PRESENT LAW AND BACKGROUND ON THE FEDERAL TAXATION OF DOMESTIC TRUSTS

Scheduled for a Public Hearing
Before the
SUBCOMMITTEE ON OVERSIGHT
of the
HOUSE COMMITTEE ON WAYS AND MEANS
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INTRODUCTION

The Subcommittee on Oversight of the House Committee on Ways and Means has scheduled a public hearing for December 8, 2021, called "The Pandora Papers and Hidden Wealth." This document,[1] prepared by the staff of the Joint Committee on Taxation, describes empirical information, legal background, and policy considerations related to certain topics to be considered in the hearing.

Trusts

Trusts, the main subject of this document, are legal arrangements that may be created upon the transfer of wealth.[2]

A trust is a three-party legal arrangement for the ownership of property arranged as follows: (1) A settlor or grantor transfers legal title to the property to (2) one or more fiduciaries called trustees, who hold title on behalf of (3) one or more beneficiaries. The trustee has a fiduciary duty to protect the beneficial or equitable rights of the beneficiaries with respect to the property; the trustee may be subject to certain requirements related to the property held by the trust and the income derived by the trust. The three parties to the trust need not be different; a grantor may also be a trustee or a beneficiary, and a trustee may be a beneficiary. The beneficiaries of a trust are generally individuals but may also include, for example, charitable organizations and business entities.

The beneficiary of a trust may not be a specified person. For example, a grandparent may create a trust that has as a class of beneficiaries all grandchildren, including grandchildren not born at the time of the trust's creation. Similarly, a person's status as beneficiary may be contingent on future events. For example, a grandparent may create a trust for the benefit of her daughter and, in the case of her daughter's death, her grandchild.

Individuals create trusts for various tax planning and non-tax-planning purposes. For example:

- A parent may wish to transfer legal ownership of property to a minor child and may want a trustee to make decisions about the property until the child reaches a certain age.
- The owner of a business may use a trust as the legal arrangement for transferring ownership interests in the business over time to family members or employees.
- A married couple may place assets in trust with the intention that, after one spouse dies, the other spouse will benefit from the assets until death (by, for example, using

[1] This document may be cited as follows: Joint Committee on Taxation, *Present Law and Background on the Federal Taxation of Domestic Trusts* (JCX-49-21), December 6, 2021. This document can be found on the Joint Committee on Taxation website, www.jct.gov. In this document, references to the "Code" are to the Internal Revenue Code of 1986, as amended. Section references are to the Code, unless otherwise indicated.

[2] See Lane and Zaritzky, *Federal Income Taxation of Estates and Trusts*, 3d. edition, Chapter 1; see also Treas. Reg. sec. 301.7701-4(a) (trusts); *Commissioner v. Beebe*, 67 F.2d 662, 664 (1933) (estates).

the income from the assets) and that the principal of the assets placed in trust will be preserved for the couple's children.

- A trust might be used to manage assets for a disabled relative or to protect assets from creditors.
- An individual may organize a trust to hold an insurance policy outside the individual's taxable estate, to remove from the individual's taxable estate future appreciation in the value of property placed in trust, or to transfer wealth through multiple generations of family members without paying transfer tax on each generational transfer.

A person — for example, the parent who wishes to transfer legal ownership but not control of property to a minor child — may create a trust to hold property during the person's life. This sort of trust is referred to as an *inter vivos* (during life) trust. Alternatively, during life a person may arrange for a trust to arise only when the individual dies. For example, a person may specify in her will that, on her death, certain property will be held in trust for the benefit of an heir until certain conditions are satisfied. This sort of trust is referred to as a testamentary trust (because it is provided in what is sometimes referred to as a "will and testament").

An individual who creates a trust may retain certain powers over the trust, such as the power to make decisions about distributions of trust assets. In this case the trust may be considered a grantor trust for Federal income tax purposes, with the consequence that the grantor is considered to own the trust's assets directly. Trusts that are not grantor trusts are referred to as nongrantor trusts.

A trust is governed by a trust instrument and is also subject to State statutes and common law.

Estates

Estates, like trusts, are legal arrangements related to the transfer of wealth.

Unlike a trust, which may hold property during the life of an individual or after an individual dies, an estate arises only on the death of an individual. A decedent's property is held in an estate by a fiduciary (referred to as an executor) who controls the property on behalf of one or more beneficiaries, the heirs of the estate, until the affairs of the estate are concluded and the property is distributed to the heirs.

An estate may be governed by a will but may also arise even if the decedent does not have a will. Like a trust, an estate is subject to State statutes and common law.

Present law, data, and issues related to trusts and estates

Part I of this document gives an overview of the income tax rules relating to trusts and estates and the estate, gift, and generation-skipping transfer tax rules in relation to which trusts may be organized.

Part II of this document describes the Federal tax reporting rules applicable to trusts and estates. These reporting rules include requirements under the Federal income tax for non-grantor trusts and grantor trusts. The reporting rules also include requirements under the Federal transfer tax in respect of transfers made (in trust or otherwise) during life or at death.

Part III of this document provides Federal tax data related to trusts and estates.

Part IV of this document describes issues related to trusts' and estates' beneficial ownership of interests in entities or accounts; beneficial ownership of trusts; and tax planning using trusts. Beneficial ownership generally refers to the substantive benefits associated with owning property, in contrast with the holding of formal legal title to the property. Sometimes the person who has formal legal title to property is also the beneficial owner of the property. In other situations the title holder is not the beneficial owner because, for example, the title holder acts as a nominee for the person who has the substantive benefits of ownership. Features of Federal and State (non-tax) law have allowed the identities of beneficial owners of trusts to remain undisclosed. Congress enacted a law in 2020 in part to address this problem. Policymakers also may be concerned about features of Federal tax law that have facilitated the use of trusts to minimize taxation of intergenerational wealth transfers.

I. PRESENT LAW RELATING TO DOMESTIC TRUSTS AND ESTATES

A. Income Tax

Income tax treatment of trusts and estates

Trusts and estates are generally subject to Federal income tax.[3] The taxable income of a trust is generally computed in the same manner as the taxable income of an individual. Estates generally compute taxable income in a similar manner to trusts. The computation is subject to certain modifications:[4] (1) no standard deduction is allowed;[5] (2) a small personal exemption is allowed;[6] (3) an unlimited charitable deduction is allowed for amounts paid to (or in the case of an estate or certain trusts, amounts permanently set aside for) charity;[7] and (4) trusts and estates may deduct trust administration costs.[8]

Trusts and estates are allowed a deduction for amounts distributed to beneficiaries during the taxable year.[9] The amount of the deduction is limited by distributable net income, a measure of income to be distributed.[10] Because of this deduction, the beneficiary, not the trust, is generally subject to income tax on the distributed amount. By use of this deduction, trusts may eliminate income tax liability to the extent they distribute (rather than retain) income.

