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ATTORNEY CLIENT PRIVILEGED INFORMATION

October 8, 2025

Asset Protection Services of America Trust
c/o Jay Butler, Trustee
732 South 6th Street
Suite N
Las Vegas, Nevada 89101

Re: Application of IRC § 643(b) to the Income Taxation of Non-Grantor Trusts

Dear Mr. Butler:

Attached you will find the legal opinion you have asked my office to prepare in connection with the interpretation and application of IRC § 643(b) to the Benson Financial Non-Grantor, Irrevocable, Complex, Discretionary, Spendthrift Trust.

Should you or your office have any questions, please do not hesitate to contact me.

Very truly yours,

Steven E. Gurian, Esq., LLM

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October 2, 2025

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c/o Jay Butler, Trustee
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Ladies and Gentlemen:

We have acted as counsel to Asset Protection Services of America Trust, in connection with the above-referenced matter. Asset Protection Services of America Trust, has requested that we deliver this opinion to you, and we understand that Asset Protection Services of America Trust will rely on this opinion and the legal analysis contained herein.

BACKGROUND

Non-Grantor, Irrevocable, Complex, Discretionary, Spendthrift Trusts (hereinafter the "Trust") were created as an asset protection and tax planning vehicle. A third-party settlor, acting on behalf of the taxpayer creates and funds the Trust, and the taxpayer gives the authority to add or remove trustees and beneficiaries to a compliance officer/ overseer. The Trustee manages the day to day operations of the Trust including the filing and payment of federal income tax, but does not have the authority to add/remove trustees and beneficiaries. By designating the Trust as a non-grantor trust, the settlor of the Trust gives up control over any assets that are transferred to it. Consequently, these assets become creditor protected. Likewise, the spendthrift provision in the Trust adds an extra layer of protection by eliminating the beneficiaries' ability to transfer or assign their interest in the trust. The spendthrift provision also prevents creditors from attaching or taking Trust assets that are for the benefit of the beneficiary. The spendthrift provision of the Trust protects a beneficiary's interest in the Trust from both voluntary and involuntary transfers, including claims by creditors. A valid spendthrift provision must restrain both voluntary and involuntary transfers of the beneficiary's interest which is the case with the Trust. This means that creditors generally cannot attach to the assets of the trust or compel distributions to satisfy debts before the beneficiary receives the distribution.[1]

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[1] *See* Fla. Stat. § 736.0502; *See also In re Williams,* 118 B.R. 812, 813 (Bankr. N.D. Fla 1990); *Kraft v. Commissioner*, 142 T.C. 259, 266 (2014)(holding that the commissioner looks to state law to determine the validity and enforceability of a spendthrift provision in order to determine whether or not a taxpayer has "property" or "rights to property" that could be the subject of levy.

From a tax standpoint, by structuring the Trust as a non-grantor Trust, the settlor does not pay tax on any income earned, but rather the trust has its own obligation to pay tax as a legally distinct entity. However, when a non-grantor trust makes a distribution to a beneficiary, the taxable ordinary income is passed to the beneficiary and taxed on their personal income tax return. Additionally, the Trust may take advantage of certain business deductions under IRC § 162 for ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business. A non-grantor trust is treated as a separate taxable entity, and it may deduct expenses under IRC § 162 if it engages in a trade or business. If the Trust is primarily engaged in passive activities, *e.g.*, investment management, those expenses may not qualify as IRC § 162 deductions; however, they instead might fall under IRC § 212, which covers expenses for the production of income.

IRC § 643(b) clearly and unambiguously states:

> (b) Income
> For purposes of this subpart and subparts B, C, and D, the term "income", when not preceded by the words "taxable", "distributable net", "undistributed net", or "gross", means the amount of income of the estate or trust for the taxable year determined under the terms of the governing instrument and applicable local law. Items of gross income constituting extraordinary dividends or taxable stock dividends which the fiduciary, acting in good faith, determines to be allocable to corpus under the terms of the governing instrument and applicable local law shall not be considered income.

A plain reading of IRC § 643(b) would remove extraordinary dividends or taxable stock dividends from the definition of "income" if a fiduciary has the sole and absolute authority to designate something as extraordinary dividends or taxable stock dividends, and that designation is paid to the corpus of the Trust and not subject to distribution. Such interpretation and classification of extraordinary dividends or taxable stock dividends as "non-income" would make those alternate forms of the "income" under IRC § 643(b) non-taxable.

IRC § 162 allows for a deduction of:

> all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including –
>
> (1) a reasonable allowance for salaries or other compensation for personal services actually rendered;
>
> (2) traveling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business; and

(3) rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

Non-grantor trusts are treated as separate entities for tax purposes, meaning they file their own tax returns, *i.e.,* Form 1041, and pay taxes on their income. As separate taxpayers, they are entitled to deductions that any other taxpayer engaged in a trade or business can claim, provided they meet the criteria.

While as of the date of this Opinion no legal authority challenging the use of the Trust exists, on August 18, 2023, the Office of Chief Counsel for the Internal Revenue Service released an internal memorandum (Number: AM 2023-006) (hereinafter the "Memorandum") which addressed the use of this Trust as an estate planning tool. The Memorandum states that the structure does not offer the tax benefits claimed by promoters of the Trust. Specifically, the Memorandum states that any and all promotional materials on the Trust take IRC § 643(b) out of context and that IRC § 641 is not factored into any analysis concerning the taxation of the Trust. It is important to note that the Memorandum is not binding precedent, and the Internal Revenue Service has not issued an opinion on the Trust, nor has a court of competent jurisdiction issued an opinion on the Trust.

