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

Presenter:
Nell Graham Sale
Attorney at Law, Pregenzer, Baysinger, Wideman & Sale
Albuquerque, NM

- Materials
- PowerPoint

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Nell Graham Sale

2424 Louisiana Blvd NE, Suite 200
Albuquerque, NM 87110
(505) 872-0505 (Ph)
(505) 872-1009 (f)
ngsale@pbwslaw.com
www.pbwslaw.com
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Income Taxation of Trusts

The story of grantor trusts begins with an explanation of the income taxation of trusts. There are three ways that income earned by a trust can be described. The three types of income in trusts are: “trust accounting income” as defined in Treas. Reg. §1.643(b)-1; “income” as defined in Treas. Reg. §1.671-2(b); and “distributable net income” as defined in Treas.Regs. §§1.652(a)-1 and 1.661(a)-2. Trust accounting income is all of the earnings of the trust which may or may not be distributed. Trust accounting income is akin to “gross income” in that it is the total of everything that is earned by the trust assets, which may include interest, dividends and capital gain.\(^1\) Income is the earnings of the trust which are attributed for income tax purposes to the trust, the beneficiary or the grantor. It can be understood as “taxable income.”\(^2\) Distributable net income is the calculation of what has been distributed by the trust during the tax year. Distributable net income is a deduction against the taxable income of the trust. It may represent the value of principal that was distributed by the trust. A distribution of principal that is less than or equal to the accounting income of the trust will “drag out” the equivalent value of income earned.\(^3\) Distributable net income is reported as distributed to the individual taxpayer as income, and that taxpayer must report the distribution as income.

Federal income taxation of trusts depends initially on whether a trust is categorized as a “grantor trust,” in which the taxable income is attributed to the “grantor” of the trust, or a “non grantor trust,” which is all other trusts. The provisions in the Internal Revenue Code (“Code”)

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\(^1\) Treas. Reg. § 1.643(b)-1.
\(^2\) Treas. Reg. § 1.671-2(b).
pertaining to taxation of non grantor trusts are found in Chapter J, Sections A through D, and the provisions in the Code pertaining to grantor trusts are found in IRC §§ 671 to 678. A non grantor trust has its own employer identification numbers (“EIN”) and if the trust earns any taxable income or gross income of more than $600, it must file an income tax return each calendar year using Form 1041.

On the Form 1041, a trust may be identified as either a simple trust or a complex trust. A simple trust is one which distributes all of the income in a tax year. A complex trust is every other kind of trust other than a simple trust. A complex trust, for example, could be a discretionary trust, where distributions of income and principal are discretionary with the trustee. In a given year, the trustee of a discretionary trust may decide to distribute all of the income to the beneficiary. In that particular tax year, the trust would be a simple trust. However, in the following tax year, the trustee may decide to retain some of the income and reinvest it. In that tax year, the trust would be a complex trust. A qualified disability trust is a complex trust with a disabled beneficiary. Non grantor special needs trusts are generally complex trusts, because they would never be drafted to have a mandatory distribution of income each year. However, if all income were distributed, the special needs trust could be a simple trust for that tax year, and it could also be a qualified disability trust.

Trusts, like individual taxpayers, may take deductions against trust accounting income. The primary deduction and usually the largest deduction is distributable net income. The trust uses the amount of income that has been distributed as a deduction against its own taxable income. Consider the trust as a funnel and you can see that the income that it keeps is the amount that it brings in minus the amount that it sends out. The calculation of distributable net

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3 IRC § 651; IRC § 661.
4 IRC § 651.
income is too complex for our purposes here. However, it needs to be noted that even if the trust does not distribute trust accounting income, but instead distributes an item of principal, such as real estate, to the extent that the value of the principal that was distributed is more than or equal to the trust accounting income, the trust will report a distribution of all of its income.\(^5\) The beneficiary of the item of principal will ordinarily receive a Schedule K-1 from the trustee reporting that the beneficiary received income even if the beneficiary did not receive any cash. This is how distributable net income works. The amount of distributable net income can be reduced by deducting expenses of the trust, such as administrative expenses or fiduciary fees.