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[3] Sec. 1(e), Part 1 of Subchapter J of Chapter 1. The term "trust" may also refer to a number of other types of arrangements or entities. Certain trusts may be classified as business entities. See Treas. Reg. sec. 301.7701-4(a). Trusts may also be pension trusts, sec. 401, or charitable entities, sec. 501. These types of trusts are all outside the scope of the document.

In addition, many trusts are subject to special rules beyond the ones discussed herein. See, *e.g.*, sec. 641(c) (small business trusts), sec. 642(b) (qualified disability trusts), sec. 644 (charitable remainder trusts), and sec. 646 (Alaska Native Settlement Trusts).

[4] Sec. 641(b).

[5] Sec. 63(c)(6)(D).

[6] Sec. 642(b). For estates, the amount of the exemption is $600. For trusts required to currently distribute all income, the amount is $300, while for other trusts, the amount is $100.

[7] Sec. 642(c).

[8] Sec. 67(e).

[9] See secs. 651 (simple trusts) and 661 (complex trusts). A trust that is not a grantor trust (discussed below) may be a simple trust or a complex trust. A trust is a simple trust if: (1) the trust instrument requires that all income be distributed currently; (2) the trust instrument does not provide that any amounts are to be paid, permanently set aside, or used for charitable purposes; and (3) the trust does not distribute amounts allocated to the corpus of the trust. Treas. Reg. sec. 1.651(a). A complex trust is a non-grantor trust that does not qualify as a simple trust.

[10] Sec. 643(a).

The tax rates for trusts and estates are the same as the tax rates that apply to individuals. If, however, a trust or estate retains income and has taxable income, the rate brackets[11] that apply are more compressed than the individual tax brackets, meaning that a trust is subject to tax at the highest marginal rate at lower income levels than an individual.[12] If a trust or estate is subject to tax, it generally pays the tax using income or assets of the trust. Thus, for example, the trust grantor does not pay the tax. This reduces the funds of the trust or estate held for the beneficiaries.

Table 1.–2021 Federal Income Tax Rates for Estates and Trusts

If taxable income is:	Then income tax equals:
Not over $2,65......................................	10% of the taxable income
Over $2,650 but not over $9,550	$265 plus 24% of the excess over $2,650
Over $9,550 but not over $13,050............	$1,921 plus 35% of the excess over $9,550
Over $13,050	$3,146 plus 37% of the excess over $13,050

Like individuals, trusts and estates may claim the foreign tax credit[13] or credits under the general business credit.[14] However, these credits may in some cases instead be allocated to the beneficiaries of the trust or estate.[15] Similarly, trusts and estates are subject to the alternative minimum tax ("AMT").

Trusts and estates, like individuals, are subject to lower rates on certain capital gains and certain dividends.[16] They may claim a deduction for qualified business income.[17] Trusts and estates are also subject to a separate net investment income tax on certain income.[18]

[11] Sec. 1(e), (j)(2).

[12] For example, for taxable years beginning in 2021, trusts are subject to the highest marginal rate of 37 percent on taxable income above $13,050, while married filing separately taxpayers (the next most "compressed" bracket) are subject to the highest marginal rate on taxable income above $314,150.

[13] Sec. 642(a).

[14] Subpart D of Subchapter A of Chapter 1 of the Code.

[15] See, *e.g.*, secs. 52(d) and 901(b)(5).

[16] Sec. 1(h), (j)(5). These lower rates apply for both the regular tax and the AMT. Sec. 55(b)(3).

[17] Sec. 199A.

[18] Sec. 1411.

Two or more trusts are treated as a single trust generally where the trusts have substantially the same grantors and beneficiaries and a principal purpose of the trusts is avoiding Federal income tax.[19]

Tax treatment of grantors and beneficiaries

Grantors

A grantor or settlor generally cannot take a deduction for a transfer to a trust or estate. However, a grantor may be able to claim a charitable deduction if the transfer is to a trust with a charitable organization as a beneficiary.[20]

Different rules (discussed below) apply to transactions between grantors and grantor trusts.

Beneficiaries

The transfer of property to a trust or estate is not a taxable event for the beneficiary.[21]

If a beneficiary receives a distribution from a trust or estate, the amount of the distribution, limited by distributable net income, is included in the beneficiary's gross income.[22] An item of income retains its character when received by the beneficiary.

Grantor trusts

Under the grantor trust rules, if the grantor or settlor of a trust retains certain rights or powers with respect to a trust, the grantor of the trust is treated as the owner of the trust.[23] A grantor may own only a portion of a trust. Additionally, these rules may apply to an individual other than the grantor who possesses the requisite rights or powers.[24] The common estate planning tool sometimes known as a revocable living trust is a grantor trust.

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[19] Sec. 643(f).

[20] Sec. 170(f)(2). The charitable organization, exempt from tax, will not have to pay tax on the income received.

[21] The transfer may be a gift or bequest to the beneficiary, excluded from gross income under section 102. Alternatively, if the transfer is to a grantor trust (discussed more below), the Secretary generally has held that the transaction has no effect for income tax purposes.

[22] Secs. 652 and 662.

[23] Secs. 671-679. A grantor is treated as the owner of any portion of a trust if: (1) the grantor has a reversionary interest in either the corpus or the income from the corpus, if certain conditions are satisfied; (2) the grantor has a power of disposition without the approval or consent of any adverse party; (3) the grantor can exercise certain administrative powers of over the trust; (4) the grantor or a nonadverse party has the power to revoke, *i.e.*, revest in the grantor title of a portion of the trust; and (5) without prior approval of an adverse party, the income from the trust may be distributed to or for the benefit of the grantor or the grantor's spouse.

[24] See sec. 678.

If a trust is a grantor trust, the grantor (and not the trust) is taxed on the income of the trust. The grantor may pay the tax out of funds not owned by the trust. If the grantor does so, the funds of the trust available to the beneficiaries are undiminished by the tax payment. Additionally, IRS guidance provides that transactions between the grantor and the grantor trust are disregarded.[25] Thus, for income tax purposes, a transfer of property to a grantor trust is not a gift, and a sale to a grantor trust is not a sale for tax purposes and does not give rise to gain or loss. The transfer tax consequences of a transfer to a grantor trust may be different.