In light of the above, we were asked to opine on the following matters with respect to application of IRC § 643(a) and (b) to Non-Grantor, Irrevocable, Complex, Discretionary, Spendthrift Trusts and the use of the Trust:

1. In the context of IRC § 643, is there a distinction between "distributable net income" and "taxable income?"
2. Whether the Trust will recognize income on its capital gains?
3. Whether the Trust will recognize income on extra ordinary dividends?
4. Whether the Trust can take advantage of deductions under IRC § 162?
5. How a contribution to the Trust would be made in compliance with the Internal Revenue Code and Regulations?

GENERAL QUALIFICATIONS AND ASSUMPTIONS

For purposes of this opinion we have examined the executed original, or a copy certified or otherwise authenticated to our satisfaction of only the documents listed on the attached **Exhibit "A"** (the "Documents"). With respect to the Documents we have assumed: (i) the genuineness of all signatures, and the incumbency, authority, legal right and power and legal capacity under all applicable laws and regulations, of the officers and other persons and entities signing each of said documents as or on behalf of the parties thereto; (ii) the authenticity of all documents submitted to us as originals; (iii) the conformity to authentic originals of all documents submitted to us as certified, conformed, or photostatic copies; (iv) the due execution and delivery of all documents by all parties thereto (including those documents furnished to us in unexecuted form); and (v) that the aforesaid documents, in the forms thereof submitted to us for our review, have not been and will not be altered or amended in any respect material to our opinion. For the purposes of rendering our opinion, we have not reviewed any document other than the documents set forth above and we assume that there exists no provision of any such other document that bears upon or is inconsistent with our opinion. We have conducted no independent factual investigation of our own, but rather have relied solely upon the foregoing documents, the statements, representations, and information set forth therein, and the additional matters recited or assumed herein, all of which we assume to be true, complete, and accurate in all material respects. Notwithstanding anything to the contrary set forth herein, we are not aware of any facts or circumstances that render our assumptions false, misleading, or materially incorrect.

We have also assumed that: (i) there has not been any mutual mistake of fact or misunderstanding, fraud, duress, or undue influence in connection with the transactions described herein; (ii) the conduct of the parties to the transactions that are the basis for your request for this opinion has complied with all tax reporting requirements, applicable laws (federal, state, and/or local), and any requirement of good faith, fair dealing, and conscionability in all respects material; (iii) that the information contained in any and all tax reporting forms would be accurate and comport with the Internal Revenue Code, Treasury Regulations, and all local and federal laws; (iv) you and your agents have acted in good faith and without notice of any facts or allegations that would be inconsistent, in any material respect, with the facts and assumptions contained, or the opinion as expressed, herein; (v) the constitutionality or validity of a relevant statute, rule, regulation, or agency action is not in issue unless a reported decision has specifically addressed but not resolved, or has established, its unconstitutionality or invalidity; (vi) other documents (aside from those executed in connection with the creation and administration of the Trusts) and court orders (pertaining to matters arising from or directly affecting the Trusts) have not been written, entered, rendered, authored, or otherwise provided to us that have or would undermine our opinion; and (vii) any and all tax reporting obligations have been met and are an accurate reflection of the transactions reported therein and are in conformity with the Internal Revenue Code and applicable law.

We have also assumed that the parties to the Documents have in all material respects complied and will comply at all times with their respective representations, warranties, covenants duties, and agreements contained in the Documents, and have not taken or made and will not take or make any actions or statements that are in any material respect inconsistent with or contradictory to such representations, warranties, covenants and agreements. Further, we have assumed that the Trust are not or will not be used in a manner that is inconsistent with the tax reporting, filing, and payment requirements imposed by the Internal Revenue Code.

The law covered by the opinion expressed herein is limited to the Internal Revenue Code, Treasury Regulations, as well as the express provisions of the Trust (the “Opining Law”). Accordingly, we do not express any opinion as to any matter governed by any law other than the Opining Law.

We express no opinion as to any matter not specifically set forth herein. We express no opinion on whether a court of competent jurisdiction, including but not limited to the United States Tax Court, United States Courts of Appeals, and/or Supreme Court of the United States would or would not, enter an order or judgment in contravention to the opinions set forth herein. We cannot opine as to what action a court will take in the future when reviewing actions that have or have not occurred as of the date hereof. This opinion is expressly limited to the inquires stated *supra.*

OPINIONS

A. Distributable Net Income and Taxable Income

It is our opinion that IRC § 643(a) modifies what is considered taxable income as defined in IRC § 63(a). Specifically, IRC § 643(a)(1) through (4) make modifications to what would otherwise be taxable income. Further, the Trust allows the trustee to determine the allocation of principal, income, and capital gains.

B. Taxation of Capital Gains

It is our opinion that the gains from the sale or exchange of a capital asset will be excluded from taxable income to the extent that such gains are allocated to the corpus of the Trust and are not paid, credited, or required to be distributed to any beneficiary during the taxable year. The trusts provided in Exhibit “A” appear to comport with IRC § 643 and provide the fiduciary-trustee with the discretion for such an allocation, as would presumably, local law and/or state law. The Trust allows the trustee to determine the allocation of principal, income, and capital gains.

C. Taxation of Extraordinary Dividends

It is our opinion that extraordinary dividends or taxable stock dividends are excluded from gross income so long as the fiduciary-trustee does not pay or credit to any Trust beneficiary such dividends that are allocable to corpus under the terms of the governing instrument and local law. The trusts provided in Exhibit “A” appear to comport with IRC § 643 and provide the fiduciary-trustee with the discretion for such an allocation, as would presumably, local law and/or state law.

