What is a Grantor Trust, and When Do You Need an EIN?

Tax intensive
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Income Taxation of Trusts

• Gross earnings of more than $600 per year or any taxable income
• Depends on explicit terms of the trust
• Revocable or irrevocable trust
• Who is the taxpayer?
  – Grantor
  – Trust
  – Beneficiary

Types of Trusts for Income Tax Purposes

• Form 1041 is the tax return for Trusts
• Form 1041 requires an Employer Identification Number, EIN. (Also called Taxpayer Identification Number, TIN)
• Trust types listed on Form 1041 include:
  – Simple Trust
  – Complex Trust
  – Qualified Disability Trust
  – Grantor type trust

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Simple Trust

- All income required to be distributed to the beneficiary

- Examples:
  - Marital Trust
  - Trust holding subchapter S stock

Complex Trust

- Distribution of income discretionary with Trustee

- Examples:
  - Special needs trust
  - Trust for minor child

Income Tax Rates for Trusts 2015

- Income tax rates for estates and trusts in 2015:

<table>
<thead>
<tr>
<th>If Taxable Income Is:</th>
<th>The Tax Is:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not over $1,000</td>
<td>15% of the taxable income</td>
</tr>
<tr>
<td>Over $1,000 but not over $5,000</td>
<td>$150 plus 20% of the excess over $1,000</td>
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<tr>
<td>Over $5,000 but not over $7,000</td>
<td>$1,150 plus 28% of the excess over $5,000</td>
</tr>
<tr>
<td>Over $7,000 but not over $12,000</td>
<td>$2,010 plus 30% of the excess over $7,000</td>
</tr>
<tr>
<td>Over $12,000</td>
<td>$4,310 plus 35% of the excess over $12,000</td>
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<tr>
<td></td>
<td>+ 3.8% Medicare Surtax</td>
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Qualified Disability Trust

- Distribution of income discretionary with Trustee
- Must be for a disabled beneficiary
- Described in IRC § 642(b)(2)(C)(i) and (ii)
- Complex trust with higher exemption
- Example:
  - Testamentary Special Needs Trust

History of Grantor Trust Status

- The present rules were enacted by Congress in 1954 to stem abuses by high income taxpayers who were shifting income to beneficiaries in much lower brackets and yet retaining the benefit of the assets
- Helvering v. Clifford, 309 U.S. 331 (1940) was the foundation of the current rules. The Court held that the income was taxable to the grantor of the trust.
- Treasury adopted so-called “Clifford Regulations” in 1946

Grantor as Owner of Trust Property

- IRC § 671
  1. Income taxed to Grantor
  2. As if the trust did not own the corpus
  3. Pertains to any trust property that the Grantor “owns”
Who is the Grantor?

- Treas. Reg. § 1.671-2(e)(1)
  1. A person who creates a trust; or
  2. A person who makes a gratuitous transfer to a trust, directly or indirectly
  3. Grantor must be alive

What Creates Ownership in the Grantor?

- Reversionary interest in grantor; IRC § 673
- Power to control beneficial enjoyment; IRC § 674
- Power to revoke; IRC § 676
- Income for benefit of grantor; IRC § 677
- Certain administrative powers; IRC § 675:
  - Power to dispose of corpus for less than fair market value
  - Power to borrow from the trust at lower than market rate
  - Power not to repay loan from the trust by end of tax year
  - Power of administration in a non-fiduciary capacity
    - Power to vote stock
    - Power to direct investments
    - Power to reacquire trust assets by substituting other property of equal value

Adverse Parties can Change Grantor Trust Status

IRC § 672

- Adverse Party: 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.
- Example: Grantor retains the power to change beneficiaries of the trust, but such change requires the approval of a beneficiary who has a general power of appointment over the trust. Not a grantor trust.
- Certain powers cannot be abrogated by an adverse party
  Ex. Administrative powers under IRC § 675
Advantages of Grantor Trust Status

- Income tax on earnings of trust assets paid by Grantor
- Transfer to trust not treated a completed gift from Grantor, so no gift tax issues
- No need for Crummey powers for transfers to trust
- Basis of transferred assets remains the same as in hands of Grantor
- Any capital gain from sale of assets by trust taxed to Grantor

Grantor type trusts with the EIN of the Grantor

- Treas. Reg. § 301.6109-1(a)(2) provides that a grantor trust treated as owned by a single person under the grantor trust rules does not need to obtain an EIN, if the trustee furnishes the name and Social Security number of the grantor and the address of the trust to all payers of income to the trust.