Just as grantor trusts are not separate income tax taxpayers, they are not separately subject to the net investment income tax.[26]

Foreign trusts and estates

Domestic trusts are generally subject to tax on worldwide income. Foreign trusts are generally taxed similarly to nonresident aliens.[27]

In general, a trust is considered to be a domestic trust if it meets both a court test and a control test.[28] A foreign trust is any trust that is not a domestic trust.[29] The terms of the trust instrument and applicable law are applied to determine whether the tests are met.[30]

The court test is satisfied if a court within the United States is able to exercise primary supervision over the administration of the trust.[31] The regulations provide a safe harbor under which a trust satisfies the court test if: (1) the trust instrument does not direct that the trust be administered outside of the United States; (2) the trust in fact is administered exclusively in the United States; and (3) the trust is not subject to an automatic migration provision.[32] If both a U.S. court and a foreign court are able to exercise primary supervision over the administration of the trust, the court test is satisfied.[33]

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[25] Rev. Rul. 85-13, 1985-1 C.B. 184, 1985-7 I.R.B. 28.

[26] Treas. Reg. sec. 1.1411-3(b)(1)(v).

[27] Sec. 641(b) ("[A] foreign trust or foreign estate shall be treated as a nonresident alien individual who is not present in the United States at any time.").

[28] Sec. 7701(a)(30); Treas. Reg. sec. 301.7701-7(a)(1).

[29] Treas. Reg. sec. 301.7701-7(a)(2).

[30] Treas. Reg. sec. 301.7701-7(b).

[31] Treas. Reg. sec. 301.7701-7(a)(1)(i).

[32] Treas. Reg. sec. 301.7701-7(c)(1). A court within the United States generally is not considered to have primary supervision over the administration of the trust if the trust instrument provides that a U.S. court's attempt to assert jurisdiction or otherwise supervise the administration of the trust directly or indirectly would cause the trust to migrate from the United States. Treas. Reg. sec. 301.7701-7(c)(4)(ii).

[33] Treas. Reg. sec. 301.7701-7(c)(4)(i)(D).

The control test is satisfied if one or more United States persons have the authority to control all substantial decisions of the trust.[34] The term control means having the power, by vote or otherwise, to make all of the substantial decisions of the trust, with no other person having the power to veto any of the substantial decisions.[35] Substantial decisions are those decisions that persons are authorized or required to make under the terms of the trust instrument and applicable law and that are not ministerial. Substantial decisions include: (1) whether and when to distribute income and corpus; (2) the amount of any distributions; (3) the selection of a beneficiary; (4) whether a receipt is allocable to income or principal; (5) whether to terminate the trust; (6) whether to compromise, arbitrate, or abandon claims of the trust; (6) whether to sue on behalf of the trust or to defend suits against the trust; (7) whether to remove, add, or replace a trustee; (8) in certain cases, whether to appoint a successor trustee; and (9) in general, investment decisions.[36]

Because of these rules, the trust's status as foreign or domestic is not solely determined based on where it is formed. In other words, a trust that is formed under the laws of a U.S. State may be treated as a foreign trust for U.S. Federal income tax purposes, and a trust that is formed under the laws of a foreign jurisdiction may be treated as a U.S. domestic trust for U.S. Federal income tax purposes. A trust's status as foreign or domestic may change depending on the circumstances.

In certain cases, the transfer of property by a U.S. person to a foreign trust results in grantor trust treatment.[37]

A foreign estate is an estate the income of which, from sources without the United States which is not effectively connected with the conduct of a trade or business within the United States, is not includible in gross income.[38] A domestic estate is any estate that is not a foreign estate.[39]

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[34] Treas. Reg. sec. 301.7701-7(a)(1)(ii).

[35] Treas. Reg. sec. 301.7701-7(d)(1)(iii).

[36] Treas. Reg. sec. 301.7701-7(d)(1)(ii).

[37] Sec. 679.

[38] Sec. 7701(a)(31)(A).

[39] Sec. 7701(a)(30)(D).

B. Transfer Tax

Separate from the taxes imposed on the income of a trust or estate, there are Federal wealth transfer taxes, which include the gift tax, the estate tax, and the generation-skipping transfer tax.[40] These taxes are imposed on individual taxpayers. A gift tax is imposed on certain lifetime transfers, and an estate tax is imposed on certain transfers at death. Transfers subject to tax include both direct transfers and transfers in trust. A generation-skipping transfer tax generally is imposed on transfers, either directly or in trust or through similar arrangement, to a "skip person" (generally a beneficiary in a generation more than one generation below the generation of the transferor).

A unified credit effectively exempts a total of $11.7 million (for 2021) in cumulative taxable transfers from the gift tax[41] or the estate tax. Transfers in excess of this amount generally are taxed at a 40-percent rate.[42] A transfer to a spouse or to charity generally is not subject to gift or estate tax.

The generation-skipping transfer tax is imposed using a flat rate equal to the highest estate tax rate (40 percent) on cumulative generation-skipping transfers in excess of an exemption amount ($11.7 million for 2021). Generation-skipping transfer tax exemption may be allocated to a trust to which a donor or decedent transfers assets. In some cases, the trust assets can then grow indefinitely and benefit multiple successive generations with no further generation-skipping transfer tax consequences.

As discussed in the introduction, a taxpayer might engage in trust planning to reduce tax liability, to achieve a non-tax-related goal, or both, and taxpayers sometimes use a trust as a vehicle for transferring wealth by gift or at death. As discussed in Part IV, a taxpayer might seek to reduce transfer taxes using a trust through an "estate freeze" transaction or by transferring assets to a "perpetual dynasty trust" that is exempt from generation-skipping transfer tax.

[40] See Chapters 11, 12, and 13 of the Code.

[41] Rev. Proc. 2020-45, I.R.B. 2020-46, p. 1024. Donors of certain lifetime gifts are also provided an annual exclusion of $15,000 per donee in 2021 that does not count against the unified credit. Sec. 2503(b).

[42] Sec. 2001(c).

II. SELECTED REPORTING REQUIREMENTS RELATING TO DOMESTIC TRUSTS

A. Income Tax Reporting

An entity that is subject to Federal income tax generally files a tax return with the IRS to report its income tax liability. An entity that is itself not subject to Federal income tax, such as a partnership, certain foreign persons, and certain tax-exempt organizations, but whose payees or beneficiaries may be U.S. taxpayers, generally files one or more information returns rather than an income tax return.