D. Deductions Under IRC § 162

It is our opinion that the Trust is entitled to the deductions allowable under IRC § 162, Treas. Reg. § 1.482-1, and Treas. Reg. § 1.162.1 so long as the Trust actively carries on a trade or business. This requires more than passive investment activities, such as owning rental properties or holding stocks and bonds. Courts have generally required regular, continuous, and substantial activity. Further, the expenses must be both ordinary, *i.e.,* common and accepted in the business, and necessary, *i.e.,* helpful and appropriate for the business. If the Trust is primarily engaged in passive activities, *e.g.,* investment management, those expenses may not qualify as IRC § 162 deductions. Rather, they might fall under IRC § 212, which covers expenses for the production of income.

ASSUMPTIONS OF FACT

A. Trustees

1. Each trustee has complied at all times and in all respects material with the provisions of Trust.
2. Each trustee has not and will not engage in any type of fraudulent activity in connection with the Trust.
3. Each trustee and their agents and/or representatives has not taken any action in contravention to the Trust.
4. Each trustee has filed a complete and accurate tax return in conformity with applicable law.

B. Purpose of the Trust

1. That the Trust complies with IRC § 2511 and 26 U.S.C. Subtitle A.
2. That the Trust is property funded and complies with state law.
3. That the asset protection benefits of the Trust comport with local and state law.
4. That gross income generated by the Trust would constitute an extraordinary dividend as defined in IRC § 643(b).

LEGAL ANALYSIS

A. Discussion of the Law.

The following discussion comprises of our analysis in reaching the opinion expressed herein and does not constitute an independent opinion as to any element of the analysis.

1. The Characterization of Distributable Net Income vs. Taxable Income within the Meaning of IRC§ 643

   Under **IRC § 61(a),** the Internal Revenue Code defines gross income as follows:

   (a) General definition - Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

(1) Compensation for services, including fees, commissions, fringe benefits, and similar items; (2) Gross income derived from business; (3) Gains derived from dealings in property; (4) Interest; (5) Rents; (6) Royalties; (7) Dividends; (8) Annuities; (9) Income from life insurance and endowment contracts; (10) Pensions; (11) Income from discharge of indebtedness; (12) Distributive share of partnership gross income; (13) Income in respect of a decedent; and (14) Income from an interest in an estate or trust.

Under **IRC § 63(a)**, the Internal Revenue Code defines taxable income as follows:

(a) In general - Except as provided in subsection (b), for purposes of this subtitle, the term "taxable income" means **gross income** minus the deductions allowed by this chapter (other than the standard deduction). *[Emphasis Added].*

Under **IRC § 641(a)**, the Internal Revenue Code imposes tax on income of trusts and estates as follows:

(a) Application of tax - The tax imposed by section 1(e) shall apply to the taxable income of estates or of any kind of property held in trust […].

IRC **§ 643(a)** clearly and unambiguously states:

(a) Distributable net income

For purposes of this part, the term "distributable net income" means, with respect to any taxable year, the taxable income of the estate or trust **computed with the following modifications** —

(1) Deduction for distributions

No deduction shall be taken under sections 651 and 661 (relating to additional deductions).

(2) Deduction for personal exemption

No deduction shall be taken under section 642(b) (relating to deduction for personal exemptions).

(3) Capital gains and losses

Gains from the sale or exchange of capital assets shall be excluded to the extent that such gains are allocated to corpus and are not (A) paid, credited, or required to be distributed to any beneficiary during the taxable year, or (B) paid, permanently set aside, or to be used for the purposes specified in section 642(c). Losses from the sale or exchange of capital assets shall be excluded, except to the extent such losses are taken into account in determining the amount of gains from the sale or exchange of capital assets which are paid, credited, or required to be distributed to any beneficiary during the taxable year. The exclusion under section 1202 shall not be taken into account.

(4) Extraordinary dividends and taxable stock dividends

For purposes only of subpart B (relating to trusts which distribute current income only), **there shall be excluded those items of gross income constituting extraordinary dividends or taxable stock dividends which the fiduciary, acting in good faith, does not pay or credit to any beneficiary by reason of his determination that such dividends are allocable to corpus under the terms of the governing instrument and applicable local law.** *[Emphasis Added].*

A cursory overview of IRC § 61(a) would demonstrate that any revenue generated from the enumerated specified sources of income would be categorized as "gross income". IRC § 63(a) goes on to state that "gross income" minus allowable deductions is categorized as "taxable income." Under IRC § 643(a), Distributable Net Income is "taxable income," *i.e.,* income that is taxable under IRC § 63(a), that is computed with the **modifications** delineated in subsections (1) through (4). In other words, IRC § 643, *et. seq.,* modifies the definition of taxable income, and therefore the method of calculation, of what would be considered taxable income. *See* Treas. Reg. § 1.643(a)-0 (defining taxable income (as defined in section IRC § 63) of the estate or trust, computed with the modifications set forth in §§ 1.643(a)–1 through 1.643(a)–7). Reading IRC § 643(a) in conjunction with Treas. Reg. § 1.643(a)-0 would demonstrate that what is considered taxable income under IRC § 63(a) is modified by the plain language of IRC § 643(a)(1) through (4). Here, the Trust allows the trustee to determine the allocation of principal, income, and capital gains.

Because IRC § 643(a) is clear and unambiguous, it must be afforded its plain and obvious meaning. *See CRI-Leslie, LLC v. Comm'r of Internal Revenue,* 147 T.C. 217, 224 (2016), aff'd, 882 F.3d 1026 (11th Cir. 2018)(holding that a court will interpret a statute according to its plain meaning). It is therefore our opinion that IRC § 643(a) reasonably modifies taxable income as defined in IRC § 63(a), by virtue of subsections (1) through (4). Therefore, the assessment made in the Memorandum with respect to IRC § 643(a) not acting as a modifier of IRC § 63(a) is inaccurate and incomplete at best, as the Memorandum fails to properly analyze the entirety of IRC § 643(a). Further, the Memorandum's analysis with respect to IRC § 643(b) is also incomplete.

