustee is **required** in my opinion to object and defend the trust, which almost always requires legal action. However, once the grantor has met his burden of going forward, the trustee's role shifts slightly from defender to **guardian**. In the **defender** role, the trustee is pretty much required to take some legal action to defend the trust's interests.

However, in its **guardian** role, the trustee's role is much more passive and really is focused on making sure that the trust value is maintained after the swap. In its guardian role, the trustee may, but need not, take legal action to protect the trust's interests. Quite often, all the trustee needs to receive are qualified appraisals of the assets sought to be swapped into the grantor trust to ensure that equivalent value is received.

The Words of the Swap Power Matter

What is clear is that courts are going to examine the **actual words** of the Swap Power. Suppose the court interprets the Swap Power to permit the unilateral and unchecked authority to swap out assets. Does the scrivener have some possible exposure to the beneficiaries of the trust if that exercise of the Swap Power

damages the trust value? Possibly. However, it is easy to build in some intermediate protections in the Swap Power itself that can include what constitutes an equivalent value certification procedure, provide relative to promissory notes as substituted assets, and whatever else might be included in the grantor's good faith burden of moving forward, which I believe should be included. Additionally, why not draft to slow down the swap process by interposing a minimum amount of time, e.g., 90 days, before the swap becomes effective, which would permit appraisals to at least get substantially underway if not completed? I believe that this is how the Swap Power should be drafted.

Proper Standard of Value

Is it the willing buyer-willing seller fair market value standard, or are they to be valued pursuant to a read of the internal Revenue Code, such that interest at the applicable federal rate was to be considered a sufficient rate of interest? These questions were at issue in *In re Condiotti*, and the trial court held that the willing buyer willing seller standard fair market value for the promissory note was the proper standard, and the court is correct in my opinion. The district court reached the same conclusion in *Benson v. Rosenthal*.

However, in *In re Rigoni*, the court blessed the work of the trustee's appraiser, who opined that since the trustee was not a willing seller, the proper standard of value was fair value, which meant that no valuation discounts were applied. Equivalent value seemingly effectively means fair market value, although, in *In Re Rigoni, supra.*, the court sided with the appraiser who posited that fair market value was *not* the proper standard because the seller was not a willing seller in that instance, thereby undercutting the principal tenet of fair market value, which involves a willing buyer and a **willing seller**. I would expect that very few of these contested exercise cases involves a **willing** seller, such that the proper standard of value in these cases probably is fair value, which means that valuation discounts are inapplicable.

Differences between current IRC Sec. 675(4)(C) and its counterpart in the Clifford Regulations:

While the Swap Power may be held by anyone and count as a tainted power as to the grantor in current IRC Sec. 675(4)(C), the Swap Power of the grantor, or any person not having a substantial adverse interest in its exercise, or both were the only power holders to be tainted with grantor trust status in the Clifford Regulations. When the word reacquire was used in the Clifford Regulations, it made sense because the tainted power was limited to the grantor or any person not having a substantial adverse interest in its exercise, or both, and it probably was the grantor who originally contributed the property to the grantor trust.

Congress picked up the word reacquire in IRC Sec. 675(4)(C), but it was unnecessary and wrong, since the tainted administrative powers in IRC Sec. 675(4) may be held by **anyone**, i.e., not limited to the grantor or any person not having a substantial adverse interest in its exercise, or both, like was the case in the Clifford Regulations. It would be silly for the IRS to argue that while a Swap Power may be technically held by a third party (no one who would have a substantial adverse interest) because the statute so clearly provides, but it can't ever be exercised because the power holder didn't contribute the property to the trust, and thus, can't reacquire something never previously owned. This probably explains why the IRS has always interpreted the word reacquire to mean acquire. Mystery solved.

IRC Sec. 675(4)(C) provides in pertinent part: *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.* [Emphasis added]

Treas. Reg. Sec. 39.22(c)-22(e) provided as follows: *Any one of the following powers of administration over the trust corpus or income is exercisable in a nonfiduciary capacity by the grantor, or any person not having a substantial adverse interest in its exercise, or both.* Note that in the Clifford Regulations, the tainted

Swap Power can only be held by the grantor *or any person who doesn't have a substantial adverse interest*, while the Swap Power under IRC Sec. 675(4)(C) may be held by *anyone*.

For federal income tax purposes, a trust that has a Swap Power is a grantor trust in whole, but only with respect to the portion of the grantor trust over which the Swap Power applies.²⁶ Similarly, a grantor or another person includes both ordinary income and other income allocable to corpus in the portion he is treated as owning if he is treated as an owner under section 675 or 678 because of a power over corpus. Therefore, if the grantor trust Swap Power is expressly inapplicable to certain assets, e.g., IRC Sec. 2036(b) voting stock in certain closely-held corporations, unless the scrivener adds another defective trust power, the trust won't be a wholly grantor trust for income tax purposes.

In *Jordahl Est. v. Comr.*,²⁷ the Tax Court decided that the right to buy an asset, exercisable in a *fiduciary* capacity, for its fair market value is not a retained right or interest for purposes of IRC Secs. 2038 or 2042, and the IRS acquiesced in the result of the case.²⁸ Given that the power in *Jordahl Est. v. Comr.* was exercisable in a *fiduciary* capacity, most practitioners believed it to be of limited utility for a non-fiduciary Swap Power under IRC Sec. 675(4)(C).

Exercise by the grantor:

There should be no tax consequences to either the grantor or the grantor trust.²⁹ The grantor would take the grantor trust's basis in the swapped out asset, and the trustee would take the same basis in the substituted asset as if nothing had been transferred for tax purposes.³⁰

Caveat from Howard Zaritsky:

A grantor could have a Swap Power that the instrument states is held in a non-fiduciary capacity, but other facts indicate the existence of a fiduciary relationship, e.g., the grantor could own a majority of the interests in a closely-held entity and initially fund the grantor trust with a minority interest in that entity. We saw similar facts in *In re Rigoni* and *Eden v. Shinazi*.

The grantor's fiduciary duty as majority shareholder could **trump** the trust instrument's declaration that the Swap Power is held in a non-fiduciary capacity, which would take you outside of the ambit of the Swap Power. Exercise by a third party. If a third-party holds and exercises the Swap Power, the transaction should be deemed to be an exchange between the third-party and the grantor, for income tax purposes. This could be a taxable exchange to the grantor, the third-party or both.

If the third-party swaps appreciated assets with the trustee in exchange for other appreciated property of equivalent value, both the grantor and the third-party would recognize gain equal to the difference between their respective adjusted basis in the transferred asset and the fair market value of that asset on the date of the exchange unless the trust is a grantor trust as to the transferor.³¹

Note that the Treas. Reg. Sec. 39-22-22(e) provides that the power may be held by anyone who doesn't have a substantial adverse interest. Contrast that with the language of IRC Sec. 675(4)(C), which permits *anyone* to hold the Swap Power. Query: is a Swap Power held by a third party really illusory? However, given that it is far less likely that the Swap Power would be exercised, perhaps the third person is the best holder of the Swap Power.

Adverse party

An adverse party is a defined term in IRC Sec. 672(a) and means "any person having a substantial beneficial interest in the trust which would be adversely affected by the exercise or non-exercise of the power which he possesses respecting the trust. A person having a general power of appointment over the trust property shall be deemed to have a beneficial interest in the trust." The IRS has privately blessed situations where the beneficiary held the Swap Power.³²

Non-adverse party

Treas. Reg. Sec. 1.675-1(b)(4). requires a non-adverse party-IRC Sec. 675 says any person-surely the statute **trumps** the regulation? The regulation reflects the law under the Clifford Regulations, but not the law since 1954.

Beneficiary

Ordinarily, a beneficiary is going to be an adverse party, which takes you outside of the literal cover of Treas. Reg. Sec. 1.675-1(b)(4), but not outside IRC Sec. 675(4)(C), which is a power that can be held by **anyone** acting in a non-fiduciary capacity. Nevertheless, the IRS has privately blessed situations where a beneficiary held the Swap Power.³³ Still, I don't recommend naming a beneficiary as the holder of the Swap Power because of the obvious conflict there.