Trusts, like individuals, have exemptions against taxable income. A simple trust, one which distributes all of its income, may take an exemption of $300 per year.\(^7\) Therefore, the trust may report that it distributed all but $300 of its income, and reduce its taxable income to zero with the exemption. This saves the taxpayer $300 in reportable taxable income. Complex trusts have an exemption of $100.\(^8\) Qualified disability trusts may use the amount of the personal exemption of the beneficiary as the exemption amount of the trust.\(^9\)

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5 IRC § 661.
6 IRC § 652.
7 IRC § 642(b).
8 IRC § 642(b)(2)(A).
9 IRC § 642(b)(C)(i).
Trusts have the same tax rates as individuals. However, the tax brackets of trusts are highly compressed. For example, in 2015, a trust will pay the highest rate of 39.6% on taxable income over $12,300.\textsuperscript{10} Consequently, a trustee of a complex trust will want to carefully consider the income tax consequences of retaining income in the trust, because more dollars will be paid in income tax by the trust than by an individual taxpayer on the same amount of income. Furthermore, as of January 1, 2013, the Health Care and Education Reconciliation Act of 2010 imposed a Medicare surtax of 3.8% on taxpayers who are in the highest federal income tax bracket, which in 2015 is 39.6%.\textsuperscript{11} This rate is imposed on income calculated under a new method called Modified Adjusted Gross Income (“Modified AGI or MAGI”). MAGI is defined as adjusted gross income (“AGI”) increased by the excess of (a) the amount excluded from gross income under IRC § 911(a)(1), over (2) the amount of any deductions taken into account in computing AGI or exclusions disallowed under IRC § 911(d)(6) with respect to the amounts described in the previous paragraph (1).\textsuperscript{12} MAGI includes tax exempt income and Social Security income not otherwise included in AGI. Individual taxpayers who have MAGI over $200,000 will pay the Medicare surtax. Estates and trusts, other than charitable trusts, are subject to this surtax on the lesser of undistributed net investment income or the excess of AGI in

\begin{table}[h]
\centering
\begin{tabular}{|l|l|}
\hline
\textbf{2015: If Taxable Income Is:} & \textbf{The Tax Is:} \\
\hline
Not over $2,500 & 15% of the taxable income \\
Over $2,500 but not over $5,900 & $375 plus 25% of the excess over $2,500 \\
Over $5,900 but not over $9,050 & $1,225 plus 28% of the excess over $5,900 \\
Over $9,050 but not over $12,300 & $2,107 plus 33% of the excess over $9,050 \\
Over $12,300 & $3,179.50 plus 39.6% of the excess over $12,300 \\
& + 3.8% Medicare Surtax \\
\hline
\end{tabular}
\end{table}

\textsuperscript{10} P.L. 111-152; IRC § 1411(a)(2)(A) & B \\
\textsuperscript{11} Id. \\
\textsuperscript{12} Id.
excess of the highest tax bracket.\textsuperscript{13} Therefore, trusts that retain income in excess of $12,300 in 2015 will pay federal income tax on the amount over $12,300 at 39.6\%, plus pay a surtax of 3.8\% on the MAGI amount, making the effective federal rate 43.4\%. Additionally, in 2015, as a result of the American Taxpayer Relief Act of 2013 (“ATRA”), non grantor trusts have even further income tax burdens. The ATRA imposes a higher capital gain rate of 20\% on taxpayers in the 39.6\% bracket, which for a trust occurs when taxable income exceeds $12,300.\textsuperscript{14} For individual taxpayers, the income threshold for the 20\% capital gain rate is $413,201 for single filers in 2015.\textsuperscript{15}