A trust might be required to file both income tax and information returns. As a separate income tax taxpayer, a trust that meets certain thresholds must file an annual income tax return. As discussed in Part I, however, certain income of a trust might be taxed to a beneficiary rather than to the trust. The Code thus requires that certain information be shared between the fiduciary of a trust and a person who holds an interest in the trust, such as a beneficiary. Similar rules apply to an estate. These rules are described in the following subsections.

Additional reporting rules and tax consequences apply to a foreign trust or to a grantor or beneficiary of a trust that is foreign for Federal tax purposes.[43] A detailed discussion of these rules is beyond the scope of this publication.

Depending on the circumstances, a trust also might file other types of returns or forms, including employment tax returns.[44]

Annual income tax reporting

A domestic taxable trust is required to file an income tax return for a taxable year if it has (1) any taxable income or (2) gross income of $600 or more regardless of the amount of taxable income.[45] An estate is required to file an income tax return for a taxable year if it has gross income of $600 or more.[46] A trust or an estate also must file an income tax return for a taxable

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[43] A trust organized under the laws of one of the States may be considered a foreign trust for Federal tax purposes, as discussed in Part I. The consequences of such a determination may include third-party reporting obligations (for example, section 6048 requires: (1) disclosure of certain reportable events involving a foreign trust, including the creation of, or transfer of money or property to, a foreign trust by a U.S. person (sec. 6048(a)); (2) reporting by a trust that is treated as owned by a U.S. person under the grantor trust rules (sec. 6048(b)); and (3) reporting by a U.S. person who receives a distribution from a foreign trust (sec. 6048(c)) as well as penalties (see sec. 6677). See also IRS Form 3520, *Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts*, and IRS Form 3520-A, *Annual Information Return of Foreign Trust with a U.S. Owner*. A foreign trust with U.S. sourced income might be required to file IRS Form 1041-NR, *U.S. Nonresident Alien Income Tax Return*.

[44] For a general description of other types of returns or forms that might have to be filed, see Internal Revenue Service, *2020 Instructions for Form 1041 and Schedules A, B, G, J, and K-1*, pp. 11-12. A discussion of these returns and forms is beyond the scope of this publication.

[45] Sec. 6012(a)(4).

[46] Sec. 6012(a)(3).

year if it has a beneficiary that is a nonresident alien.[47] A fiduciary generally arranges for filing of the annual return using IRS Form 1041, "U.S. Income Tax Return for Estates and Trusts." Form 1041 is due by the 15th day of the fourth month following the close of the trust's or estate's tax year[48] (for example, April 15, 2021, for a trust with a tax year that ended December 31, 2020).[49]

Information provided to beneficiaries

If a fiduciary of a trust or estate is required to file an income tax return for the trust or estate for a year, the fiduciary also must provide a statement to each beneficiary (or nominee of a beneficiary) who receives a distribution with respect to the taxable year or to whom any item with respect to the taxable year is allocated.[50] The fiduciary is required to request and provide a proper identifying number for each recipient of income. The IRS provides that a fiduciary may use Form W-9, "Request for Taxpayer Identification Number and Certification," to request a beneficiary's identifying number.[51]

A nongrantor trust or an estate generally uses Schedule K-1 (Form 1041) to report a beneficiary's share of income, deductions, and credits from a trust or estate, using the beneficiary's taxpayer identification number. A trust or estate that claims a distribution deduction must include with its Form 1041 a Schedule K-1 for each beneficiary. The fiduciary also must provide a copy of Schedule K-1 to the beneficiary.

A beneficiary who receives a distribution or to whom any item with respect to the taxable year is allocated must treat, on the beneficiary's income tax return, any reported item in a manner that is consistent with the treatment of the item by the applicable trust or estate.[52] This consistency requirement generally does not apply if the beneficiary files with the Secretary a statement identifying an inconsistency.[53] A beneficiary makes such a statement by filing Form 8082, "Notice of Inconsistent Treatment or Administrative Adjustment Request (AAR)."

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[47] Sec. 6012(a)(5).

[48] A trust or estate may apply for an automatic five and one-half month extension by filing IRS Form 7004, *Application for Automatic Extension of time to File Certain Business Income Tax Information and Other Returns*.

[49] A trust that is exempt from Federal income tax might file a different return, such as IRS Form 990, *Return of Organization Exempt from Income Tax*, IRS Form 990-PF, *Return of Private Foundation or Section 4947(a)(1) Nonexempt Charitable Trust Treated as a Private Foundation*, or IRS Form 5227, *Split-Interest Trust Information Return*.

[50] Sec. 6034A(a).

[51] See Internal Revenue Service, *2020 Instructions for Form 1041 and Schedules A, B, G, J, and K-1*, p. 40.

[52] Sec. 6034A(c)(1).

[53] Sec. 6034A(c)(2)(a). Where the applicable trust or estate has filed a return and the beneficiary has not filed a statement with the Secretary identifying any inconsistency, any adjustments required to make the treatment by the beneficiary consistent with the treatment of the items on the entity's return are treated as arising out of mathematical or clerical errors and assessed according to section 6213(b)(1). Sec. 6034A(c)(3).

If a person holds an interest in a trust or estate as a nominee for another person, the nominee must furnish to the trust or estate the name and address of such other person and any other information that the Secretary may require. The nominee is also required to furnish to such other person the information provided by the trust or estate.[54]

Reporting rules for grantor trusts

Special reporting rules apply for grantor trusts. If an entire trust is a grantor trust, only the entity information is completed on Form 1041. Dollar amounts are not shown on the face of the form; they are instead shown on an attachment to the form. If only part of a trust is a grantor trust, any income, deductions, and other items that are allocable to the nongrantor portion of the trust are reported on Form 1041 under normal reporting rules. Amounts allocable to the grantor portion of the trust are shown only on an attachment. The fiduciary is required to provide a copy of the attachment to the person who is treated as the deemed owner of the grantor portion of the trust.

A grantor trust may also use one of three optional filing methods.[55]

- **Optional method 1**: If a trust is treated as owned by only one person, the trustee may provide all payers of income to the trust during the year the name and taxpayer identification number for the deemed owner, while providing the address of the trust rather than the address of the deemed owner. To use this method, the deemed owner must provide the trustee with a signed form W-9, "Request for Taxpayer Identification Number and Certification." Unless the deemed owner is a trustee of the trust, the trustee must provide a statement to the deemed owner that shows all items of income, deduction, and credit of the trust and includes certain other required information.
- **Optional method 2**: If a trust is treated as owned by only one person, the trustee may provide all payers of income to the trust during the year the name, address, and taxpayer identification number for the trust. The trustee then files with the IRS appropriate Forms 1099 showing the trustee as payer and the deemed owner as the payee, essentially treating all items of income, deduction, and credit as if earned directly by the deemed owner. Unless the deemed owner is a trustee of the trust, the trustee must provide a statement to the deemed owner that shows all items of income, deduction, and credit of the trust and includes certain other required information.

