

## **INTENTIONALLY DEFECTIVE GRANTOR TRUST**

An individual creates an irrevocable trust, usually for the benefit of his/her children and/or grandchildren. The grantor's spouse may also be a beneficiary for his or her lifetime. Certain provisions are added to the trust that cause the grantor to be treated as the owner of the trust for income tax purposes under the grantor trust rules of Code Secs. 671-677. The provisions should not, however, cause the grantor to be treated as the owner of the trust for transfer tax purposes.

The grantor trust will result in all income of the trust being taxed to the grantor of the trust. Conventional thinking had focused on avoiding grantor trust status where possible. However, what at first glance appears to be a disadvantage is truly an advantage. By paying income tax on gains recognized by the trust, the grantor is able to make a gift tax-free addition to the trust. This provides a tremendous benefit to those clients who are already maximizing their annual exclusion gifting.