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The IRS has advanced many theories to challenge the gift and estate tax savings occasioned by the use of family entities and grantor trusts in estate planning. Until recently, most IRS arguments had been rather unsuccessful. However, the IRS discovered a potent weapon in IRC § 2036(a), which provides that the value of the gross estate includes the value of all property to the extent the decedent has made a transfer but has retained (i) the possession or enjoyment of, or the right to income from, the property, or (ii) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

The IRS has been successful in arguing that IRC § 2036(a) requires the inclusion in the decedent's estate of=20 (i) partnership assets if the decedent continued to derive benefits from the partnership, or of (ii) trust assets, if the decedent continued to receive distributions, disguised in the form of a note, from assets sold to a "defective" grantor trust. The IRS has been most successful where=20 the transactions with not imbued with a sufficient quantum of non-tax objectives, or the economics of the transaction were questionable, most often because the grantor had not left himself with sufficient assets to live according to his accustomed standard without receiving partnership (or trust) distributions.

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