IRC § 643(b) clearly and unambiguously states:

(b) Income

For purposes of this subpart and subparts B, C, and D, the term "income", when not preceded by the words "taxable", "distributable net", "undistributed net", or "gross", means the amount of income of the estate or trust for the taxable year determined under the terms of the governing

> instrument and applicable local law. **<u>Items of gross income constituting extraordinary dividends or taxable stock dividends which the fiduciary, acting in good faith, determines to be allocable to corpus under the terms of the governing instrument and applicable local law shall not be considered income</u>**. *[Emphasis Added].*

The Memorandum fails to address the fact that both subsections (a) and (b) modify the meaning of "taxable income." IRC § 643(b) specifically states that unless the words "taxable", "distributable net", "undistributed net", or "gross", precede the word "income", then "income" would mean the amount of income of the estate or trust for the taxable year determined under the terms of the governing instrument and applicable local law. *See also* Treas. Reg. § 1.643(b)-1. Clearly, there is a modification of what constitutes "income" under IRC § 643(b) as well.

In essence, IRC § 61(a)(14) states that income received by a trust is considered gross income which is then modified by IRC § 63(a), which allows for deductions. It is IRC § 63 that creates the concept of taxable income (gross income minus allowable deductions). Once taxable income is determined, IRC § 641(a) then provides the framework for further computing taxable income within the context of a trust. IRC § 643 then modifies the computation under IRC § 641(a) by providing rules for excluding certain amounts *e.g.,* extraordinary dividends or capital gains allocated to corpus from distributable net income.

2. <u>Taxation of Capital Gains</u>

IRC § 643(a)(3) clearly and unambiguously states:

> **<u>(3) Capital gains and losses</u>**
>
> **<u>Gains from the sale or exchange of capital assets shall be excluded to the extent that such gains are allocated to corpus and are not (A) paid, credited, or required to be distributed to any beneficiary during the taxable year, or (B) paid, permanently set aside, or to be used for the purposes specified in section 642(c)</u>**. Losses from the sale or exchange of capital assets shall be excluded, except to the extent such losses are taken into account in determining the amount of gains from the sale or exchange of capital assets which are paid, credited, or required to be distributed to any beneficiary during the taxable year. The exclusion under section 1202 shall not be taken into account.

The Memorandum states that the Trust will recognize income on its capital gains and dividends, except to the extent those amounts are distributed or deemed to be distributed to its beneficiaries. Looking at IRC § 643(a)(3) as a whole, the assessment made in the Memorandum is correct. Gains from the sale of a capital asset are excluded to the extent that such gains are allocated to corpus and are not paid, credited, or required to be distributed to the beneficiary during the taxable year, or paid, permanently set aside, or to be used for the purposes specified in section 642(c). Treas. Reg. § 1.643(a)-3 expounds further by stating that gains from the sale or exchange of capital assets are ordinarily excluded from distributable net income and are not ordinarily considered as paid, credited, or required to be distributed to any beneficiary except as provided for in § 1.643(a)–6 and paragraph (b) of this section which addresses income from foreign trusts and certain sales of capital assets.

Treas. Reg. § 1.643(a)-3(b) clearly and unambiguously states:

> (b) Capital gains included in distributable net income. Gains from the sale or exchange of capital assets **<u>are included in distributable net income to the extent they are, pursuant to the terms of the governing instrument and applicable local law, or pursuant to a reasonable and impartial exercise of discretion by the fiduciary</u>** (in accordance with a power granted to the fiduciary by applicable local law or by the governing instrument if not prohibited by applicable local law)—
>
> (1) **<u>Allocated to income</u>** (but if income under the state statute is defined as, or consists of, a unitrust amount, a discretionary power to allocate gains to income must also be exercised consistently and the amount so allocated may not be greater than the excess of the unitrust amount over the amount of distributable net income determined without regard to this subparagraph § 1.643(a)–3(b));
>
> (2) **<u>Allocated to corpus but treated consistently by the fiduciary on the trust's books, records, and tax returns as part of a distribution to a beneficiary</u>**; or
>
> (3) **<u>Allocated to corpus but actually distributed to the beneficiary or utilized by the fiduciary in determining the amount that is distributed or required to be distributed to a beneficiary.</u>** *[Emphasis Added].*

Subsections (1) through (3) describe the only three instances (with its own set of limitations) where capital gains **<u>would</u>** be included in distributable net income. Because IRC § 643(a) modifies taxable income as defined in IRC § 63(a), by virtue of subsections (1) through (4), it is reasonable to infer that gain from the sale or exchange of a capital asset is likewise excluded from taxable income.

3. <u>Taxation of Extraordinary Dividends</u>[2]

IRC § 643(a)(4) clearly and unambiguously states:

> (4) Extraordinary dividends and taxable stock dividends

[2] Although the focus of this opinion is the taxation of a complex trust, under Treas. Reg. § 1.643(a)-4 "a trust which qualifies under subpart B (section 651 and following) as a "simple trust," there are excluded from distributable net income extraordinary dividends or taxable stock dividends which are not distributed or credited to a beneficiary because the fiduciary in good faith determines that under the terms of the governing instrument and applicable local law such dividends are allocable to corpus."