The trustee

A Swap Power that's held by someone who is a trustee may be held in a nonfiduciary capacity, but the regulations presume that the power is exercisable in a fiduciary capacity primarily in the interests of the beneficiaries. This presumption may be rebutted only by **clear and convincing proof** that the power is not exercisable primarily in the interests of the beneficiaries.³⁴ Nevertheless, the IRS has privately blessed situations where the trustee held the Swap Power.³⁵

The Grantor-pro's and con's.

My general advice is to only vouchsafe the Swap Power in the grantor's hands absent some compelling reason to do otherwise.

Pro-No "reacquire" issue.

Con-If the trust holds voting stock in a closely held family corporation or life insurance on the life of the grantor Swap Power holder, pretty certain unnecessary estate tax exposure unless you cull those assets out of the Swap Power, and give the Swap Power over those assets to a third party.

Pro-Can swap assets out of the grantor trust with no tax consequences.

The grantor's spouse-pro's and con's

Pro-No IRC Sec. 2036(b) or life insurance policy problem.

Con-Possible "reacquire" issue.

Con-Only good during the marriage and grantor trust status ends upon the spouse's death, unless additional plans are made.

Third party-pro's and con's.

A Swap Power to substitute assets held by someone who is not a trustee may still be deemed to be held in a fiduciary capacity. The determination of whether the power is exercisable in a nonfiduciary capacity depends on all the terms of the trust and the circumstances.

Given the tax cost of exercising the Swap Power, is giving the Swap Power to a third party really illusory from the beginning? The literal language of IRC sec. 675(4) says that the Swap Power must be held in a **non-fiduciary** capacity. Nevertheless, the IRS has recognized and possibly required at one time that the Swap Power be exercised in a fiduciary capacity.³⁶

Can a promissory note be substituted in for hard assets and be considered equivalent value?

All five grantors in the court actions sought to substitute promissory notes as partial or whole substitution for the assets in the trusts. The grantor was successful in *Benson v. Rosenthal*, where the notes were fully collateralized by security interests in hard assets and bore an appropriate rate of interest to reflect market rate interest, not merely interest at the applicable federal rate (AFR). However, in *Benson v. Rosenthal*, additional significant assets were sought to be swapped into the grantor trust as well as a significant amount (approximately \$100,000,000) of debt relief.

In *In re Condiotti*, the grantor unsuccessfully sought to substitute in an unsecured \$9,500,000 promissory note that bore interest only at the applicable federal rate of 1.27% and paid interest only for nine years. The court determined that the proffered notes were not equivalent in value to the assets in the grantor trust.

In *In re Dino Rigoni Intentional Grantor Trust for the Benefit of Christopher Rajzer*, the terms of the promissory notes were not discussed, but, in all likelihood, the proffered promissory notes were unsecured and bore an insufficient rate of interest.

However, in *Schinazi et al. v. Eden*,³⁷ in response to an attempted substitution of a promissory note in the amount of \$58,290,000, but no other particulars about the note, i.e., whether it was negotiable, bore a market rate of interest or was secured by any assets for the trust assets, the trustee resisted, alleging lack of equivalent value, but the trial court granted summary judgment to the grantor on that issue. The trustee appealed that issue nominally, but she conceded the issue on appeal. However, subsequent decisions in the matter make clear that the equivalent value issue hasn't been finally determined.

Moreover, in *Manatt v. Manatt*, the court ruled that the grantor properly exercised the Swap Power and properly became the owner of the swapped out assets upon exercise of the Swap Power, notwithstanding that the trustee hadn't yet examined the evidence of equivalent value, but some pre-judgment transfers prevented the court from giving the grantor the relief that he sought.

It seems clear beyond cavil that trustees are right to reject promissory notes that don't bear a market rate of interest consonant with the risk that the trustee is assuming by taking the promissory note in substitution that isn't collateralized by security interests in assets of the grantor. This includes attempts to proffer a note that only bears interest at the AFR, which the grantor in *In re Condiotti* unsuccessfully tried to do.

[Does the trustee of a grantor trust where the grantor has exercised a Swap Power have to go to court in all situations?](#)

Note that neither Rev. Rul. 2008-22 nor Rev. Rul. 2011-28 requires the trustee to seek judicial approval in all cases as a precondition to the swap; hence, the "satisfying itself" language. The trustee need only satisfy itself that the swap will not diminish the trust's value because the substituted property is of equivalent value to the property substituted out of the grantor trust. I submit that if a grantor who formed

the trust has the unilateral ability to simply substitute property without it being tested for equivalence in value, the underpinning requirement of an irrevocable trust may be missing.

Query whether it is still a trust where the grantor retains the unchecked power prior to the swap to substitute assets that may well be worth *less* than the value of the assets being substituted into the grantor trust. To allow the grantor of a trust to unilaterally substitute property in and out of the trust with no possible stopping by the trustee wastes time and is contrary in my opinion to the inherent fiduciary duty that the settlor owes to the trust on formation. Traditional notions of fiduciary duty and the very essence of the trust mandate that while the grantor's Swap Power be respected, the grantor should have to first meet some minimum good faith burden of going forward, not of the least of the Swap Power training wheels.

If the grantor doesn't present enough evidence to meet his burden of moving forward, the trustee is required in my opinion to object and *defend* the trust, which almost always requires legal action. However, once the grantor has met his burden of going forward, the trustee's role shifts slightly from *defender* to *guardian*. In the *defender* role, the trustee is pretty much required to take some legal action to defend the trust's interests.

However, in its *guardian* role, the trustee's role is much more passive and really is focused on making sure that the trust value is maintained after the swap. In its guardian role, the trustee may, but need not, take legal action to protect the trust's interests. Quite often, all the trustee needs to receive are qualified appraisals of the assets sought to be swapped into the grantor trust to ensure that equivalent value is received.

What is clear is that courts are going to examine the *actual words* of the Swap Power. Suppose the court interprets the Swap Power to permit the unilateral and unchecked authority to swap out assets. The trustee owes several duties to the beneficiaries of the grantor trust where the grantor attempts to

substitute new property of alleged equivalent value to the trust assets. One thing that the trustee can't do is simply resist the effort without just cause. However, the trustee must ensure that the interests of the grantor trust in the substitution are protected and that the grantor trust must receive assets of equivalent value.

The trustee of the grantor trust has an affirmative duty under Rev. Rul. 2008-22 (particularly if the Swap Power expressly references Rev. Rul. 2008-22) and applicable state law to take steps to protect the trust after exercise of the Swap Power if the trustee satisfies itself that the proposed assets to be swapped into the grantor trust are worth *less* than the assets that are being swapped out of the grantor trust. Grantor trust status is key to the grantor's ability to swap assets and sell assets to a grantor trust because transactions between the grantor and the grantor trust are ignored for federal income tax purposes. See Rev. Rul. 85-13, notwithstanding a contrary decision in *Rothstein v. U.S.*³⁸.

Does the scrivener have some possible exposure to the beneficiaries of the trust if that exercise of the Swap Power damages the trust value or is incomplete in any material way?

Possibly, due to the foreseeability of problems as demonstrated by a rash of reported decisions involving the *exercise* of a Swap Power where the Swap Power was inadequate. As I already said, the courts are going to construe the provisions you draft. The scrivener should balance the interests of the trustee and the power holder in the crafting of the Swap Power. However, it is easy to build in some intermediate protections in the Swap Power itself that can include what constitutes an equivalent value certification procedure and whatever else might be included in the grantor's good faith burden of moving forward, which I believe should be included.