As stated earlier, one of the three types of income defined in the Internal Revenue Code is simply called “income.” The definition of income for trust purposes is that amount that is attributed for tax purposes to a particular individual taxpayer.\textsuperscript{16} That taxpayer can either be the trust, the beneficiary of the trust or it can be the grantor. To whom the income is attributed is determined by the terms of the trust agreement. If a trust is a non grantor trust, the income retained by the trust will be attributed to the trust, and the income distributed will be attributed to the beneficiary. However, if a trust is a grantor trust, whether the trust is a simple trust or a complex trust, no matter who actually receives the earnings of the trust, the grantor will report on his or her Form 1040 the income earned by the trust. As drafters of trust agreements, therefore, it is very important that we understand what provisions of trust agreements will govern to whom the income for tax purposes will be attributed.

\begin{itemize}
\item \textsuperscript{13} \textit{Id.}
\item \textsuperscript{14} Rev. Proc. 2013-15, § 2.01, Table 5.
\item \textsuperscript{15} IRC § 1(h)(1) and § 1(i)(3) as amended by ATRA §§ 101 and 102.
\item \textsuperscript{16} Treas. Reg. § 1.671-2(b).
\end{itemize}
The Grantor Trust Rules

Prior to 1940, income tax rates and brackets were spread so broadly that some taxpayers transferred assets to trusts naming lower bracket taxpayers as the beneficiaries in order to reduce income tax paid on the earnings of the trust assets. However, the grantors retained significant control over the trusts. The United States Supreme Court ruled in Helvering v. Clifford that the income earned by the trust would be taxable to the grantor, even though the income was actually distributed to the beneficiary, because of the amount of control retained by the grantor.17 The Internal Revenue Service (“IRS”) issued regulations called the “Clifford Regulations” in 1946, and in 1954 new sections were added to the Code, which are now the grantor trust rules. While income tax rates today are not as far apart as they were in 1954, and even though the IRS targeted abuses with the grantor trust rules, those rules offer favorable opportunities for taxpayers today. The grantor trust rules are found at Sections 671 to 678 in the Code and in the accompanying Treasury Regulations at Sections 1.671-1 to 1.678(a)-1 et.seq.

To begin with, the Code defines what a grantor is.18 In our practices, we usually associate the term “Grantor” with the person who creates a trust. We understand that this term can be substituted with the terms “Trustor” or “Settlor.” However in the Code, the term “grantor” has a specific meaning that is somewhat broader than what we are accustomed to. In Treasury Regulation Section 1.671-2(e)(1), the term “grantor” for the purposes of the grantor trust rules can be a person who creates a trust (the meaning with which we are comfortable) or a person who makes a gratuitous transfer to a trust, directly or indirectly. (In this paper, the term “Grantor” will be capitalized when referring to the creator, Settlor or Trustor of a trust. The term “grantor,” without being capitalized, will refer to the term as defined in the Code.) Therefore, a

17 Helvering v. Clifford, 309 U.S. 331 (1940).
18 IRC § 671.
person who creates a trust and has the title of Grantor according to our common meaning of the term might fit one of the definitions of grantor under the Code. However, there can be additional grantors under the Code who are persons who gratuitously transfer anything into that trust. The additional grantors can become such by either a direct transfer or an indirect transfer. What would that look like? Let’s say that a parent created an irrevocable trust for a child. The parent is of course the Grantor or creator of the trust. Somewhat later, a grandparent decides to make a gift to the trust for the benefit of the child. Under Treas. Reg. Section 1.671-2(e)(1), the grandparent may also be a grantor, even though the grandparent did not create the trust. The Code provides that a married couple can be counted as one grantor.

Under the Code, once a person has become a possible grantor by creating the trust or donating to the trust, if the terms of the trust establish sufficient control in such person, then the person is deemed to be the owner of the trust property, not the trust. Thus the grandparent who transferred property in the above example could be treated as the continuing owner of the transferred property, depending on the terms of the trust. For income tax purposes, the grantor is taxed on the income earned by the property in the trust of which the grantor is deemed to be the owner. 19 The trust is ignored for income tax purposes and the income is treated as if it were distributed to the grantor, even if it is not actually distributed to the grantor. In the example of the transfer from the grandparent, if the grandparent is a grantor, the income earned by the assets in the trust that were contributed by the grandparent is attributed to the grandparent for income tax purposes. Therefore, if a drafter wants income to be attributed to the person who establishes a trust, or to persons who contribute assets to the trust but who did not create the trust, then the drafter needs to make sure that the terms of the trust agreement provide sufficient control in the grantor to establish a grantor trust.
The status of grantor in the Code is determined by who can exercise sufficient control over the trust under the terms of the agreement so as to create an ownership interest in the trust. Helpfully, the elements of control that are recognized are defined and described in the Code. If a person has any of the following powers, and if he or she created or contributed property to the trust, he or she will have grantor status. It should also be remembered that a person can renounce or relinquish such powers in order to evade grantor status.