> For purposes only of subpart B (relating to trusts which distribute current income only), **<u>there shall be excluded those items of gross income constituting extraordinary dividends or taxable stock dividends which the fiduciary, acting in good faith, does not pay or credit to any beneficiary by reason of his determination that such dividends are allocable to corpus under the terms of the governing instrument and applicable local law</u>**. *[Emphasis Added].*

The plain language of IRC § 643(a)(4) excludes extraordinary dividends and taxable stock dividends from gross income so long as the fiduciary-trustee does not pay or credit to any Trust beneficiary such dividends that are allocable to corpus under the terms of the governing instrument and local law.

The Memorandum also addresses **IRC § 643(b)** which clearly and unambiguously states:

> (b) Income
>
> For purposes of this subpart and subparts B, C, and D, the term "income", when not preceded by the words "taxable", "distributable net", "undistributed net", or "gross", means the amount of income of the estate or trust for the taxable year determined under the terms of the governing instrument and applicable local law. **<u>Items of gross income constituting extraordinary dividends or taxable stock dividends which the fiduciary, acting in good faith, determines to be allocable to corpus under the terms of the governing instrument and applicable local law shall not be considered income</u>**. *[Emphasis Added].*

A plain reading of the pertinent portions of IRC § 643(b) at issue would demonstrate that gross income that is characterized as extraordinary dividends or taxable stock dividends would not be considered income. As stated *supra*, IRC § 61(a) delineates 14 classes of income which are subject to taxation by virtue of IRC § 63(a) (minus deductions). Therefore, if IRC § 643(b) explicitly removes extraordinary dividends or taxable stock dividends from income as defined in IRC § 61(a), it therefore would not be subject to tax under IRC § 63(a), assuming that certain conditions precedent are met. *See* Treas. Reg. § 1.643(b)-2 ("Extraordinary dividends or taxable stock dividends which the fiduciary, acting in good faith, determines to be allocable to corpus under the terms of the governing instrument and applicable local law are not considered "income" for purposes of subpart A, B, C, or D, part I, subchapter J, chapter 1 of the Code. *See also* section 643(a)(4), § 1.643(a)–4, § 1.643(d)–2, section 665(e), paragraph (b) of § 1.665(e)–1, and paragraph (b) of § 1.665(e)–1A for the treatment of such items in the computation of distributable net income"). In sum, IRC § 643(b) offers a deferral mechanism for the payment of income tax only to the extent sums are not distributed out from trust, to trust beneficiaries. It is not a perpetual tax avoidance scheme, but a tax deferral mechanism similar to that of a like-kind exchange under IRC § 1031 or a tax-deferred exchange of property for stock in a corporation under IRC § 351.

Some materials have criticized the interplay between IRC § 643 and IRC § 641. For instance, some critics have taken the position that the promotional materials do not address IRC § 641 which provides that the trust's taxable income is computed as it is for individuals; however, these materials fail to account for the modification of IRC § 643(a).

IRC § 641(b) clearly and unambiguously states:

> The taxable income of an estate or trust shall be computed in the same manner as in the case of an individual, **<u>except as otherwise provided in this part</u>**. The tax shall be computed on such taxable income and shall be paid by the fiduciary. For purposes of this subsection, 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. *[Emphasis Added].*

While IRC § 641 serves as the foundational section for determining the taxable income of trusts and estates, it can be modified pursuant to its very own language. IRC § 641 provides that Subpart A can modify the computation of taxable income. Subpart A consists of IRC §§ 641 through and including 646. IRC § 641 establishes that trusts are separate taxable entities and provides the framework for computing their taxable income. IRC § 641 governs the tax computation of ordinary income, *e.g.,* interest, dividends, rent, capital gains, and other items not excluded under IRC § 643. However, IRC § 643 does modify this computation as IRC § 643(a) provides rules for excluding certain amounts *e.g.,* extraordinary dividends or capital gains allocated to corpus from distributable net income. In other words, IRC § 641 simply ensures that the trusts overall taxable income is properly computed.

It is important to note that distributable net income exclusions are not full exemptions. Even if an amount like an extraordinary dividend is excluded from distributable net income under IRC § 643(a), it does not mean it escapes taxation. Rather, the trust must compute its total taxable income under IRC § 641, including amounts allocated to corpus unless another specific provision *e.g.,* IRC § 643(a)(4) excludes it. In other words, if a fiduciary allocates extraordinary dividends or gains to corpus, IRC § 643 allows for their exclusion from distributable net income. Under IRC § 641, the trust still determines if these corpus allocations are taxable to the trust itself; however, IRC § 643 would be the tool used to determine whether or not extraordinary dividends or gains are allocated to the corpus of the trust. If allocated to the corpus of the trust, the allocation would be classified as undistributed net income; however, the allocated amount would not be subject to taxation by virtue of IRC § 643(a)[3][4]. For

[3] Note that distributions for health, education, support, and maintenance are taxable to the beneficiary only if they consist of taxable income generated by the trust. If the distributions are from the trust's principal, they generally are not taxable as income to the beneficiary. Reviewing the trust's tax filings and consulting with a tax advisor is advisable for precise determinations.

[4] Additionally, IRC § 2503(e). provides that qualified transfers made directly to a medical care provider or educational institution for someone else's benefit are not subject to gift tax.

example, if the corpus allocation is treated as a return of principal (as in PLR-133314-14), it might avoid taxation at both the trust and beneficiary levels.

In a relatively recent Private Letter Ruling, the Internal Revenue Service addressed the tax implications of a settlement agreement involving a family trust and its beneficiaries while analyzing and applying IRC § 643. Private Letter Ruling (PLR) 201519012[5], also known as PLR-133314-14, was issued by the Internal Revenue Service on May 8, 2015.