Additionally, why not draft to *slow down* the swap process by interposing a *minimum* amount of time, e.g., 90 days, before the swap becomes effective, which would permit appraisals to at least get substantially underway if not completed? One important thing to keep in mind is the risk of loss passing

point, which must be addressed in the Swap Power. I believe that this is how the Swap Power should be drafted. In these cases, does the trustee have a duty to, or, alternatively, should a trustee always seek cover from a local court before acceding to the Swap Power?

Clearly, the bigger the dollars involved, the more likely it is that the trustee, particularly, an institutional trustee (most of which are afraid of their own shadows), will lean on a court instructions action to provide insulation against liability to the beneficiaries of the trust for a breach of a duty in connection with a swap of assets. But whether a trustee goes to court or not probably will be dependent upon the role that the trustee is playing, i.e., defender v. guardian, as discussed earlier.

This particularly is true where, as Howard Zaritsky astutely observed, relations between the grantor and the beneficiaries have soured either on some other issue or over exercise of the Swap Power, which was the situation in all five court cases thus far.

[Is it possible for a trust asset to be so unique that nothing sought to be swapped in will be of equivalent value?](#)

In light of *Benson v. Rosenthal*, the answer appears to be no. In *Benson v. Rosenthal*, the assets sought to be swapped out of the grantor trust were significant non-voting interests in the NFL New Orleans Saints and the NBA New Orleans Pelicans.

Assets don't get more unique and exclusive than interests in major league sports teams, but this uniqueness/exclusivity issue doesn't appear to have been broached. Perhaps the trustee should have made such an argument. Maybe in a future case. The delta between the cash flow from these different assets, i.e., team revenue, including share of television advertising revenue, and a fixed income promissory note, is gigantic. The answer to this issue is, in my opinion, much closer than the efficacy of substituting secured promissory notes for hard assets if one focuses on the whole meaning of "equivalent value."

If the desired asset swap attempts to substitute a promissory note for all or substantially all of the grantor trust's assets, is this akin to a loan, which must be authorized by applicable state law or by the governing instrument? In *In re Condiotti*, the trust instrument prohibited the grantor from borrowing money from the trust. When the grantor attempted to substitute an unsecured promissory note bearing interest only at the applicable federal rate of 1.27% for all of the assets in the grantor trust, the trustees, in reliance in part on the loan prohibition, refused to comply because the ultimate real effect of the swap was effectively a loan of the entire trust corpus, which the trust instrument prohibited. In *In re Condiotti*, the appellate court decided the case adversely to the grantor on this issue alone.

But this theory might be limited to unsecured promissory notes. See *Benson v. Rosenthal, infra.*, where the district court distinguished *In re Condiotti* because, unlike the promissory note in *In re Condiotti*, the grantor's 13 notes proffered in substitution were fully secured by pledges or other security interests in other assets.

What does the phrase "equivalent value" mean, and can equivalent value ever be supplied by promissory notes?

This was the issue in several of the litigated cases, with three of the five grantors being successful in substituting promissory notes at least in part for the swapped out assets.

The phrase "equivalent value" only appears once in the Internal Revenue Code, in IRC Sec. 675(4)(C). Then what does the word "equivalent," which the Internal Revenue Code doesn't define, mean? According to the *Merriam-Webster Dictionary*, the word "equivalent" means "equal in force, amount, or value." What did Congress intend by coining a new term in the Code? Equivalent value just might require more than mere **equality** in fair market value, as it is possible that it is a higher standard.

It's not out of the realm of possibility that the word "equivalent" requires comparability of tax and non-tax characteristics, e.g., quality of the asset, i.e., whether it is a nonmarketable minority interest, mere

assignee interest, income/cash flow produced by each asset, likelihood of appreciation, the income tax basis of each asset, etc.

The trustee owes a fiduciary obligation to the trust beneficiaries to receive at least equivalent value in the swap. Thus far, the IRS appears to consider only fair market values of the involved assets, although the IRS hasn't yet addressed that issue head on, and none of the reported decisions thus far have dealt with this issue, except for *In re Condiotti*, meaning that it's still open.

In PLR 200846001, which involved a Swap Power that was held in a *fiduciary* capacity, the IRS held that an exchange of assets by the grantor and a grantor trust pursuant to the Swap Power was an exchange of assets of equivalent value as long as both assets (publicly traded stock) were valued pursuant to the gift tax regulations. Equivalent value seemingly effectively means fair market value, although, in *In Re Rigoni, supra.*, the court sided with the appraiser who posited that fair market value was *not* the proper standard because the seller was *not* a willing seller in that instance, thereby undercutting the principal tenet of fair market value, which involves a willing buyer and a willing seller.

I would expect that very few of these contested exercise cases involves a willing seller, such that the proper standard of value for the grantor trust assets to be swapped out in these cases possibly is fair value, which means that valuation discounts are inapplicable.³⁹ However, in my opinion, the proper standard for valuing the promissory note is fair market value.

Can non-voting stock or an assignee interest ever be considered equivalent value to voting or full interests?

No one knows the answer for certain, but if the proper analysis is the "willing buyer-willing seller" fair market value standard, then it should be mathematically possible, assuming that the values are equivalent, unless the term "equivalent value" means something different than mere equality in dollar value. In *Benson v. Rosenthal*, while the plaintiff didn't attempt to make such a distinction, the trial court

reasoned that the willing buyer willing seller fair market value standard of value was the proper standard in this situation. This is the only appropriate and sensical interpretation in my opinion.⁴⁰

On its face, the administrative powers in IRC Sec. 675(4) that are tainted with grantor trust status are only exercisable in a non-fiduciary capacity. So why does the IRS spill ink on Swap Powers that a fiduciary holds in Treas. Reg. Sec. 1.675-1? It's the last sentence of this regulation that usually prevents the IRS from ruling on whether a Swap Power is exercisable in a non-fiduciary capacity because it's a facts and circumstances test.⁴¹

Third party holders of the Swap Power.

Note that neither Rev. Rul. 2008-22 nor Rev. Rul. 2011-28 apply to a Swap Power held by a third party in a non-fiduciary capacity. Both rulings posited a grantor who possessed the Swap Power. However, the IRS has issued a number of private letter rulings, many involving grantor charitable lead trusts, where a third party Swap Power creates grantor trust status.⁴²

The Treasury Department issued Rev. Procs. 2007-45 and 2008-46 to provide sample forms for charitable lead trusts, the grantor trust versions of the charitable lead trust use a third-party Swap Power to achieve grantor trust status. Given the probably wrongful and unnecessary inclusion of the word *reacquire* from the Clifford Regulations, it would seem untoward to have a third party Swap Power, although the reason why the third party is interposed is to avoid a prohibited transaction. Typically, the Swap Power is unilaterally held either by the grantor or a third party and is effective at all times with no impediments save satisfaction by the trustee of the equivalence in value of the swapped in assets.

Can the Swap Power be conditioned on meeting certain conditions?

Nevertheless, a scrivener can put some conditions on the exercise of a Swap Power, including a notice requirement. Additionally, a scrivener could subject exercise of the Swap Power to an approval of a non-fiduciary, non-adverse person. Note that IRC Sec. 675(4)(C) won't allow a person in a *fiduciary* capacity to veto or refuse the attempted exercise of a Swap Power. However, the section says nothing about

conditioning exercise of the Swap Power to the consent of a non-adverse, *non-fiduciary* third party, so this can be done, which can have some benefits for asset protection. In the Clifford Regulations, as I discussed earlier, the IRS position here is sound.

In addition, allowing a third party to hold the Swap Power could create additional flexibility to “turn off” or to “toggle on” grantor trust status. Maximum flexibility of grantor trust planning often involves restoring grantor trust status to a non-grantor trust that once was a grantor trust or making a trust a grantor trust that has never been one.

[Toggling the Swap Power on and off.](#)

However, it is critical that when the grantor or the grantor’s spouse has the authority to relinquish the power that causes grantor trust status, only a third party should be given the authority to reinstitute the Swap Power, i.e., to toggle back “on” the grantor trust status. Neither the grantor nor the grantor’s spouse should be permitted to toggle grantor trust status back on once it has been toggled off. If the grantor or the grantor’s spouse has the right to relinquish a power that causes grantor trust status but has the right to get the power back, query whether the relinquishment would be given effect. Many of the grantor trust powers must be exercisable without the consent of any adverse party to result in grantor trust status.

