

Drew;

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I have researched the issue whether an exchange of art for stock under a substitution clause in a defective grantor trust is subject to sales tax.

A defective grantor trust (IDGT) is a grantor trust whereby the grantor retains certain powers as prescribed in IRC sec 671-677. Basically, the powers retained include the following:

- a) Reversionary interest
- b) Power to control beneficiary enjoyment
- c) Administrative powers (including the power of substitution)
- d) Power to revoke
- e) Income for benefit of the grantor.

IRC section 674(a) provides that a grantor will be treated as the owner of any portion of a trust over which the grantor has retained a power of disposition. This power is defined in Treas.Reg 1.674(a)-1(a) as any power that can effect the beneficial enjoyment of the trust property.

The above powers for Federal Tax purposes considers the IDGT as a non entity, whereby the grantor will be taxed on all income generated by the trust. In fact the IDGT would retain the grantors tax ID (SSN). The question is how is an IDGT treated for NYS sales tax purposes when there is a sale between the grantor and the IDGT.

I have not found any specific authority with regard to treatment of an IDGT as a separate entity for sales tax purposes. However an Advisory Opinion for Cleveland Browns Transportation LLC (TSB-A-06(8)S) discusses among other issues as to whether the Petitioners charges to affiliates are subject to sales tax. The opinion concludes "However, if the activities of Petitioner were so dominated and controlled by the parent or affiliates or their activities were so commingled that they would be considered to be operating as alter egos of each other rather than separate legal entities, then the corporate structures would be disregarded and the conclusions reached in this opinion would not apply. See Harfred Operating Corporation etc."

Harfred Operating Corporation (TSB-A-86 (28)S) discusses whether a subsidiary is a separate entity or merely an alter ego of the parent. In Harfred the advisory clearly states that for New York law "this area is hardly clear as a mountain lake in springtime". Nevertheless the advisory tries to determine the status based on various cases in various jurisdictions.

I believe that based on these cases as outlined below, there is substantial authority to consider a transaction between a grantor and an IDGT as alter egos of each other and should not be subject to sales tax on the exchange of art for stock in a defective grantor trust:

- 1) Brunswick Corp v. Waxman, 599 F2d 34,35- in order to invoke the alter ego doctrine the parent must dominate the finances, policy and business practices of the controlled corporation. (SEE b,c,d above)
- 2) Fisser v International Bank, 282 F2d 231- common officers and directors, common offices and telephone numbers between entities are relevant but are not sufficient by themselves to show that one entity is the alter ego of the other. Consideration must also be given to factors such as degree of overlap of personnel, the amount of business discretion displayed, whether the entities operate independently, whether the parent owns all or most of the stock, and whether the parent causes the incorporation of the subsidiary.

An IDGT is an entity controlled, set-up, and owned by the grantor. I believe that if the same personnel would work for the grantor and the IDGT and the operations would be from the same location, than there would be more support for the trust to be considered as an alter ego of the grantor. Drew please advise what additional procedures should be instituted so that the IDGT and grantor would be considered an alter ego of each other.

- 3) Worldwide Carriers, Ltd v. Aris Steamship Co., 301 F Supp 64- Also significant is whether the corporations trade under their own names and whether they hold themselves out to the public as separate and distinct businesses.
This may be problematic. However, I think that since the IDGT uses the same SS # and is taxed to the grantor it can be argued that it is the same as the grantor. (I don't know whether the fact that the IDGT is out of the grantors estate would cause an issue). Also, I am not sure whether or not an IDGT is considered held out to the public or whether there is any public thought or concern whether or not it is considered one entity. I believe this provision may therefore not be applicable to our situation.
- 4) In Laws of Corporations and Other Business Enterprises 3d Ed.(1983) pp. 354-356 states that while many of these cases relating to alter ego doctrine concern parent and subsidiary corporations, this same reasoning should be applicable to affiliated corporations. (This is used as authority in Harfred Operating Corporation). I believe that this reasoning may be extended to the situation of a grantor and an IDGT.

Drew, though the area is gray, I believe that there is some authority to apply the alter ego doctrine to our situation and the above transaction should be exempt from NYS sales tax.

PLEASE ADVISE