The case involved a family trust that became the subject of litigation among the decedent's descendants. To resolve the disputes, the parties entered into a settlement agreement, which included the following key provisions: 1) Termination of Interests: The interests of certain great-grandchildren in the trust would be completely terminated in exchange for a distribution of a specified amount to each from the trust; 2) Funding the Distributions: To fund these distributions, an LLC would distribute a certain amount to its members, of which a portion would go to the trust; 3) Dismissal of Claims: The great-grandchildren would dismiss their claims with prejudice, and other family members would dismiss their respective claims; 4) Income Distribution Adjustments: Until the death of a specific grandchild, the income of the trust would be distributed among specified beneficiaries in defined percentages, and 5) Post-Death Distributions: Following the death of the grandchild, all distributions to beneficiaries by the trust would be determined under the terms of the trust, assuming that both of the specified great-grandchildren were deceased and not survived by issue. The Internal Revenue Service was asked to rule on several tax implications of this settlement, including whether the trust would continue to be exempt from the Generation-Skipping Transfer Tax provisions and how the distributions would be treated for income tax purposes.

The Internal Revenue Service issued favorable rulings on all requested points, including
the exemption from the Generation Skipping Transfer Tax of distributions to the great-grandchildren. However, what is noteworthy is that the Internal Revenue Service ruled that the distribution received by the trust from the LLC, pursuant to the settlement agreement, was considered an extraordinary dividend and excluded from the definition of "income" within the meaning of IRC § 643(b). The characterization of the LLC distribution to the trust under the settlement agreement was a return of corpus. Because it qualified as an extraordinary dividend and was allocated to corpus, it fell outside the definition of "income" under IRC § 643(b). As a result, the trust did not include that amount in its taxable income. *i.e.,* distributable net income, and thus the beneficiaries likewise did not have to report it as income under IRC § 662. The key takeaway is application of the extraordinary dividend exception. The revenue ruling confirms that if a fiduciary, in good faith, allocates an extraordinary dividend to corpus under valid instrument terms and state law, it is excluded from distributable net income and taxable income under IRC § 643(b). Here, reliance on IRC §§ 643(a)(4) and 643(b)

[5] While this ruling turned on a specific set of facts and should not be considered precedent for other taxpayers, it does offer insight into the application of IRC § 643.

— the “good faith allocation to corpus” removed the amount from the definition of income.

From a practical application standpoint, the Internal Revenue Service agreed that the distribution was an extraordinary dividend allocated to corpus, allowing its exclusion from distributable net income. Despite being excluded from distributable net income, the trust still needed to consider the distribution under IRC § 641 to determine whether it represented taxable income, *e.g.,* ordinary income, capital gains. The Internal Revenue Service concluded that the distribution qualified as a return of corpus, thus avoiding taxation under IRC § 641. With respect to the beneficiaries, because the amount was excluded from distributable net income and properly treated as corpus, it was not taxed to the beneficiaries under IRC § 662.

4. <u>Deductions Allowable Under IRC § 162</u>

Deductions for trust expenses can be allowed to the trust under IRC § 162 and Treas. Reg. § 1.162-1, provided the expenses meet the requirements for being an ordinary and necessary business expense.

> **IRC § 162(a)** clearly and unambiguously states:
>
> (a) In general
>
> There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including—
>
> (1) a reasonable allowance for salaries or other compensation for personal services actually rendered;
>
> (2) traveling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business; and
>
> (3) rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

Under **IRC § 162(a)**, a trust can deduct certain expenses if they possess the following key requirements for deductibility: (1) Ordinary, *i.e.,* common and accepted in the type of business the trust operates, (2) Necessary, *i.e.,* appropriate and helpful for the trust’s business operations, (3) Incurred during the taxable year *i.e.,* the expenses must be paid or incurred in the current tax year that the deduction is being sought, and (4) Reasonable, *i.e.,* the lease payments should not exceed what would be expected in an arm’s-length transaction.

For example, if the Trust were to take a deduction for lease payments in connection with a business, and the lease payments are a necessary, customary, and ordinary business expense, the Internal Revenue Service would ordinarily allow such a deduction. *See B. Forman Co. v. Commissioner,* 453 F.2d 1144, 1160 (2d Cir. 1972) (holding that the test for determining deductibility of business expense is whether hard-headed businessman, under the circumstances, would have incurred the expense). If lease agreements were executed with the intent of furthering a business purpose already in existence before or at the time of the creation of the Trust, the Trust would be allowed to take a deduction for the payments. If the Trust and the lessee have a business purpose for entering into a lease agreement, *e.g.,* if a lessee is leasing equipment, office space, or other property essential to its operations, those payments could qualify for a deduction under IRC § 162. Further, if the leased property is being used in the lessee's trade or business and not for personal purposes. Finally, the lease is a true lease and not a disguised sale or financing arrangement. This distinction ensures that the payments qualify as deductible rental expenses and not as capital expenditures.

Under **Treas. Reg. § 1.162-1(a)**, "Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, such as salaries, rentals, or other payments for the use of property." The regulation explicitly includes "rentals" as an example of deductible business expenses if they are ordinary, necessary, and directly connected with the business. If the Trust conducts or operates a business then the lease payments in the instant example are deductible because they represent a cost incurred to generate income in the business. Therefore, deducting them matches expenses with the income they help produce, adhering to the principle of matching expenses under tax accounting. They are also considered a legitimate, recurring cost of doing business, similar to salaries, supplies, or utilities.