However, the power to eliminate or reinstate a grantor trust power could be held by either an adverse party or a non-adverse party. Having the status of an adverse or a non-adverse party is important for the person who holds the power that may make a trust a grantor trust, but that distinction has no relevance for a person who has the authority to eliminate or reinstate that power. Thus, it is possible for a beneficiary to be given the power to toggle on or off grantor trust status.

IRS Notice 2007-73 identifies two rather complicated and highly unusual series of transactions involving toggling of grantor trusts. In each, a grantor trust would be formed that creates a unitrust interest and a noncontingent remainder interest for the grantor. The non-contingent remainder interest causes grantor

trust status. The goal of the scenarios is either to generate a tax loss to the grantor that is not a real economic loss or to avoid the recognition of gain. The Notice states “transactions that are the same as, or substantially similar to, the transactions described in this notice are identified as transactions of interest” that require disclosure.

Uses of the Swap Power

One could attempt to cleanse the taint of IRC Sec. 2036 exposure for family limited partnerships by swapping the remaining partnership interests with the grantor trust. Given the current high applicable exclusion amount for federal transfer tax purposes, it makes imminent sense for death bed planning to utilize the Swap Power to bring low basis assets out of the grantor trust in exchange for cash, other high basis assets or a promissory note so that the grantor will die owning the low basis assets, which will then get a new basis for federal income tax purposes.⁴³

For non-taxable estates, consider swapping out minority interests in entities for high basis assets to eliminate or substantially reduce at least minority interest valuation discounts. The Swap Power also could be used to reconfigure the grantor’s balance sheet to bring the grantor within the ambit of IRC Secs. 303 or 6166. The Swap Power also should be considered for near death swaps to preserve loss. Remember that IRC Sec. 1014 gives a **new basis** at death, but it cuts **both ways**. Basis can and does go down at death unless something is done by swapping the loss assets into the grantor trust, which will preserve the loss.

A caveat about asset protection ramifications on the Swap Power.

In *Steve Leimberg’s Asset Protection Planning E-Mail Newsletter* No. 313 (February 3, 2016), Ed Morrow wrote an exhaustive analysis of the possible “dark side” of Swap Powers. In my opinion, this article is required reading for anyone using a Swap Power. By “dark side,” he meant the potential asset protection and bankruptcy ramifications of the Swap Power if it was to get into the hands of the wrong people, like a creditor or bankruptcy trustee. Ed’s lengthy article is divided into sections. He begins with a general review of the income tax consequences of the Swap Power, beginning with its source: IRC Sec. 675(4)(C).

Ed then examines the federal estate tax consequences of the Swap Power, working from *Jordahl Est. v. Comr.* to the recently issued revenue rulings, 2008-22 and 2011-28, which have clarified the IRS position concerning the estate tax efficacy of the Swap Power. Ed then chronicles the explosion in the use of the Swap Power, particularly after the Congress enacted ATRA in the wee hours of the morning on January 1, 2013. Ed then reviews the many possible uses of the Swap Power in tax planning, from basis planning to preservation of loss basis.

In the next section, Ed commences with a complete analysis of the bankruptcy code and how it impacts the Swap Power, which, frankly, was sobering and scary. Ed then closes with some suggested solutions to the Swap Power conundrum from an asset protection standpoint. These solutions range from parking the Swap Power in the hands of the grantor's spouse or a third party to adding a non-adverse, non-fiduciary consent to the grantor's exercise of the Swap Power, the latter of which is very clever.

[Checklist of items to include in a Swap Power clause:](#)

What follows is a checklist of some items to include in a Swap Power:

When and how exercisable. Expressly permit exercise of the Swap Power via a power of attorney.

Retained power to swap assets.

Proper standard of value.

Whether promissory notes are permitted as swap in assets, and the terms of any such promissory notes and security requirements.

Exercisable in a non-fiduciary capacity without the consent or permission of anyone in a fiduciary position.

Swap must be of assets with an equivalent value within the meaning of IRC Sec. 675(4)(C).

The Swap Power must not be exercised in a manner that may shift benefits among the trust beneficiaries within the meaning of Rev. Rul. 2008-22.

The Trustee must have the power to reinvest the trust corpus and a duty of impartiality with respect to the trust beneficiaries at all times while the Swap Power is in effect.

Cull out from Swap Power powers over life insurance on the grantor's life and voting stock in certain closely-held controlled corporations within the meaning of IRC Sec. 2036(b) if this is of concern. However, another defective power would have to be included so that the *entire* trust would be a grantor trust for federal income tax purposes.

Surrender of Swap Power; effect.

Whether Swap Power is assignable.⁴⁴

Succession of Swap Power holder.⁴⁵

Certification process.

How disputes over equivalent value are to be resolved.

The timing of the swap, i.e., either before or after value is known.

If a taxpayer is concerned about the potential application of IRC Secs. 2036(b) or 2042, a third party might be given a Swap Power with respect to stock of a closely-held family controlled corporation and life insurance. Additionally, a third party might have to hold the Swap Power to avoid a prohibited transaction with a disqualified person, e.g., charitable lead trust situations.⁴⁶

One might also consider a third party for asset protection purposes, and a third party might be the client's spouse, although this isn't a perfect solution either. In addition, allowing a third party to hold the Swap Power could create additional flexibility to "turn off" or "toggle on" grantor trust status, subject to my concerns about toggling discussed elsewhere in the article.

Why wouldn't you want a third party to hold a Swap Power?

The Swap Power seems unlikely to ever be exercised because it would be a wholly taxable transaction, but this fact could make it a perfect power to include if all that is desired is grantor trust status. Additionally, the grantor might want to have the Swap Power personally in case it's ever needed or wanted in the future. If the grantor wanted or needed the property, but the Swap Power was held by a third party, that wouldn't assist the grantor because the Swap Power holder might refuse to act on request, leaving the grantor little recourse other than to sue.

What if this third person Swap Power holder never signs anything and/or agrees to accept the "right to reacquire" or even knows about the power? Is it illusory, or effective regardless? What if this third person is besieged by creditors/files bankruptcy and the receiver/trustee would prefer the assets in the trust? Can the bankruptcy trustee succeed to the grantor's Swap Power and reach assets inside of the trust? Quite possibly, as Ed Morrow discusses.

Burning questions, do's and don'ts for crafting Swap Powers

That follows is a series of questions, do's and don'ts with respect to crafting Swap Powers.

What if the third party dies or is incapacitated?

Does the trust instrument name an adequate backup Swap Power holder?

Do have the promissory note(s) and other assets tendered in the exercise of a Swap Power appraised by an independent qualified appraiser.

Do make the Swap Power exercisable in a nonfiduciary capacity.

Don't give the Swap Power to an adverse party.

Don't give the Swap Power to the trustee.

Do make sure that the Swap Power covers the entirety of trust assets.

If substituting a promissory note for assets of a grantor trust, **do** secure the promissory notes and charge a market rate of interest.

Don't give the Swap Power to a third person, including a spouse, except as necessary as a last resort to attaining grantor trust status.

If a third party holds the Swap Power, **do** have the third party sign an acknowledgment of the grant of authority and accepting that grant.

Do make the Swap Power non-assignable.⁴⁷

Do provide for backup Swap Power holders.⁴⁸

Don't solely rely upon the Swap Power to achieve grantor trust status.

Do build in an exit strategy for the Swap Power.⁴⁹

Does exercise of the Swap Power require *simultaneous* substitution of property of equivalent value?