[54] Sec. 6034A(b).

[55] See Internal Revenue Service, *2020 Instructions for Form 1041 and Schedules A, B, G, J, and K-1*, pp. 13-14.

- **Optional method 3**: If a trust has two or more deemed owners, the trustee provides all payers of income to the trust during the tax year the name, address, and taxpayer identification number of the trust. The trustee then files one or more Forms 1099 with the IRS with respect to each deemed owner showing the trust as the payer and the deemed owner as the recipient. The trustee must provide a statement to each deemed owner that shows all items of income, deduction, and credit of the trust attributable to the portion of the trust that is treated as owned by the deemed owner and includes certain other required information.

B. Transfer Tax Reporting

Certain taxpayers who make a gift during life, and the estates of certain decedents, must file a gift tax return or an estate tax return, whether assets are transferred outright to recipients or heirs or are transferred in trust.

A citizen or resident of the United States generally must file a gift tax return for a year if he or she gave gifts during the year to someone (other than a spouse) that total more than $15,000 in value (in 2021), although a return may also be required in certain other cases. Only taxpayers who are individuals must file a return. If a trust, estate, partnership, or corporation makes a gift, the individual beneficiaries or owners generally are treated as having made the gift. The information is reported using Form 709, “United States Gift (and Generation-Skipping Transfer) Tax Return.”

For a decedent who is a U.S. citizen or resident, an estate tax return generally must be filed if the gross estate plus adjusted taxable gifts (generally, taxable gifts made by the decedent after December 31, 1976) exceed the estate tax exemption amount of $11,700,000 (for decedents dying in 2021). The information is reported using Form 706, “United States Estate (and Generation-Skipping Transfer) Tax Return.”

Special versions of Form 706 must be filed by the trustee of certain trusts to which generation-skipping transfer tax exemption has been allocated in the event of a taxable distribution or a taxable termination. If a trust makes a distribution that is treated as a taxable distribution for generation-skipping transfer tax purposes — generally, a distribution to a person two or more generations below the generation of the transferor (a “skip person”) — the trustee of the trust must file Form 706-GS(D-1), “Notification of Distribution from a Generation-Skipping Trust.” The form includes the recipient's identifying number, the trust's employer identification number, and information about the distribution. A skip person who receives a taxable distribution from a trust must file Form 706-GS(D), “Generation-Skipping Transfer Tax Return for Distributions.” If a generation-skipping trust has a taxable termination, the trustee generally must file Form 706-GS(T), “Generation-Skipping Transfer Tax Return for Terminations.”

III. DATA ON THE INCOME TAXATION OF TRUSTS AND ESTATES

This section provides income tax data for trusts and estates. As mentioned above, trusts and estates are generally taxed in the same manner as individuals. However, they are allowed a deduction for amounts distributed to beneficiaries. Beneficiaries are taxed on distributions. The information below comes from taxpayers who filed Form 1041 for taxable years beginning in 2017.[56]

In 2017, 3.2 million Form 1041s were filed. Trusts and estates generally are subject to tax on income that is not distributed but is instead retained. For 2017, 1.1 million trust and estate income tax returns reported net taxable income. Total trust and estate income was $178 billion, and total net taxable income (*i.e.*, income after exemptions and deductions including the deduction for income distributed to beneficiaries) was $90 billion. Total tax liability was $24 billion.[57]

Based on income distributions reported on Schedule K-1 (Form 1041), beneficiaries who are U.S. taxpayers received on net $56.0 billion of distributions from trusts and estates. The $56.0 billion consists of interest (5.0 percent), dividends (33.7 percent), business income (7.7 percent), short-term capital gains (0.7 percent), long-term capital gains (20.8 percent), rent (17.6 percent), and other/unknown sources (14.7 percent).

Table 2 provides additional information about trust and estate distributions for 2017. The Joint Committee staff calculated an income distribution table of total net income from trusts and estates. The income groups are based on beneficiary adjusted gross income ("AGI") exclusive of distributions received from trusts or estates. Because of this, there is a "negative" AGI category of taxpayers who, absent distributions, do not have positive AGI.

Table 2 shows the number of individual returns that report trust distributions received, the amount of distributions, the group's percentage share of total distributions, the average distribution received, and average AGI excluding distributions. The last six columns, for each income group, represent the percentage of returns for which the distributions are less than a certain percent of total AGI. The $100,000-$200,000 income group reported the largest number of returns (318 thousand) totaling $8.3 billion, which represents 14.8 percent of the total amount

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[56] Thus, it excludes two types of trusts which file different income tax returns, Qualified Funeral Trusts (which file Form 1041-QF), and Electing Alaska Native Settlement Trusts (which file Form 1041-N). *See also* sec. 646 (Electing Alaska Native Settlement Trusts), sec. 685 (Qualified Funeral Trusts).

The data also includes a small number of bankruptcy estates, which are subject to tax under section 1398 and 1399, and which file Form 1041.

[57] In comparison, for 2017, 152.4 million individuals had a total income tax liability, after credits, of $1,581.5 billion, and 1.6 million corporations had a total income tax liability of $264.6 billion. (Most of these 1.6 million corporations are domestic corporations that are subject to tax under subchapter C of the Code. A smaller portion of the 1.6 million corporations in this group includes other Form 1120 filers such as homeowners associations (Form 1120-H), life insurance companies (Form 1120-L), and foreign corporations (Form 1120-F). This group of 1.6 million corporations excludes S corporations, RICs, and REITs.)

reported in the year 2017. However, the less than $0 income group reported the largest amount, $10.0 billion, which represents 17.9 percent of the total amount reported in the year 2017. The less than $0 income group had an average distribution of $129,348 and an average AGI of -$141,493. The $1 million and over income group had the largest average distribution and average AGI of $303,373 and $4,271,561, respectively. As shown in the table, taxpayers across income groups receive distributions from trusts and estates, as measured by both the total distributions received and the percentage shares. However, individuals in higher income groups receive on average higher distributions, while, at the same time, those distributions are more likely to account for a smaller percentage of AGI.