As long as the Trust meets these criteria and substantiates the expenses with appropriate documentation, *e.g.,* lease agreements and proof of payment, lease payments should qualify as deductible business expenses. If the Trust is primarily engaged in passive activities, *e.g.,* investment management, those expenses may not qualify as IRC § 162 deductions. Rather, they might fall under IRC § 212, which covers expenses for the production of income. In some two trust structures, one trust is allocated or funded with passive income assets which take advantage of deductions under IRC § 212 while another trust may contain assets that generate income from an active trade or business and are thus allowed deductions under IRC § 162.

B. <u>Illustrative Example</u>

Here are two illustrative examples of contributions and use of Trusts as an asset protection/tax planning vehicle.

1. <u>Traditional Non-Grantor, Irrevocable, Complex, Discretionary, Spendthrift Trust</u>

As discussed above, the first method would be where a third-party settlor, acting on behalf of the taxpayer creates and funds the Trust, and the taxpayer is appointed as trustee and is given the authority to add or remove trustees and beneficiaries. The taxpayer-client can sell an appreciated capital assets to the Trust in exchange for a demand note, the demand note would be based on the book value or the taxpayer-client's basis in the contributed asset. In either scenario, if there is a capital event such as the sale of real estate, capital gains tax would be calculated by ascertaining what would qualify as gross income under IRC § 61(a)(3), followed by a determination of what taxable income would be under IRC § 63(a). Because the entity selling real estate is a non-grantor trust, IRC § 641 would determine the computation of tax based on the sale of real estate by the Trust. However, to the extent that IRC § 643(a)(1-4) and IRC § 643(b) reclassifies income items based on their allocation to corpus, no tax would be due on the sale of the real estate. However, tax would be due if/when the Trust makes an income distribution to its beneficiaries as a result of their inclusion in the distributable net income of the Trust. *See* Treas. Reg. § 1.643(a)-3(b). Notwithstanding, if the Trust generates income and it is not distributed but allocated to the corpus of the Trust, the Trust will not recognize gain or loss as a result of the use IRC § 643.

To illustrate an example, assume that Jane owns a commercial property she purchased 20 years ago for $500,000.00. The property is now worth $1,000,000.00. If Jane sells the property outright, she faces a significant capital gains tax liability, estimated at $100,000.00 (based on a twenty percent (20%) federal income rate, state taxes, and depreciation recapture).

Jane wants to defer the capital gains taxes and create a tax-efficient income stream for retirement. Jane consults her tax and legal advisors, who create an irrevocable trust. Jane contributes the commercial property via gift under IRC § 2010(c) to the Trust. The gift is made using the commercial property's fair market value, but the Trust takes a carryover basis under IRC §§ 1015(a) and 2512. If the Trust later sells the commercial property, it would realize a gain of $500,000.00 under IRC §§ 61(a)(3) and 63(a). Since the seller of the commercial property is a non-grantor trust with its own tax reporting and payment obligations, IRC § 641 would determine the computation of tax based on the sale of real estate by the Trust. However, if Jane as trustee in good faith, allocates the capital gain to corpus under valid instrument terms and state law, it is excluded from distributable net income and taxable income under IRC § 643(b). Here, reliance on IRC §§ 643(a)(4) and 643(b) — the "good faith allocation to corpus" would remove the amount from the definition of income. Therefore, to the extent that IRC § 643(a)(1-4) and IRC § 643(b) reclassifies income items based on their allocation to corpus, no tax would be due on the sale of the commercial property. However, if the Trust makes a distribution of income to a beneficiary, the distribution is taxable because it is allocated to the distributable net income of the Trust. Distributions for health, education, support, and maintenance are taxable to the beneficiary only if they consist of taxable income generated by the trust. If the distributions are from the trust's principal, they generally are not taxable as income to the beneficiary.

2. Deferred Sales Trust[6]

The deferred sales trust method, where the Trust is established before the sale of an appreciated asset, is an alternative example of how trusts are used in deferring taxation. Here the seller enters into a legal agreement with the Trust, transferring ownership of the appreciated asset to the trust. The Trust then becomes the legal owner of the asset and sells it to a third-party buyer. The seller relinquishes direct control over the asset and the proceeds of the sale, but becomes the beneficiary of the Trust. Control over trust assets is exercised by the trustee (a third party or professional trustee). Since the Trust is structured to defer the seller's receipt of the sales proceeds, the seller does not immediately incur a taxable event. In return for transferring the asset to the Trust, the seller receives a promissory note (installment contract) from the Trust. The note outlines periodic payments (principal and interest) over a set period or the seller's lifetime. These payments are taxed incrementally, spreading out the capital gains tax liability and potentially reducing the overall tax burden. The Trust would then reinvest the proceeds from the sale into income-generating or growth-oriented assets. Investments are chosen to align with the seller's financial goals, such as retirement income, estate planning, or further tax optimization. Capital gains taxes are deferred until the seller receives payments; therefore, because payments are spread over time, the tax liability can often be managed to keep the seller in a lower tax bracket. The deferred nature of taxes allows the seller to use more of the proceeds upfront for investment or other purposes.

To illustrate an example, assume that Jane owns a commercial property she purchased 20 years ago for $500,000.00. The property is now worth $5,000,000.00. If Jane sells the property outright, she faces a significant capital gains tax liability, estimated at $1,200,000.00 (based on a twenty percent (20%) federal income rate, state taxes, and depreciation recapture).

Jane wants to defer the capital gains taxes, reinvest the proceeds to generate passive income, and create a tax-efficient income stream for retirement. Jane consults her tax and legal advisors, who create an irrevocable trust. The trust is structured under IRC § 453 (installment sale method) and Treas. Reg. § 15a.453-1 to allow deferred recognition of capital gains. Jane then transfers the property to the Trust in exchange for a promissory note. This exchange is not treated as a sale for tax purposes because the seller does not yet realize the capital gains per IRC § 453(f).