In *In re Rigoni*, the grantor argued that he had an **absolute right** to substitute the asset without deterrence or delay, and that the trustee's only recourse was to sue for the remaining equivalent value after the fact, a la eminent domain. The trial court rejected this argument, asserting that the Swap Power and the substitution of property of equivalent value pursuant to the Swap Power were "inextricably intertwined," and the appellate court affirmed on this issue. In rejecting the grantor's argument, the appellate court concluded:

In fact, Rigoni's argument would substantially rewrite the substitution clause by essentially causing it to read, "I may substitute any property for trust assets; if the trustee determines that the value of the property substituted was not equivalent, it may seek

additional value afterwards.” We decline to rewrite the unambiguous language of the substitution clause in such a fashion. [Emphasis added]

The *In re Rigoni* courts’ conclusion on this point may be correct. However, see the district court’s opinion in *Benson v. Rosenthal*, discussed *supra.*, in which the district court seems to allow for the significant time delays and valuation uncertainty of a complex exercise of the Swap Power. See also, *Manatt v. Manatt*, *supra.* How should a grantor who seeks to exercise the Swap Power exercise that right? The grantor in *Benson v. Rosenthal* must have believed that the third time was the charm, and, in my opinion, got it right on the third attempt, as the district court’s opinion relates:

On August 24, 2015, after filing suit, the grantor again supplemented the Notice of Exchange in accordance with the valuation adjustment clauses included in the promissory notes. The grantor retained a prominent business appraisal firm to conduct a valuation of the assets that he sought to remove from the trusts as of December 31, 2014 as well as the promissory notes to be substituted into the grantor trusts. This appraiser’s services had been used in the valuation of assets of the trusts on prior occasions and the trustee had relied upon the appraiser in the past. Based on the appraiser’s updated valuation of the trust assets, the grantor delivered to the trustee thirteen new promissory notes of specific values and collateral assignments securing each of those notes.

In *Benson v. Rosenthal*, the district court held that the grantor complied with all of the requirements of the Substitution Provisions of the trusts to effect a substitution on January 24, 2015. The court noted that the trustee must now comply with their obligations under the trusts in confirming the equivalence of value as of that date. The district court seems to be keeping the exchange open until the trustee finishes his examination of the appraisals and evaluation of the 13 secured promissory notes.

Query: does the equivalent value require or in any way mandate that the swapped in assets be similar in *nature or quality* to the swapped out assets? Are promissory notes permissible assets to swap into a grantor trust for hard assets?

Clearly, the answer to the first question is no. Had Congress intended IRC Sec. 675(4)(C) to be so limited, it would have used the like-kind requirement of IRC Sec. 1031. In IRC Sec. 1031, the Congress clearly demonstrated that it well understood the difference between these standards and opted for the more expansive and relaxed standard of equivalent value in IRC Sec. 675(4)(C). But could Congressional use of a new term signal that it required **more similarity** than just dollar value? This is possible. How about similarities in tax attributes, e.g., basis, etc.?

Are promissory notes permissible assets to swap into a grantor trust for hard assets? But does IRC Sec. 675(4)(C) nevertheless have an outside limit on the *types* of property that can be swapped into the grantor trust? The key is the meaning of the all important term “equivalent value,” which I discussed earlier. Whether a promissory note is a proper asset to swap into a grantor trust is a question of applicable state law, but, in my experience, every state of which I’m aware permits promissory notes to be held in trust. However, with that said, not every promissory note will be treated as equivalent value at face value. The differences will be the interest rate and whether it’s commensurate with the risk of default as well as whether the note is secured by collateral.

Multiple simultaneous holders of the Swap Power.

In PLRs 200729006-16, the grantors of the trust each held the Swap Power. How would that have worked in the event of an exercise? The private letter rulings didn’t specifically say whether the Swap Power was a power to be exercised jointly by both unanimously or whether each possessed a **separate and independent** Swap Power. It seems that holding of the Swap Power by more than one person simultaneously is fraught with lots of unknowns and imponderables highly suggestive of litigation. For example, if each held a separate and independent Swap Power, what would happen if each, acting **independently**, exercised the Swap Power over the **same** assets?

How is that dispute resolved, as it is highly doubtful that the Swap Power addressed this scenario, even though one could make a compelling argument that it should have been addressed? First come first served? Would the original contributor get the prior right to reacquire the property? Should they? Why would a couple *each* want the Swap Power? Obviously, the reasons are self-serving and self-preservational.

Nevertheless, unless one is going to address the questions that I laid out above expressly in the Swap Power, I don't endorse the use of jointly and simultaneously held Swap Powers unless unanimity in action is required. And if unanimity is required, is that a permissible condition on the Swap Power, since neither had a unilateral right to the exercise of the Swap Power? At a minimum, the Swap Power should expressly provide that the powers are in fact held in *non-fiduciary* capacities, but the better advice is to avoid jointly held Swap Powers like the plague.

Conclusion.

I've attempted to examine the Swap Power from soup to nuts. While it can be a very helpful grantor trust power, cautious and conservative practitioners *should not solely rely upon the Swap Power* to create and maintain grantor trust status. Because of the plethora of potential problems involved in exercise of a Swap Power, practitioners should spend much more time and attention in drafting the Swap power with a view toward its possible exercise.

Appendix

Comparison of Swap Powers
Five cases involving attempted exercises of swap powers
Suggested Composite Swap Power Clause
L. Paul Hood, Jr.
paul@paulhoodservices.com

Five cases involving attempted exercises of swap powers

Manatt v. Manatt: *10.14 Power to Exchange Assets. During my lifetime, I, acting alone in my individual and not in any fiduciary capacity, shall have the power, with respect to any trust created under this instrument, to reacquire trust assets by substituting other property having an equivalent value herewith; provided, however, that this substitution power cannot be exercised in a manner that can shift benefits among the trust beneficiaries as provided in Rev. Rul. 2008–22. Neither the consent of the trustee nor the consent of any other person shall be required. The power described in this paragraph may be exercised by an agent appointed under a durable power of attorney or through any other means, whose actions shall be conclusive and binding.*

In all events, the trustee shall satisfy himself or herself that the properties acquired and substituted pursuant to this paragraph are, in fact, of equivalent value; and, further the trustee shall ensure that this substitution power is exercised in a manner that cannot shift benefits among the trust beneficiaries as such phrase is used in Rev. Rul. 2008–22. By written instrument delivered to the trustee, I (or an agent appointed under a durable power of attorney) may irrevocably release the power under this paragraph 10.14; and on the first to occur of (a) my death, (b) the expiration of the term beginning on September 1, 2012 and ending on August 31, 2027 and (c) the release of my power pursuant to this paragraph 10.14, my power under this paragraph 10.14 shall terminate and have no further legal force or effect under this instrument.

Schinazi v. Eden: *[The grantor] expressly reserve[d] the right, exercisable in a nonfiduciary capacity without the approval or consent of any person in a fiduciary capacity, during [his] lifetime to reacquire any part or all of the property of any trust created hereunder by substituting property of equivalent value.*

Benson v. Rosenthal: The Swap Power in the 2009 Trusts read as follows:

Notwithstanding any other provision of this agreement to the contrary, the Grantor hereby reserves the right and authority, exercisable in a nonfiduciary capacity and without the approval or consent of any person in a fiduciary capacity, to reacquire or exchange any property of the Trust created hereunder by substituting other property of an equivalent value; however, if this power of substitution is exercised, the Grantor shall certify in writing that the substituted property is of equivalent value to the property for which it is substituted and the Trustee has a fiduciary obligation independently to verify that the properties acquired and the properties substituted by the Grantor are in fact of equal value. Any dispute regarding the value of the substituted property may be resolved in an appropriate court. This power is intended to create grantor trust status under section 675(4) of the Code.