In Section 672 of the Code, we learn that the status of the grantor trust can be defeated even if some of the following powers exist if the exercise of that power can be blocked by an adverse party. An adverse party is any person having a substantial beneficial interest in the trust which would be adversely affected by the exercise or nonexercise of the power which he possesses respecting the trust. Sounds circular, doesn’t it? We will see how this plays out in the following paragraphs.

1. Reversionary Interest

If the grantor retains a reversionary interest in the contributed property, this will establish a grantor trust. For example, a parent creates a trust for a child, and the terms of the trust state that income and principal can be distributed for the child by the trustee, but if the child takes up gambling, the trust will revert to the grantor. This would be a grantor trust because of the reversionary interest. Even though the trustee might distribute the income to the child during the term of the trust, for income tax purposes, the income would be attributed to the parent who would pay income tax on all income earned and distributed by the trust. This power pertains only to that part of the trust that is more than 5% of the value of the trust at the inception of the

19 Id.
20 IRC § 672(a).
21 Id.
22 IRC § 673(a).
trust.\textsuperscript{24} It does not apply to an interest that reverts to a parent of a child who dies before the age of 21.\textsuperscript{25}

2. Retaining Power to Control Beneficial Enjoyment

If the grantor retains a power to control the beneficial enjoyment of the trust or to direct the disposition of trust assets, this creates a grantor trust.\textsuperscript{26} In this section, we see the role of an adverse party as a way to convert what would be a grantor trust away from being a grantor trust. If the grantor retains the power to change beneficiaries, or how much a particular beneficiary will receive, and the exercise of such power does not require the consent or approval of an adverse party, the trust is a grantor trust.\textsuperscript{27} The power given to the adverse party could defeat the grantor trust status, unless it fits one of the following exceptions.

The following powers, even if their exercise would require an adverse party’s consent, will not defeat grantor trust status. These exceptions are: a power to apply income to support a dependent to the extent that the grantor would not be subject to tax; the power affecting beneficial enjoyment only after the occurrence of an event; a power exercisable only by Will unless that power is in the grantor to appoint income that has been accumulated for the grantor to dispose of without the consent of an adverse party; a power to allocate among charitable beneficiaries; a power to distribute corpus according to an ascertainable standard or for a current income beneficiary as long as the distribution of corpus is chargeable against the share of the beneficiary; a power to withhold income temporarily from a beneficiary as long as the beneficiary will ultimately receive such income; a power to withhold income during the

\textsuperscript{23} IRC § 673(b).
\textsuperscript{24} IRC § 673(a).
\textsuperscript{25} IRC § 673(b)(2).
\textsuperscript{26} IRC § 674(a).
\textsuperscript{27} \textit{Id.}
disability of a beneficiary; or, a power to allocate between income and principal. A power to add after-born or after-adopted children to the beneficiaries or class of beneficiaries does not confer grantor trust status.

3. Retaining Certain Administrative Powers

Section 675 of the Code lists several administrative powers that, if possessed by the creator of or donor to a trust, will establish an ownership interest sufficient to obtain grantor status for that person. These powers, which may be exercised by the grantor or a nonadverse party without the approval of an adverse party, include: a power to dispose of corpus for less than fair consideration; a power to borrow from the trust without adequate interest or security; a power to borrow corpus and not repay it by the end of the tax year; a power of administration in a non-fiduciary capacity, which includes a power to vote stock, a power to direct investments, or a power to reacquire trust corpus by substituting other property of equal value. By inserting any one of these administrative powers into a trust agreement, and having a person retain any of these powers, one can achieve grantor status for that person.