Table 2.–Distribution from Trusts and Estates by Distribution-Exclusive AGI Group, 2017

Income Group	Number of Returns (Thousands)	Total Distributions Received ($ Millions)	Share (%)	Average Distribution Received ($)	Average AGI Excluding Distributions ($)	Distributions as Percentage of AGI					
						<10% (Percent)	10%-25% (Percent)	25%-50% (Percent)	50%-75% (Percent)	75%-90% (Percent)	>90% (Percent)[1]
Less than $0	77	10,000	17 9	129,348	-141,493	*	*	*	*	*	*
$0-$15,000	231	3,026	5 4	13,075	18,577	24 9	9 5	18 2	21 4	13 7	12 3
$15,000-$30,000	139	3,724	6 7	26,875	49,357	35 8	18 0	18 2	16 4	9 9	1 7
$30,000-$50,000	144	3,812	6 8	26,391	66,846	40 2	24 4	17 2	14 0	3 8	0 5
$50,0000-$75,000	180	4,153	7 4	23,070	85,949	50 4	20 7	20 7	6 6	1 4	0 2
$75,000-$100,000	147	3,235	5 8	22,056	108,733	59 3	20 3	16 0	3 5	0 9	0 1
$100,000-$200,000	318	8,294	14 8	26,101	168,166	65 9	21 0	10 2	2 5	0 3	0 1
$200,000-$500,000	174	7,238	12 9	41,553	338,492	73 3	16 4	8 5	1 4	0 3	0 0
$500,000-$1,000,000	44	3,604	6 4	82,048	770,709	78 2	13 4	6 4	1 7	0 3	0 0
$1,000,000 and Over	29	8,899	15 9	303,373	4,271,561	83 6	9 9	4 8	1 5	0 2	0 1
Total	**1,484**	**55,987**	**100**	**37,735**	**210,854**	**53.3**	**18.2**	**14.4**	**8.2**	**3.8**	**2.0**

Note: "*" Distribution as a percentage of AGI is not calculated for returns with negative AGI   Details may not add due to rounding
[1] "0 0" less than 0 5 percent
Source: Joint Committee staff calculations

IV. DISCUSSION

A. Beneficial Ownership Determination and Information Reporting

Policymakers may be interested in whether there are patterns of noncompliance among taxpayers. Differing degrees of tax compliance may be associated with higher or lower income taxpayers and may further vary among types of taxpayers, including trusts, depending on whether taxpayers have sources of income that are more difficult for the IRS to identify and monitor than others. When taxpayers misreport their incomes, their "true" income is often invisible to the IRS, to policymakers, and to researchers. Because noncompliance may be attributable to actions ranging from unintentional taxpayer errors to intentional fraud, the Code provides a series of information reporting requirements, both self-reporting requirements as well as third-party information reporting.

Information reporting is intended to enable taxpayers in receipt of such reports to prepare their income tax returns accurately as well as to help the IRS determine whether such returns are correct and complete. These reporting rules affect trusts and estates in three ways. First, as explained in part II, trusts may be required to file tax returns. Information reporting may help ensure that trusts and estates properly report income with respect to entity interests or other assets they own. Second, individuals or other taxpayers may be beneficiaries of trusts or estates, and information reporting may help ensure that such ownership and related income is taken into account for income tax purposes. Finally, beneficial ownership determination and information reporting may help with transfer tax compliance.

In addition to information returns filed by trusts, trusts that are considered to be foreign for purposes of the Code are also subject to third-party reporting.[58] Such reporting provides the IRS with independent information about income received and taxes withheld, thus enabling the IRS to fulfill its oversight and enforcement roles.[59] The availability of reliable and objective third-party verification of income increases the probability that underreporting is detected, thereby potentially improving the overall level of compliance. The value of such reporting is limited however if the report does not identify, or enable identification of, the beneficial owner of the subject of the report. To the extent that trusts are formed under laws of jurisdictions that do not require disclosure of the identity of persons holding beneficial interests in the trusts, otherwise reportable receipts or transactions may go unreported.

1. Developments in beneficial owner concept under the Code

Until recently, none of the reporting or withholding provisions of the Code referred to beneficial owners, although the Code frequently refers to beneficial interests in property,

[58] Sections 6041 through 6060 encompass the third-party reporting requirements of the Code; section 6048 specifically applies to trusts that are foreign for Federal tax purposes.

[59] In fiscal year 2019, the IRS received more than 3.5 billion third-party information returns, 89.6 percent of which were filed electronically. In addition, individual income tax withheld totaled $1.35 trillion out of $1.98 trillion of individual income tax collected, before refunds. See Internal Revenue Service, *Data Book 2019*, Publication 55-B, Washington, DC, June 2020, Tables 1 and 22.

including in provisions relating to interests in trusts.[60] Because all persons required to make certain returns or statements must furnish a taxpayer identification number ("TIN") when doing so, a trust that is subject to reporting requirements will need to obtain its own TIN, by applying for an EIN. As part of that process, the IRS will identify an appropriate party as "the responsible party."[61] Where there is more than one responsible party with respect to an entity, the entity may list the party the entity wants the IRS to recognize as the responsible party.

In contrast, "beneficial owners" rather than responsible parties are required to be identified under the anti-money laundering regulations under the Bank Secrecy Act of 1970,[62] which require U.S. financial institutions to exercise due diligence in ascertaining the identity of persons opening financial accounts in addition to requiring banks to maintain records and submit reports on certain cash or cash equivalent transactions. Financial institutions are required to verify enough customer information to enable the financial institution to form a "reasonable belief that it knows the true identity of each customer."[63] To partially bridge the gap between the Code and the Bank Secrecy Act, the concept of a beneficial owner was introduced to the Code in designing the new withholding and reporting regime with respect to foreign account tax compliance and cross-border transactions in 2010, commonly referred to as FATCA.[64]

FATCA imposes a withholding tax equal to 30 percent of the gross amount of withholdable payments[65] to a foreign financial institution unless the foreign financial institution enters into an information reporting agreement with the Secretary under which the institution

[60] Secs. 672, 674, 676, 677. As discussed in Part II, section 6034A specifically addresses the need for trusts to report with respect to beneficiaries, including a TIN.

[61] Sec. 6109; Internal Revenue Service Website, *Small Business & Self Employed,* "Responsible Parties and Nominees," available at http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Responsible-Parties-and-Nominees. Where there is a nominee, the true responsible party is the principal officer, general partner, etc., not the nominee. Since 2019, the IRS has required that the applicant for the EIN be an individual with a valid tax ID number (whether SSN or Individual TIN), precluding entities from using their own numbers to obtain additional numbers. The application must disclose the name and TIN of the "true principal officer, general partner, grantor, owner or trustor," who will be considered by the IRS to be the responsible party. The term "beneficial owner" does appear in forms that enable foreign owners to establish foreign status, *e.g.,* Form W-8BEN (Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding) or Form W-8BEN-E, (Certificate of Status of Beneficial Owner for United States Tax Withholding and Reporting (Entities)), used by foreign individuals and foreign entities, respectively.