  - Examples: GRAT; QPRT; d(4)(A) SNT; QSF; Income Only Trust

Reasons for Separate EIN for Trust

- Grantor is deceased
- Adverse party obtains a power to defeat grantor trust status
- Not drafted as a grantor trust
- Clear demarcation of ownership of assets
- Institutional holder of trust insists on EIN
- Required by IRS: ABLE accounts; Qualified Subchapter S Trusts
Intentionally Defective Grantor Trust (IDGT)

- Grantor Trust status obtained using a power not affected by adverse party
- Grantor is not the Trustee and retains no other powers to control trust assets
- Gifts to IDGT are completed gifts
- Gifts to IDGT not included in Grantor's taxable estate
- IDGT can have its own EIN

Obtaining an EIN for the Trust

- Form SS-4 used to obtain EINs
- Page 4 of the SS-4 instructions regarding EINs for trusts states "Do not file this form for certain grantor-type trusts. The Trustee does not need an EIN for the trust if the trustee furnishes the name and TIN of the grantor/owner and the address of the trust to all payers."

Grantor type trusts with an EIN different than the Grantor

First option

- Form 1041 instructions provide two options when the grantor trust with one Grantor has an EIN other than that of the Grantor. The first is an attachment to Form 1041.
  - Fill in only the entity information on Form 1041 and no dollar amounts. Do not use Schedule K-1.
  - On an attachment, give the name, Social Security number and address of the Grantor.
  - Report the income and deductions in the same detail as would be used on the Grantor's 1040.
  - The Grantor must report all trust income on his or her own 1040.
Grantor type trusts with an EIN different than the Grantor

Second option

- The Trustee must give all payers of income the EIN of the trust.
- The Trustee must file 1099s with the IRS to report income paid to the trust during the tax year with the trust as payer and the Grantor as payee. A separate 1099 is required for each item of income. The 1099s must be filed by March 2 of the year following the tax year.
- The Trustee must provide to the Grantor a statement that shows all income and deductions of the trust and explain how to report these items on the Grantor’s 1040, and must inform that Grantor that those items must be reported.

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Grantor type trusts with an EIN different than the Grantor

- The Trustee can switch methods of reporting using the Form 1041 from one year to the next.
- If the Trustee had filed the Form 1041 previously, it can file a Final Form 1041 stating that it is for a grantor trust, and use an optional reporting method in the future.

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EINs for Special Needs Trusts

- Non grantor special needs trusts must have an EIN and file Form 1041
- Trust or beneficiary pays income tax

Examples:
- Testamentary special needs trust
- Qualified disability trust
- Non grantor third party special needs trust
Grantor Special Needs Trusts

- Grantor special needs trusts do not have to have an EIN separate from the Grantor
- Grantor pays income tax
Examples:
  d(4)(A) trusts
  Grantor third party settled trusts

Conclusion

There is not clear cut advice from the IRS about when to use an EIN separate from the Grantor’s TIN for a trust. One must look at the terms of the trust to understand whether the Grantor is the taxpayer or not. If it is a grantor trust with a single Grantor, the trustee may not need to apply for a separate EIN. If it is not a grantor trust, the trust will need a separate EIN. But, if it is a grantor trust, but has a separate EIN, an informational Form 1041 can be filed using an attachment to show that income is to be reported by the Grantor separately from the Form 1041, or the Trustee can file 1099s using the Grantor’s TIN with the IRS in lieu of the Form 1041.

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