4. Power to Revoke

Section 676 describes one of the more straightforward powers to achieve grantor status, which is the power to revoke the trust, or the portion of the trust of which the grantor is the donor. This power must be exercisable by the grantor or a non adverse party. The provision will not apply to a power that can only affect the beneficial enjoyment of the grantor for a period

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28 IRC § 674(b).
29 IRC § 674(d).
30 IRC § 675(1) through (4).
31 IRC § 676(a).
commencing after the occurrence of an event such that the grantor would not be treated as the owner under Section 673 if the power were a reversionary interest.32

5. Income Retained for the Benefit of Grantor

Section 677 of the Code states that the grantor will be treated as the owner of any portion of a trust whose income may be distributed to the grantor or the grantor’s spouse without the approval of an adverse party, or held or accumulated for future distribution to the grantor or the grantor’s spouse, or may be applied to the payment of premiums on policies of insurance on the life of the grantor or the grantor’s spouse.33 This provision does not apply if the distributions of income are applied for the support or maintenance of a beneficiary for whom the grantor has an obligation of support.34

To Be or Not To Be

Now that we know that grantor trust status comes into being depending on how the trust is drafted, and we know what those powers are that establish a grantor trust, what are the ingredients of the decision that determine whether or not we want grantor trust status? Obviously, if a grantor wants to retain the power to revoke a trust and wants to be the primary beneficiary of all of the income, then the client has spoken and we will draft a grantor trust. All of those revocable “living trusts” that we draft are grantor trusts, because they are really self-settled custodial accounts established for convenience, incapacity planning and the avoidance of probate. Self-settled irrevocable trusts can also be grantor trusts when the grantor is the beneficiary. Examples are Income Only Trusts, Grantor Retained Annuity Trusts (“GRAT”), Qualified Personal Residence Trusts (“QPRT”) and certainly d(4)(A) special needs trusts. During the lifetime and capacity of the grantor or grantors, these are grantor trusts. The issue of

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32 IRC § 676(b).
33 IRC § 677(a).
whether or not to elect grantor trust status arises only when our client wishes to establish an irrevocable third party-settled trust for the benefit of someone else. In these cases we may elect to create a trust that is not a grantor trust or one that is a grantor trust. Thus, Hamlet’s famous question comes to mind. The contemplation of these issues must also take into account the relationship of the grantor trust rules, which are income tax rules, with the gift tax and estate tax rules.

One issue to consider is whether or not the client wants to make a completed gift to a third party-settled trust. Generally, a transfer to a grantor trust is not a completed gift, because the grantor retains control of the trust assets. If a client wants to reduce his or her taxable estate for federal estate tax purposes, and the trust is being considered as a vehicle for gifting assets from the client to others, then the best advice is for the client to make a completed gift to a trust that would exclude the assets from his or her federal taxable estate.

The transfer to the special needs trust is an incomplete gift if the grantor retains sufficient control to cause inclusion in his or her estate.\(^{35}\) It is not uncommon for a family to want to retain a large amount of control over a special needs trust, because often the parent is the primary caregiver and has been providing care for the disabled child for many years. Furthermore, the life expectancy of the disabled child may be shorter than other siblings. Therefore, having the client retain the inter vivos power to name other beneficiaries or future beneficiaries often fits with the facts of the situation. Retaining a testamentary power of appointment to name remainder beneficiaries would confer grantor trust status under Section 674 of the Code and would make the gift an incomplete gift.\(^{36}\) Therefore, even if all of the income of the trust were distributed to the beneficiary, the grantor will have the income for income tax purposes attributed

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\(^{34}\) IRC § 677(b).

\(^{35}\) Treas. Reg. § 25.2511-2(b).
to him or her. This will relieve the trust and the beneficiary from having to pay income tax on the earnings and distributions of the trust. It will also relieve the parent from the problem of making taxable gifts to the trust. Finally, the income earned by the trust will be taxed at the rate of the grantor, not at the rate of the trust.