[62] 31 U.S.C. secs. 5311-5314e, 5316-5332e; 12 U.S.C. secs. 1829b and 1951-1959e.

[63] See 31 C.F.R. sec. 1020.220(a)(2).

[64] The Hiring Incentives to Restore Employment ("HIRE") Act, Pub. L. No. 111-147. Subtitle A of Title V of the HIRE Act, entitled "Foreign Account Tax Compliance," was based on legislative proposals in the Foreign Account Tax Compliance Act ("FATCA"), a bill introduced in both the House and Senate on October 27, 2009, as H.R. 3933 and S. 1934, respectively. FATCA added new Chapter 4 to Subtitle A of the Code. FATCA was enacted in the aftermath of private banking scandals involving evasion of U.S. tax by U.S. persons through the use of offshore accounts in certain low-tax or no-tax jurisdictions. For a discussion of those events, see Joint Committee on Taxation, *Explanation of Proposed Protocol to the Income Tax Treaty Between the United States and Switzerland* (JCX-31-11), pp. 23-38, May 20, 2011.

[65] Section 1473(1).

agrees to obtain information necessary to determine whether any accounts at such institution are U.S. accounts within the scope of FATCA.[66] The information to be reported for U.S. accounts includes (1) the name, address, and taxpayer identification number of each U.S. person or a foreign entity with one or more substantial U.S. owners holding an account, (2) the account number, (3) the account balance or value, and (4) except as provided by the Secretary, the gross receipts and gross withdrawals or payments from the accounts.[67] In contrast, U.S. financial institutions are required to report under the Code with respect to specific payments, such as interest received from a debtor or paid to an account holder, but not with respect to ownership of legal entities that may be recipients or payors of such interest.

In addition to the added responsibilities of foreign financial institutions, Congress also enacted a Code provision that loosely paralleled existing reporting obligations under the Bank Secrecy Act with respect to foreign accounts. Under these disclosure requirements, U.S. individuals with foreign financial assets must disclose on their Federal income tax returns their foreign financial assets and foreign financial accounts if the aggregate value of such assets exceeds $50,000.[68] To the extent required by regulations, a specified domestic entity that such an individual uses to hold such assets, directly or indirectly must also report. Regulations provide that domestic trusts described in section 7701(a)(30)(E) are generally within the scope of the term "specified domestic entity" if the trust was formed or availed of for the purpose of holding foreign financial assets and the current beneficiaries of the trust include at least one "specified person,"[69] but exceptions exist for certain domestic trusts owned by publicly traded entities, governmental units, banks, or exempt organizations.[70] Failure to comply with this reporting requirement results in a failure to disclose penalty, an increased accuracy-related penalty, and an extended limitations period for assessment of additional tax attributable to underreported income associated with the foreign financial assets.

2. Beneficial ownership information and multilateral efforts toward transparency

Roughly contemporaneously with the enactment of FATCA, the United States agreed to be one of the first jurisdictions subjected to peer review for compliance with new standards on exchange of information that the United States had helped develop as a member of the Organization for Economic Cooperation and Development ("OECD"). These standards are

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[66] A United States account is any financial account held by one or more specified United States persons or United States owned foreign entities. Sec. 1471(d). Depository accounts are not treated as United States accounts for these purposes if (1) each holder of the account is a natural person and (2) the aggregate value of all depository accounts held (in whole or in part) by each holder of the account maintained by the financial institution does not exceed $50,000. Sec. 1471(d)(1)(B).

[67] Sec. 1471(c).

[68] Sec. 6038D.

[69] Treas. Reg. sec. 1.6038D-6(c) defines specified domestic entities that must report foreign financial assets.

[70] Treas. Reg. sec. 1.6038D-6(d). Even if required to report, certain assets may be exempt from inclusion in the report to the extent that the reporting entity included such assets in other required reports. See Treas. Reg. sec. 1.6038D-7.

generally consistent with the obligations imposed by the United States under FATCA on foreign financial institutions, in that they require that countries maintain adequate information on cross-border transactions and financial accounts, including information on beneficial ownership of financial accounts. In addition, tax administrators must have access to such information for use in their exchange of information programs, the information requested to be exchanged need only be "foreseeably relevant" to the administration and enforcement of the domestic laws of a requesting State, and otherwise applicable bank secrecy laws in the jurisdiction receiving the request or lack of a domestic tax interest in the information are not acceptable objections to complying with the obligation to exchange information. Finally, the standards require strict confidentiality as to the information exchanged and are monitored for compliance by periodic peer reviews. These standards have since been widely accepted.[71]

The peer review process quickly identified a major shortcoming in the ability of the United States to retrieve and exchange information about beneficial ownership of financial accounts, resulting in a "largely compliant" rating in 2011 and an admonishment to improve its ability to provide beneficial ownership information. The failure to do so resulted in a rating of only "partially compliant" with respect to the ownership and identity information measures in the second round of reviews in 2018.[72]

The inability to comply with requests for information about foreign persons believed to have an interest in financial accounts maintained in the United States stems from the fact that State law controls the formation of legal entities and the record keeping required of those entities. Although banks are required to exercise due diligence (*i.e.,* "know your customer" rules) when opening an account, that does not necessarily result in maintenance of adequate information to identify all ultimate owners. No uniform system of determining the identity of owners of an interest in a U.S. entity is available to the Federal authorities, impairing enforcement of U.S. tax law as well as precluding reciprocity in exchanges of information with the many countries that do maintain such information at the national level.

Revisions of the Bank Secrecy Act were included in the National Defense Authorization Act in 2020, in the form of the Corporate Transparency Act. The legislation may alleviate the barrier to piercing bank secrecy and address the U.S. shortcomings identified in the OECD peer review reports, depending on how the new legislation is implemented. Among other things, it adds a provision on beneficial ownership reporting requirements.[73] The new provision requires

[71] The OECD work on international transparency and international tax evasion was undertaken at the request of the G-20 in 2008 and 2009, leading directly to publication of the standards as "terms of reference" for members of the OECD and formation of the Global Form on Transparency and Exchange of Information for Tax Purposes ("Global Forum"). The OECD has since updated the standards to reflect automatic exchange of information standards. The Global Forum oversees and conducts the peer reviews for adherence to the standards. For an overview of the work of the Global Forum and the standards, see Global Forum, *Transparency and Exchange of Information for Tax Purposes: Multilateral Cooperation Changing the World 10th Anniversary Report,* November 2019, available at https://www.oecd.org/tax/transparency/documents/global-forum-10-years-report.pdf. For updates, see https://www.oecd.org/tax/transparency.