The Substitution Provisions in the 2012 Trusts, although less specific, express an identical power, stating: *Notwithstanding any other provision of this agreement to the contrary, the Grantor hereby reserves the right and authority, exercisable in a nonfiduciary capacity and without the approval or consent of any person in a fiduciary capacity, to reacquire or exchange any property of the Trust created hereunder by substituting other property of an equivalent value. This power is intended to create grantor trust status under section 675(4) of the Code.*

In re Rigoni: *As Grantor, I [Dino Rigoni] do hereby retain the power and right, exercisable only for my personal benefit and only in a non-fiduciary capacity, to reacquire trust assets by substituting property of an equivalent value without the approval or consent of the Trustee or any person acting in a fiduciary capacity. The Trustee shall comply with my written expressed intentions concerning the exercise of this power.*

In re Condiotti: *Notwithstanding any other provision of this instrument . . . to the contrary, [the] settlor, acting in a nonfiduciary capacity and without the approval or consent of any person acting in a fiduciary capacity, reserves the power to reacquire the trust corpus by substituting other property of an equivalent value.*

Annotated Swap Power Provision⁵⁰

Article __

A. Swap Power.

- 1. General Grant.** Until renounced by the grantor or removed by [INDICATE WHO HAS THE REMOVAL POWER] [INCLUDE IF POWER TO RESTORE GRANTOR TRUST STATUS IS USED unless subsequently restored as provided herein,⁵¹] the grantor [OR THIRD PARTY WHO HAS THE SWAP POWER] shall have a non-assignable right and power of administration pursuant to Code Section 675(4)(C), exercisable in writing at any time solely in a non-fiduciary capacity without the need for consent or approval by anyone in a fiduciary capacity pursuant to the exercise procedure set forth hereinbelow [OR ANYONE ELSE⁵²/BUT SUBJECT TO THE VETO POWER OF [NAME/S], acting in a non-fiduciary capacity,] to cause the Trustees to transfer some or all of the Trust assets of the choosing of the grantor [OR POWERHOLDER][INCLUDE IF THERE ARE EXCLUDED ASSETS that are not Excluded Assets (as defined hereinbelow)] to the grantor in exchange for assets of equivalent value within the meaning of Code Section 675(4)(C) (“Swap Power”). The Swap Power may be exercised by an agent appointed by the grantor/powerholder⁵³ under a durable power of attorney or through any other means, whose actions shall be conclusive and binding.⁵⁴
- 2. Valuation.** For purposes of the Swap Power, the term “equivalent value” shall have the same meaning given that term in Code Section 675(4)(C), which shall not in any case be less than fair market value as finally determined for federal estate and gift tax purposes.⁵⁵
- 3. Certification and Delivery.** Without reducing or eliminating the fiduciary duties imposed on the Trustees herein or by applicable law, the grantor [OR THIRD PARTY POWERHOLDER] shall exercise the Swap Power only by certifying in writing that the property proposed to be transferred by the grantor to the Trustees pursuant to the grantor’s exercise of the Swap Power and the Trust property for which it is being substituted are of equivalent value (as defined hereinabove)

pursuant to the procedure set forth below, and, on the effective date of the transfers, the grantor shall provide the Trustees with the appropriate deeds, assignments or other evidence of property ownership and transfer of the assets to be substituted into the Trust, together with current written qualified appraisals by a qualified, independent appraiser (all within the meaning of Treas. Reg. Sec. 1.170A-17), even for promissory notes sought to be substituted into the Trust.

4. **Promissory Notes; Valuation; Security Required.** If the grantor seeks to substitute promissory notes for property of the Trust, the promissory notes shall be secured by adequate security equal to at least 110% of the fair market value of the property to be substituted out of the Trust for the promissory note.⁵⁶ Said promissory notes shall bear interest at a current market rate (not merely the applicable federal rate)⁵⁷ for the risk that an unrelated third party debtor would pay and, if contemporaneous appraisals have not been provided, shall be adjustable by formula to ensure equivalence of value with the value of the property to be substituted out of the Trust as defined hereinabove.⁵⁸ [SPELL OUT MINIMUM REQUIREMENTS FOR NOTES-TERM, PAYMENTS BEFORE MATURITY, AND SECURITY]
5. **Effective Date.** The effective date of consummation of the Swap Power exchange shall be as of the date of written certification of substitution, and the risk of loss pre-consummation immediately passes⁵⁹ to the grantor and the Trustees, respectively.⁶⁰
6. [USE IF A THIRD PARTY IS THE POWER HOLDER **Successor Holders.** If there is a vacancy in the office of holder of the Swap Power, then [INSERT NAME/S OR A METHOD FOR SELECTING A SUCCESSOR POWER HOLDER] shall immediately be the power holder, effective upon the vacancy creation.

B. **Assignment Prohibited.** The grantor's Swap Power is not assignable; any attempted assignment by the grantor of the Swap Power shall render the Swap Power absolutely null and void and of no further legal effect.⁶¹

[C.] **[Excluded Assets.** The term "Excluded Assets" shall mean (a) any shares of the voting stock of any corporation in which the grantor owns, directly or indirectly, including ownership by attribution under Code Section 318, the right to vote stock constituting at least twenty percent (20%) of the total combined voting power of all classes of the said corporation's stock; and (b) all policies of life insurance insuring the grantor's life. INSERT IF WORRIED ABOUT IRC SECS. 2036(b) or 2042]⁶²

D. Exercise Procedure.

1. **Notice.** The grantor must exercise the Swap Power only in writing by certifying that the property to be transferred by the grantor to the Trustees pursuant to the grantor's exercise of the Swap Power is equivalent value (as defined hereinabove) to the assets sought to be transferred out of the Trust and must deliver said notice of exercise of the Swap Power to each of the Trustees.
2. **Timing.** [Except as provided below, INCLUDE IF 3 IS ADDED] [I]n his written exercise of the Swap Power, the grantor hereby is authorized to determine the occurrence and timing of any such proposed exchange of assets required thereby.
3. **[Delay in Effective Date of Swap.** Unless the grantor and trustee mutually agree otherwise, the effective date of the Swap Power exchange shall occur not less than [NUMBER OF DAYS IN WORDS (NUMBER OF DAYS EXPRESSED AS A NUMBER) days following the date of written notice of the grantor's exercise of the Swap Power.]⁶³

E. Trustees' Duties Regarding Exercise of the Swap Power.

1. **Fiduciary Duty.** The Trustees shall have the sole and absolute right and fiduciary duty to satisfy themselves that the assets proposed to be transferred to the Trustees as a result of the grantor's exercise of the Swap Power are of equivalent value (as defined hereinabove) to the assets being transferred out of the Trust.
2. **Court Instructions, etc.** In the exercise of the Trustees' fiduciary duty to the beneficiaries to satisfy themselves that the value of the assets being transferred to the Trustees pursuant to the grantor's exercise of the Swap Power are equivalent in value as defined hereinabove, the Trustees may, but are not required, to seek instructions from a proper court or to take any other actions in response to the grantor's exercise of the Swap Power that the Trustees feel are necessary or appropriate to protect the interests of the Trust beneficiaries, including, without limitation, alternative dispute methods such as mediation or arbitration.
3. **Immediacy.** [Except as otherwise provided herein,]⁶⁴ [T]he Trustees' duty to satisfy themselves of equivalent value (as defined hereinabove) being exchanged pursuant to the grantor's exercise of the Swap Power shall include neither a veto power over the grantor's exercise of the Swap Power nor any advance consent requirement as a condition of exercise and consummation of the substitution pursuant to the Swap Power.
4. **Equivalent Value Requirement.** The Trustees shall have a fiduciary obligation to ensure the grantor's compliance with the terms of the Swap Power by being satisfied that the properties acquired and substituted are in fact of equivalent values as defined hereinabove.