There is a hybrid use of grantor trust status that can accomplish both goals, that is, having transfers to the trust be completed gifts for gift tax purposes and retaining grantor trust status for income tax purposes. These trusts are referred to with the odd name, Intentionally Defective Grantor Trusts ("IDGT"). The trust is a grantor trust, often with the administrative power of the grantor to substitute trust property of equal value. All other aspects of the trust provide for complete separation of control by the grantor. Thus the grantor trust is "defective," because control by the grantor is so limited. A gift to an IDGT is a completed gift. Using an IDGT, which can be a special needs trust, can enable a grantor to pay the income tax liability of the trust as well as treat the trust assets as entirely separate from the grantor’s taxable estate for federal estate and gift tax purposes.

**When Does a Trust Need a Separate EIN**

A grantor trust with one grantor does not need a separate EIN. If only one grantor provides the funding for a trust of which he or she retains sufficient control of the trust assets, all the trustee must do is to provide the name and Social Security number of the grantor and the address of the trust to all payers of income to the trust. Therefore, the payers will issue K-1s or 1099s to the Trustee using the Social Security number of the grantor. The grantor will report the income on his or her Form 1040. If the Trustee of the grantor trust is the same as the sole grantor, there is no need to provide a separate address of the trust to payers. An example of such

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36 *Id.*
37 Treas. Reg. § 301.6109-1(a)(2)
a grantor trust is a d(4)(A) special needs trust. The sole grantor is also the sole beneficiary of the trust, and the grantor retains the right to all of the income of the trust. The d(4)(A) trust will always have a Trustee who is not the same person as the grantor, but that does not affect grantor trust status. Transfers to the d(4)(A) trust by the disabled beneficiary are not completed gifts, because the grantor retains the benefit of the transferred assets. The d(4)(A) trust would not file a Form 1041, and income earned would be reported on the disabled grantor’s Form 1040.

GRATs, QPRTs and Income Only Trusts do not need to apply for a separate EIN if they have only one grantor, because they are all grantor trusts. A Qualified Settlement Fund (“QSF”) can elect grantor trust status.38 If the QSF holds funds that have been contributed by one defendant or payer into the settlement, the transferor can attach a statement to its own income tax return stating that it elects to treat the QSF as a grantor trust, and include the legend “§ 1.468B-1(k) Election.” The QSF in that instance does not need a separate EIN or need to file a Form 1041.

Some trusts or accounts are required by regulation to obtain a separate EIN. A Qualified Subchapter S Trust (“QSST”) is required to obtain a separate EIN, even if it is a grantor trust. According to the proposed regulations for ABLE accounts, each account will be required to obtain an EIN separate from the disabled beneficiary, even if all of the funds in the ABLE account were transferred to the account by the disabled person.

Non grantor trusts always need to have a separate EIN. In the area of special needs trusts, a trust that is a Qualified Disability Trust (“QDT”) is a non grantor trust. In January, 2002, with the passage of the Victims of Terrorism Tax Relief Act, a new category for the income taxation of trusts was created. In addition to simple and complex trusts, we now have the

38 Treas. Reg. § 1.468B-1(k)(2)
A QDT obtains a higher tax deduction if the trust meets the requirements of the statute. A trust will qualify as a QDT if the beneficiary is disabled as defined by the Social Security Act (the “Act”), if the trust meets the definition of a disability trust pursuant to the Act, and even if remainder beneficiaries are not also disabled. The benefit of being determined to be a QDT is a significant increase in the exemption that can be taken as a deduction against taxable income by the trust. For a trust that meets the definition of a QDT, the exemption that is allowed for the trust is the allowable personal exemption for the individual beneficiary. In 2015, the personal exemption is $4,000. Therefore, if a QDT retains $5,000 of earned income, after taking the exemption amount, it would report $1,000 taxable income, and pay income tax in the 15% bracket in the amount of $150. A complex trust that is not a QDT would have only a $100 exemption, and thus would report $4,900 taxable income and pay $975 in tax in the 25% bracket.