After the Trust is funded with the property, the Trust sells the property to a buyer for $5,000,000.00. Since the Trust is the legal seller, the sale proceeds go into the Trust. The transaction is not a taxable event for Jane because she has not received cash or its equivalent, *i.e.,* IRC § 453(b). In return for transferring the asset, Jane receives a promissory note structured under IRC § 453 for installment sales. The promissory note specifies payments of $300,000.00 annually (principal and interest) over twenty (20)

[6] Unlike the Traditional Non-Grantor, Irrevocable, Complex, Discretionary, Spendthrift Trust Method where the client/seller is named as the trustee, the Deferred Sales Trust would require a separate third-party trustee to administer the trust assets and arrange payment of the installment sale note.

years. The capital gains tax is recognized incrementally as payments are received IRC § 453(a) unless allocated to corpus under IRC § 643. The trustee can then reinvest the proceeds into income-generating assets, *e.g.,* stocks, bonds, or REITs, following prudent investment guidelines. The Trust operates independently of Jane to maintain the separation required for deferral benefits. *See* Treas. Reg. § 1.451-2. The installment sale rules allow taxpayers to defer recognition of capital gains until payments are received.[7]

C. Qualifications in the Application of Law

In expressing our opinion, we note the following considerations presented by the facts of this case. First, each trustee has and will observe all applicable statutory formalities and requirements of the Trust in all material respects as well as all tax reporting requirements.

In reaching our opinion herein, we have relied upon concepts from the Trust, the Internal Revenue Code, Treasury Regulations, statutory authorities, cases, and secondary sources discussed herein which involve general principles regarding the taxation of the Trust. While we believe that the general principles applicable in the context of the analysis proffered are supported by the Documents and law, we caution that a court addressing the issues presented for legal analysis in this opinion would rule on the issues of the taxation of the Trust based upon the particular facts and circumstances before it, and might, therefore, reach a different result based on those facts. The foregoing opinion is therefore a reasoned opinion based upon an analysis of the Documents, the Internal Revue Code, Treasury Regulations, and case law decided under the laws of various jurisdictions that we believe would be applicable by analogy to the factual patterns set forth herein. Thus, the opinion expressed herein is not a guaranty as to what a particular court or regulatory committee actually would hold, but is an opinion as to the decision a court or regulatory committee would reach assuming that the issues were properly presented to a court or regulatory committee, and assuming that the a court or regulatory committee were to follow existing precedent as to legal and equitable principles applicable in any future litigation regarding the taxation of the Trust.

In this regard, we further note that legal opinions on matters involving the Opining Law unavoidably have inherent limitations that generally do not exist in respect of other issues on which opinions of third parties typically are provided. These inherent limitations exist primarily because of: (i) the pervasive equity powers of courts properly exercising jurisdiction, (ii) the overriding goal of reorganization to which other legal rights and policies may be subordinated, (iii) the potential relevance of the exercise of judicial discretion, as evidenced by the fact that courts have accorded different degrees of significance to a variety of factual elements, (iv) facts and circumstances arising in

[7] Treas. Reg. § 15a.453-1 provides detailed guidance on how installment obligations are treated for tax purposes, ensuring compliance with IRC § 453. IRC § 453(b) states that the installment method applies when a taxpayer does not receive full payment in the year of sale. IRC § 453(f) ensures that transferring property to the Trust in exchange for a promissory note does not trigger immediate tax liability. Treas. Reg. § 1.451-2 prevents Jane from being taxed on funds in the Trust since she does not have direct access to or control over the proceeds.

the future that are different from those assumed herein, and (v) the nature of the trust administration and taxation of trusts and estates in general. Accordingly, the conclusions reached herein must be considered in light of these broad statutory and equitable powers of a court or regulatory committee. Consequently, we render no opinion or advice of counsel as to the interplay of the issues opined on herein with the judicial or regulatory process with respect to the Trust generally, or strategic factors or circumstances that might affect the outcome of any litigation regarding the taxation of the Trust and related matters.

This opinion is rendered pursuant to your request and is solely for your use, and may only be relied upon by you, your successors or assigns (including any trustee or any substitute or successor trustee), and may not be relied upon for any other purpose or relied upon by, or furnished or quoted to, any other Person for any purpose. This opinion speaks only on the date hereof and is based on our understandings and assumptions as to present facts, and on our review of the above-referenced documents and the application of state and federal law as the same exist on the date hereof, and we undertake no obligation to update or supplement this opinion after the date hereof for the benefit of any Person (including any Person granted reliance in the preceding sentence) with respect to any facts or circumstances that may hereafter come to our attention or any changes in facts or law that may hereafter occur or take effect.

Very truly yours,

Steven E. Gurian, Esq., LL.M

EXHIBIT "A"

1. IRC Memo AM 2023-006;
2. Benson and Associates Legal Opinion dated June 3, 2002;
3. Myers and Associates Legal Opinion dated May 6, 2003;
4. Paul B. Benson Legal Opinion dated June 12, 2019;
5. Asset Protection Services of America Trust – Internal Revenue Code and Legal Compliance: Non-Grantor, Irrevocable, Complex, Discretionary, Spendthrift Trust;
6. 2010 IRS Nationwide Tax Forum Presentation;
7. Current Federal Tax Developments Article by Thomas, Zollars, and Lynch, Ltd.
8. Copyright Master's Trust 2012 Business Trust; and
9. Master's Irrevocable Spendthrift Trust Agreement.