F. Limitations on the Grantor's Exercise of the Swap Power.

1. **No Shift of Benefits.** The grantor's exercise of the Swap Power shall not be exercised in a manner that could in any way shift benefits among the Trust beneficiaries within the meaning of Revenue Ruling 2008-22 and all subsequently issued rulings or caselaw.
2. **Duties and Powers.** Without limiting the foregoing prohibition upon shifting benefits among Trust beneficiaries, the Trustees shall have the power to reinvest the principal of the Trust and [ADD IF IT IS A MARITAL TRUST], except in the case of a Marital Trust,) the duty of impartiality with respect to Trust beneficiaries at all times while the Swap Power is in effect, unless the Trustees shall have absolute discretion in making distributions of principal and income among the Trust beneficiaries so that the power to reinvest the principal of the Trust and the duty of impartiality are not required in order to avoid the Swap Power potentially causing a shift of benefits among Trust beneficiaries, all within the meaning of Revenue Ruling 2008-22 and all subsequently issued rulings or caselaw.
3. **Power to Resist Certain Swap Powers.** The Trustees shall wholly disregard and shall resist any attempt to exercise the Swap Power if the Trustees reasonably believe that such exercise of the Swap Power would shift benefits among the Trust beneficiaries.

G. Removal and Recreation of Swap Power.⁶⁵

1. **Cancellation; Re-Grant.** [INDICATE WHO HOLDS THIS POWER HERE] may cancel the Swap Power at any time and for any reason by a writing delivered [USE IF A THIRD PARTY IS THE HOLDER OF THE SWAP POWER to the grantor and] to the Trustees, designating the effective date of cancellation; provided, however, that [INDICATE WHO HOLDS THIS POWER HERE, WHICH SHOULD NOT BE EITHER THE GRANTOR OR FORMER HOLDER OF THE SWAP POWER OR THE SPOUSES OF EITHER] may re-grant the Swap Power only to the grantor or to the grantor's spouse at any time and for any reason, by a writing delivered to the grantor, with a copy to each Trustee and to each then-living adult beneficiary of the Trust, designating the effective date of the re-grant of the Swap Power. All re-grants of the Swap Power and any attempted exercise of the re-granted Swap Power shall be subject to this Article [INDICATE NUMBER]
2. **Alternate Holders of Cancellation and Re-Grant Powers.** If [INDICATE WHO HOLDS THIS POWER HERE] shall be or become unwilling or unable to serve under this Article, [INDICATE WHO HOLDS THIS POWER HERE] shall hold and exercise the powers of cancellation and re-grant of the Swap Power. If both named persons are unable or unwilling to serve under this article, the grantor shall name as the holder of this power an individual who is neither related nor subservient to the grantor or the grantor's spouse, as defined in Code Section 672(c), who shall immediately succeed the holder of this power upon a vacancy in the office of power holder.

Swap Power Private Letter Rulings of Interest

PLR 200846001-approved the exercise of a swap power that determined value of shares exchanged using "mean between highest and lowest quoted selling prices" on day of the swap.

PLR 200842007-determined that the exercise of a swap power was not taxable because the trust was a wholly grantor trust under IRC Secs. 675(4)(C) and 677.

PLR 200514002-a trust instrument providing that the grantor's swap power did not extend to stock of a controlled corporation was approved.

PLR 200603040-concluded that the swap power would not cause estate inclusion under IRC Secs. 2033, 2036(a), 2036(b), 2038, or 2039 because the trust instrument provided that the grantor's swap power could be exercised only in a fiduciary capacity.

PLR 200434012-third parties as swap power holders for a stock sale.

PLRs 9253010; 9419990; 800237023; 9227013; 9413045; 8808018; 200010036; 9642039; 9224029; 9247024; 9037011; 9713017; 9810019; 9713017 (provided for backup swap power holders); **9407014; 200434012; 200010036; 199908002; 9810019; 9713017; 9642039 9247024**-Third party holder of the swap power for a charitable lead trust.

PLR 201730018-conversion of non-grantor trust to grantor trust.

PLRs 201216034 and 200546054-Primary beneficiary given swap power.

PLRs 9352017; 9345035; 9248016; 9239015; 9416009; 9352004; 9351005; 200001015; 200001013; 9239015; 9352007; 9525032-Grantor given swap power over a GRAT, some of which were holding stock in S corporations.

PLRs 200449029 and 9037011-Swap power given to trustees.

PLRs 200845015; 9253010; 9239015; 9418024; 9416009; 9352004; 9227023; 9335028; 8932063; 9227013; 9645013; 9337011; 9351005; 199942017; 200729016; 8801008; 200729005; 9227013; 199908002; 9504024 (provided for release of swap power) 9126015 (beneficiary held swap power and had backup swap power holders)-Swap powers to hold S corporation stock.

PLR 8930021-Trust modification to add swap power to make the trust a valid S corporation shareholder.

PLRs 200729006-16-Jointly held Swap Powers (ruling is silent as to whether the powers were jointly held or whether each had a separate and independent Swap Power.

PLR 9525032-Grantor held swap power and had the right to borrow the trust assets without adequate security to make a GRAT a wholly grantor trust.

PLR 201730018-conversion of trust to grantor trust for charitable lead trust.

PLRs 199927010; 200404009; 9808031-negating grantor trust status.

PLR 9548013-IRS ruled that existence of a swap power made grantor trust holding S corporation stock but does not trigger inclusion under IRC Sec. 2038(a); swap power assignable.

PLR 9318019-IRS declined to rule on whether amending GST Tax “grandfathered” trust to give the grantor a swap power would cause loss of GST Tax grandfathered status, or whether it would create estate tax exposure to the grantor.

200408015-Culled out life insurance policy from swap power.

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² George Horace Lorimer, *Letters from a Self-Made Merchant to His Son* (1902).

³ See, e.g., Walter Q. Impert, "A Review of Grantor Trusts," *ABA Real Property, Probate & Trust Journal*, Fall 2014; and Stephen R. Akers, Jonathan G. Blattmachr and F. Ladson Boyle, "Creating Intentional Grantor Trusts," *ABA Real Property, Trust & Estate Journal*, Vol. 44, No. 2, Summer 2009; and Samuel A. Donaldson, Understanding Grantor Trusts, in *40 Heckerling Institute On Estate Planning 2-1* (Tina Portuando ed., 2006).

⁴ If you hear of another case, please e-mail it to my attention at paul@paulhoodservices.com.

⁵ We make no representations or warranties about the annotated swap power, which is offered purely for academic purposes.

⁶ See, e.g., PLR 200011012-Grantor as holder of the swap power for a grantor charitable lead annuity trust, even though the grantor's exercise of the swap power would be considered an act of self-dealing.

⁷ Of course, the former IDGT assets will receive a fair market value basis (not always a stepped up basis-basis can and does step down-hat tip-the late Edward B. Benjamin, Jr., Esq.) at the grantor's death, thereby potentially eliminating or reducing gain on subsequent sale by the grantor's estate or beneficiaries.

⁸ See, e.g., Rev. Rul. 2007-13.

⁹ Strained relations, as we will see, is a recurring theme of the Swap Power caselaw.

¹⁰ However, see PLR 9037011, where the trustee held the Swap Power.

¹¹ Such a use might reduce exposure to an exercise of a Swap Power that was the product of coercion or undue influence. See, e.g., *Manatt v. Manatt*, 2018 WL 3154461 (S.D. Iowa May 2, 2018) and *Benson v. Rosenthal*, Civil Action No: 15-782 Section: "H"(2) (E.D. La. Nov. 10, 2016)). See also PLRs 9437022, 9227013, and 8823112. This is not required because IRC Sec. 675(4)(C) only prohibits interference by someone acting in a *fiduciary* capacity and does not prohibit a veto power being given to someone acting purely in a *non-fiduciary* capacity, and its inclusion limits flexibility, so I do not recommend it. However, some clients may feel more comfortable with its inclusion.

¹² See, e.g., PLRs 200729006-16.

¹³ Sec. 219(g) and (h).

¹⁴ 309 U.S. 331 (1940).

¹⁵ Treas. Reg. Sec. 39.22(c)(ii).

¹⁶ Treas. Reg. Sec. 39.22(e)(1)(iv).

¹⁷ See, e.g., PLRs 9810019 and 201730017.