A QDT will be either a non grantor inter vivos special needs trust trust or a testamentary special needs trust.

There are occasions when a grantor trust could have its own EIN. One example would be an IDGT, when the taxpayer grantor wants to clearly segregate the assets in the IDGT from his or her own estate. A special needs trust can be an IDGT. Another example occurs when an institutional holder of an account insists that because a trust is an irrevocable trust it must have a separate EIN. The fight may not be worth having. This occurs quite often when trustees of d(4)(A) trusts are opening accounts.

To obtain an EIN, the Trustee files Form SS-4 with the IRS. There is a simple procedure for doing this on line. Note that page 4 of the instructions for the Form SS-4 specify that one does not need a separate EIN for certain grantor-type trusts. Once an EIN is obtained, the IRS

\[^{39}\text{26 U.S.C. §642(b)(2)(C)(i),(ii).}\]
will be looking for a Form 1041 to be filed for each year following the issuing of the EIN. If no Form 1041 is filed, the IRS will issue a notice of failure to file to the Trustee.

When a grantor trust has an EIN that is different from the TIN of the grantor, the Trustee is required to file a Form 1041. However, the taxpayer continues to be the grantor, not the trust or the beneficiary. Therefore, the Form 1041 is merely an informational vehicle. There are two options provided by the IRS for a grantor trust that is filing a Form 1041. The first option, which many accountants believe is the simpler one, provides that the Trustee puts only the name of the trust and its EIN on the first page of the Form 1041, but does not provide any of the financial information or tax calculations on the Form 1041. No Schedule K-1 is filed with an informational return. Using an attachment to the Form 1041, the Trustee provides the name, Social Security number and address of the Grantor. The income earned by the trust assets and any deductions taken are provided in the same detail as on the grantor’s Form 1040. The grantor will then report all of the same information on his or her Form 1040.

The second option requires that the Trustee provide the EIN of the trust to all payers of income to the trust. The Trustee must file 1099s with the IRS for each item of income showing the trust as payer and the grantor as payee on all income. The 1099s will provide the Social Security number of the grantor to the IRS. The Trustee then provides an annual statement to the grantor with the detail of the trust transactions and gives notice to the grantor that he or she must pay any income tax liability incurred by trust assets.

The Trustee may switch methods of reporting from one of the two options to the other. The Trustee may also switch the method of reporting away from using the separate EIN at all,
and to not file a Form 1041. To do this, the Trustee must file a Final Form 1041, which effectively takes the EIN off the books of the IRS.\textsuperscript{40}

To summarize this particular issue with regard to special needs trusts, the only time that the Trustee must obtain an EIN for a special needs trust is if the trust is a Qualified Disability Trust. All self-settled special needs trusts are grantor trusts and should not have to acquire an EIN that is separate from the TIN of the grantor who is the disabled person. However, some banking institutions may require a separate EIN, because they will not open the account for an irrevocable trust unless it has a separate EIN. Third party-settled grantor special needs trusts should not have to obtain a separate EIN from the grantor, unless there is more than one grantor. For federal estate and gift tax purposes, if the special needs trust is an IDGT, it may be advisable to acquire a separate EIN, but it is not a requirement. The IDGT is still a grantor trust.

\textbf{Conclusion}

The provisions of Sections 671 to 678 of the Code, which describe the grantor trust rules, can be regarded as mysterious, hopelessly complex, or even irrelevant. When the unified credit for federal estate tax was lower and income tax rates were higher, it may have been prudent to carefully avoid grantor trust status. However, opportunities exist today that make the use of grantor trusts very advantageous.

There is not clear advice from the IRS, nor a bright line rule in trust law, 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 the trust is a grantor trust with a single grantor, the Trustee may not need to apply for a separate EIN. If the trust is not a grantor trust, it

\textsuperscript{40} See Instructions for Form 1041 and Schedules A, B, G, J, and K-1, page 12
must have a separate EIN. If the trust is a grantor trust, but has a separate EIN for any reason, 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 Form 1041.