[72] A chart displaying the specific categories and ratings assigned the United States in each peer review can be found at https://www.oecd.org/tax/transparency/documents/exchange-of-information-on-request-ratings.htm.

[73] 31 U.S.C. sec 5336, added by section 6403 of the Corporate Transparency Act.

that any person applying to form a legal entity under the laws of a State or Indian Tribe must provide acceptable identification of the applicant.

The entity formed after such application must submit to the Secretary a report including information identifying each beneficial owner and applicant. The legislation establishes a standard for determining beneficial ownership and requires creation of a Federal database to which reporting entities must report their beneficial ownership information.[74] Reporting entities are limited to corporations, limited liability companies and "similar entities." The Secretary has published an advance notice of proposed rulemaking for implementation of the standard and solicited public comments on the new database at FinCEN.[75]

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[74] National Defense Authorization Act for Fiscal Year 2021, Title LXIV, Pub. L. No. 116-283, January 1, 2021; Conference Report to Accompany H.R. 6395, H.R. Rep. 116-617, p. 4458.

[75] Treasury's Financial Crimes Enforcement Network (FinCEN) will create and maintain the new database. See FinCEN, "Beneficial Ownership Information Reporting Requirements," ANPRM, 86 Fed. Reg. 17557, 31 CFR Part 1010, April 5, 2021.

B. Use of Trusts to Avoid Transfer Tax

Taxpayers sometimes use trust arrangements to avoid transfer tax. First, grantors sometimes structure estate "freeze" transactions that leverage the ability to create a trust that is treated as separate from the grantor for transfer tax purposes but not for income tax purposes, sometimes referred to as an "intentionally defective grantor trust," or IDGT. In a simple estate freeze transaction, a grantor might transfer assets to an IDGT by way of a taxable gift during his or her lifetime. The gift tax value is measured ("frozen") at the time of the transfer, and any subsequent appreciation accrues to the trust (and ultimately the trust beneficiaries) without further gift or estate tax consequences, provided the trust is structured to avoid inclusion in the grantor's gross estate.

Some argue that the compressed rate brackets for trusts reduce or eliminate the need for the grantor trust rules as a tool to prevent the inappropriate shifting of income to lower tax brackets; the rules now are used primarily for transfer tax avoidance.[76] Other commentators seek to address the use of IDGTs for transfer tax avoidance by harmonizing or coordinating the income and transfer tax rules governing grantor trusts. For example, one academic would repeal most of the grantor trust rules and replace them with a single rule based on the standards for determining whether a transfer is a completed gift for gift tax purposes.[77] Alternatively, the Treasury Department has proposed harmonizing the income and transfer tax rules by imposing certain transfer tax consequences on a grantor trust.[78]

Second, taxpayers sometimes use grantor retained annuity trusts, or GRATs, to avoid gift or estate tax. A GRAT is an irrevocable grantor trust in which the grantor retains an annuity interest, with the remainder passing to other trust beneficiaries, such as the grantor's children, in a taxable gift. Because the interests are valued using rules that often overstate the value of the retained annuity and understate the value of the remainder interest, the grantor often is able to value the taxable gift at an amount far below the real economic value of the remainder interest.[79]

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[76] Leo L. Schmolka, "FLPs and GRATs: What to Do?," *Tax Notes*, March 13, 2000 (special supplement), p. 1473; Jay A. Soled and Mitchell Gans, "Sales to Grantor Trusts: A Case Study of What the IRS and Congress Can Do to Curb Aggressive Transfer Tax Techniques," *Tennessee Law Review*, vol. 78, Summer 2011, pp. 973, 1005.

[77] See Robert T. Danforth, "A Proposal for Integrating the Income and Transfer Taxation of Trusts," *Virginia Tax Review,* vol. 18, Winter 1999, pp. 545, 611-615.

[78] See, *e.g.*, Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2017 Revenue Proposals*, February 2016, pp. 180-182.

[79] The annuity is valued under tables prescribed by section 7520 of the Code, which requires use of an interest rate equal to 120 percent of the Federal midterm rate in effect under section 1274(d)(1). Sec. 2702(a). The remainder interest is valued by subtracting the value of the annuity interest (as derived from the annuity tables) from the value of assets transferred to the trust. If returns on trust assets exceed the rate of return assumed under the annuity tables, any excess appreciation may pass to the remainder beneficiaries and escape gift or estate taxation.

Some have proposed additional requirements for GRATs, including a minimum 10-year term, that likely would sharply limit their utility as tools to avoid gift or estate tax.[80]

Third, taxpayers sometimes avoid generation-skipping transfer ("GST") tax by allocating GST exemption to a "perpetual dynasty trust." Once a taxpayer allocates GST exemption to a trust, the trust assets often may grow indefinitely, benefiting beneficiaries in multiple successive generations without further GST tax consequences. Some have argued that this result is inconsistent with one of the principal purposes of the GST tax: to impose transfer tax at each generational level.[81]

Policymakers could address the use of perpetual dynasty trusts by prohibiting any allocation of generation skipping tax exemption to a trust that could benefit generations other than the transferor's children or grandchildren.[82] Others have suggested that the GST exemption allocated to a trust should expire within a specified period of time. For example, in its revenue proposals for Fiscal Year 2017, the Administration proposed a rule under which the generation skipping transfer exclusion allocated to a trust terminates on the 90th anniversary of the creation of the trust.[83]

These changes may make the transfer tax system administratively less complex and increase tax collection. However, policymakers should consider how these changes may interact with each other, as well as with the transfer tax system and the income tax system.

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[80] See, *e.g.*, Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2017 Revenue Proposals,* February 2016, pp. 180-182.

[81] Since the original enactment of the GST tax, many States have repealed or sharply limited application of their rules against perpetuities, which limited the maximum duration of a trust.

[82] See, *e.g.*, Joint Committee on Taxation, *Options to Improve Tax Compliance and Reform Tax Expenditures* (JCS-02-05), January 27, 2005, p. 392.

[83] See, *e.g.*, Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2017 Revenue Proposals*, February 2016, pp. 183-184.