¹⁸ In PLR 200846001, the IRS National Office approved an exercise of a Swap Power by taking the mean between the high and low of the value of the stocks being substituted. The ruling used a fair market value analysis, as follows: "Based on the facts presented and the representations made, we conclude that the exercise by Grantor of the power of substitution will not constitute a gift to Trust for gift tax purposes if the total fair market value of assets transferred to Trust equals the total fair market value of assets transferred from Trust."

¹⁹ *In re Rigoni*, 2015 WL 4255417 (unpublished opinion, App. Mich. July 14, 2015).

²⁰ No. 14CA0969 (Col. App. July 9, 2015 unpublished opinion).

²¹ 2015 WL 4255417 (unpublished opinion, App. Mich. July 14, 2015).

²² Civil Action No. 15-782, 2016 WL 2855456 (E.D. La. May 16, 2016).

²³ 338 Ga. App. 793, 792 S.E.2d 94 (App. Ga. 2016).

²⁴ Docket No. 4:17-CV-00378-JEG (S.D. Iowa May 2, 2018).

²⁵ Civil Action No. 15-782, 2016 WL 2855456 (E.D. La. May 16, 2016).

²⁶ Treas. Reg. Sec. 1.671-3(b)(3).

²⁷ 65 T.C. 92 (1975).

²⁸ 65 T.C. 92 (1975), acq. 1977-2 C.B. 1.

²⁹ Rev. Rul. 85-13.

³⁰ PLRs 200842007 (no gain recognized on grantor's exchange of equivalent assets when grantor owned entire trust under Sec. 677); and 200846001 (no gain recognized on grantor's exchange of equivalent assets when grantor owned entire trust under Section 674(a)).

³¹ See IRC Sec. 1001.

³² See PLRs 201216034 and 200546054.

³³ See, e.g., PLRs 201216034 and 200546054.

³⁴ Treas. Reg. Sec. 1.675-1(b)(4)(iii).

³⁵ PLRs 200449029 and 9037011.

³⁶ cf. *Jordahl Est. v. Comr.* See, e.g., PLR 200842007 (trust property that grantor could substitute for assets of equivalent value not included in grantor's gross estate under IRC Secs. 2033, 2036, 2038, or 2039, where grantor held power in a fiduciary capacity.); PLR 200606006 (the IRS held that IRC Sec. 2036 would not apply to a situation in which the grantor held the Swap Power in a fiduciary capacity.) PLR 200603040 (Concerned a trust with a Swap Power where "[t]he instrument provides that Grantor's power to acquire Trust property under this section may only be exercised in a fiduciary capacity" where the taxpayer got a favorable ruling on grantor trust status.)

³⁷ 338 Ga. App. 793, 792 S.E.2d 94 (App. Ga. 2016).

³⁸ 735 F.2d 704 (2d Cir. 1984), rev'g 574 F. Supp. 19 (D.C. Conn. 1983), nonacq. 1985-13, 1985-1 C.B. 184.

³⁹ But see PLR 200846001-The IRS approved the exercise of a swap power that determined value of shares exchanged using "mean between highest and lowest quoted selling prices" on day of the swap.

⁴⁰ For an excellent article on a method of valuing the swapped in promissory note, see Samuel S. Nicolls, "The Perils of the "Power of Substitution" for "Intentionally Defective" Grantor Trusts," Insights (a publication of Willamette Management Associates), Spring 2018.

⁴¹ See, e.g., PLRs 200709012, 200709011, 200434012, 200022028, 200022018, 200010036, 9810019 and 9648045.

⁴² See, e.g., PLR 200434012, 200010036, 199908022, 9810019, 9713017, 9642039, 9247024, 9126015, and 9037011.

⁴³ IRC Sec. 1014.

⁴⁴ Ed Morrow, *Steve Leimberg's Asset Protection Planning E-Mail Newsletter* No. 313 (February 3, 2016).

⁴⁵ See, e.g., PLR 9713017.

⁴⁶ See, e.g., PLR 200011012.

⁴⁷ Ed Morrow, *Steve Leimberg's Asset Protection Planning E-Mail Newsletter* No. 313 (February 3, 2016).

⁴⁸ See, e.g., PLR 9713017.

⁴⁹ See, e.g., *Millstein v. Millstein*, 110 N.E.3d 674 (8th Dis. App. 2018), 2018-Ohio-1204, 2018 Ohio 2295.

⁵⁰ © L. Paul Hood, Jr. 2019. No representations or warranties are made about any aspect of this form.

⁵¹ All grantor trust provisions should have an exit strategy built in to prevent a *Millstein v. Millstein*: 110 N.E.3d 674 (8th Dis. App. 2018), 2018-Ohio-1204, 2018 Ohio 2295. situation, because if the grantor cannot get out of grantor trust status, he may well have a claim for professional negligence against the trust scrivener.

⁵² See, e.g., *Manatt v. Manatt*, 2018 WL 3154461 (S.D. Iowa May 2, 2018 and *Benson v. Rosenthal*, Civil Action No: 15-782 Section: "H"(2) (E.D. La. Nov. 10, 2016)). This is not required because IRC Sec. 675(4)(C) only prohibits interference by someone acting in a fiduciary capacity and does not prohibit a veto power being given to someone acting purely in a non-fiduciary capacity, and its inclusion limits flexibility, so I do not recommend it. However, some clients may feel more comfortable with its inclusion.

⁵³ Such a power should be express.

⁵⁴ See, e.g., *Benson v. Rosenthal*, Civil Action No: 15-782 Section: "H"(2) (E.D. La. Nov. 10, 2016).

⁵⁵ The term "equivalent value" is only used once in the Internal Revenue Code of 1986. The equating of equivalent value and fair market value, with fair market value as finally determined for federal estate and gift tax purposes being the floor of value, in order to prevent a gift. See also PLR 200846001, which used the fair market value rules for determining the price of substituted publicly traded common stock. In *Dino Rigoni Intentional Grantor Trust for the Benefit of Christopher Rajzer*, 2015 WL 4255417 (unpublished opinion, Court of Appeals of Michigan July 14, 2015).the court agreed with the trustee's appraiser, who concluded that fair market value was the incorrect standard of value because the trustee was not a willing seller, so fair value was the proper standard of value.

⁵⁶ Adequate security is intended to protect the trust and forestall an argument that a gift was made by the exercise of the Swap Power.

⁵⁷ *In re Matter of Condiotti*, No. 14CA0969 (Col. App. July 9, 2015 unpublished opinion).

⁵⁸ The grantor's first attempt to exercise the Swap Power actually used defined value notes.

⁵⁹ Important for insurance and liability purposes.

⁶⁰ *Benson v. Rosenthal*, Civil Action No: 15-782 Section: "H"(2) (E.D. La. Nov. 10, 2016).

⁶¹ *Steve Leimberg's Asset Protection Planning E-Mail Newsletter* No. 313 (February 3, 2016), Ed Morrow wrote an exhaustive analysis of the possible "dark side" of swap powers. By "dark side," he meant the potential asset

protection and bankruptcy ramifications of the swap power if it was to get into the hands of the **wrong people**, like a creditor or bankruptcy trustee. But see PLR 9548013, where the Swap Power was assignable, which I do not recommend.

⁶² See, e.g., PLRs 200514002 and 200408015.

⁶³ Use if you want to delay the actual substitution.

⁶⁴ Add bracketed language if there is a delay in the effectiveness of the consummation of the substitution under the Swap Power.

⁶⁵ The whole area of toggling grantor trust status off should be safe and actually is encouraged to be a part of every grantor trust provision. However, the restoration of a swap power is much riskier. I advise extreme caution, and don't vouchsafe the re-grant power in the hands of the original holder of the Swap Power or his or her spouse. The IRS has been sniffing around the toggle idea and issued Notice 2007-73 to stop a transaction type involving a grantor trust and toggling. It is now a transaction of interest to the IRS, which requires disclosure on tax returns. However, in my opinion, the notice doesn't cover all attempts to toggle grantor trust status on and off.