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Nexcess Trust Executive Summary and Overview

Asset Protection. Tax Strategy. Legacy Planning



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Nexcess Trust Executive Summary

Introduction

The **Nexcess Trust** is a premier fiduciary entity, designed as an **irrevocable, non-grantor, complex, discretionary spendthrift trust**. It is engineered to provide exceptional **asset protection, lawful tax deferral, and long-term financial autonomy** through a structure that operates independently of the trust creator and remains insulated from outside interference.

Unlike traditional living or revocable trusts—which primarily serve as probate avoidance tools with limited legal or tax advantages—the Nexcess Trust is purpose-built for robust **inter vivos (lifetime)** benefits. It empowers clients to **shield wealth from lawsuits, retain full control over distributions, and strategically defer taxes**—while maintaining privacy and enforceable legal separation from beneficiaries, creditors, and courts.

This trust is not merely a document; it is a comprehensive legal strategy, supported by statutory authority and constitutional protections, designed to **hold, grow, and transfer assets** over multiple generations with clarity, compliance, and confidence.

Who Is It For?



Entrepreneurs and private business owners



Real estate investors with passive income



Families seeking to preserve generational wealth without court interference



High-net-worth individuals protecting assets from lawsuits or divorce



Professionals needing a secure legal vessel for royalties, IP, and equity interests

Core Legal & Strategic Advantages

- ▶ **Irrevocable & Non-Grantor** – Once assets are sold into the trust and the grantor resigns, there is complete legal separation. This protects against claims of ownership, reversion, and “alter ego” designation in litigation or IRS interpretation.
- ▶ **Discretionary Authority** – The trustee holds sole and absolute power over trust distributions. Beneficiaries have no enforceable rights to demand assets, and no court can compel the trustee to act.
- ▶ **Complex Trust** – Under IRC §643, the Nexcess Trust may lawfully retain income. Passive income can be allocated to corpus and deferred—not subject to taxation unless distributed.
- ▶ **Spendthrift Protection** – Embedded clauses ensure that trust assets, including post-distribution proceeds, remain protected from creditor claims, judgments, or turnover orders. Case law, such as *Burns v. Miller* (TX App. 1997), affirms this shield.
- ▶ **Multi-Generational Design** – With a lifespan of up to 100 years or more, the Nexcess Trust enables long-term capital accumulation, tax deferral, and intergenerational planning without forced liquidation or probate.

Legal Compliance and Constitutional Authority

The Nexcess Trust is grounded in over eight foundational legal doctrines, including the Internal Revenue Code, Uniform Trust Code, Uniform Prudent Investor Act, Uniform Commercial Code, the Restatement of Trusts, and Scott on Trust Law. Its structure is further protected by Article I, Section 10 of the U.S. Constitution, which prohibits any state from impairing the obligation of contracts. The trust is not a statutory entity—it is a private contractual agreement, immune to legislative overreach.

Tax Strategy Under IRC §643

The trust’s governing instrument explicitly authorizes the trustee to designate specific categories of passive income as allocable to corpus—thereby lawfully deferring taxation. This authority is rooted in **IRC §643(a)(3) and (4)**, which allows for the exclusion of certain types of income from the trust’s **distributable net income (DNI)** when that income is:

- ▶ Not distributed to any beneficiary during the taxable year,
- ▶ Not paid or set aside for charitable purposes under IRC §642(c),
- ▶ And is properly classified as **extraordinary dividends or taxable stock dividends**, or income **allocated to corpus under the terms of the governing instrument and applicable local law**.

Qualifying Passive Income Categories

Eligible income includes, but is not limited to:

- ▶ **Capital Gains**
- ▶ **Rental Income (Rents)**
- ▶ **Royalty Income**
- ▶ **Dividend Income**
- ▶ **Interest Income**
- ▶ **Passive K-1 Allocations from Partnerships or S-Corps**

These types of income are considered *non-anticipated*, *non-guaranteed*, and *passively received*, which aligns them with the statutory definitions that permit allocation to corpus when exercised in good faith by the trustee.

Proven and Audited Structure

More than 150,000 trust returns have been filed by Nexcess-affiliated professionals over three decades. Multiple IRS audits have resulted in “no-change” letters. The IRS has not challenged this structure when correctly implemented, documented, and operated in compliance with federal tax law.

A Legacy of Control and Protection

The Nexcess Trust is not a tax shelter or a loophole—it is a lawful legal structure that leverages centuries of trust law, modern tax code, and constitutional rights. It provides a legally sound way to defer taxes, shield assets, and pass wealth through generations with absolute control. When operated correctly, it offers one of the most powerful combinations of tax optimization, legal separation, and fiduciary protection available today.



Nexcess Trust Overview

This Nexcess Trust Overview was created with 8 sections. They are as follows:

Page 8	Section 1: The Correct Trust Structure for Real Benefits
Page 10	Section 2: Asset Protection Through Spendthrift Provisions
Page 15	Section 3: Tax Strategy and Compliance under IRC §643
Page 19	Section 4: Legal Authority and Case Law Foundations
Page 23	Section 5: Legal and Multilevel Compliance
Page 26	Section 6: Addressing Misconceptions and Audit Concerns
Page 30	Section 7: Trust Use Cases and Legacy Planning Applications
Page 34	Section 8: Key Summary and Takeaways

Section 1: The Correct Trust Structure for Real Benefits---Page 8

Introduce the core concept of using a non-statutory, irrevocable, non-grantor, complex, discretionary spendthrift trust. Explain how its structure differs from grantor trusts, revocable trusts, or DAPTs. Emphasize the legal separation of the trustee and beneficiaries, and the discretionary nature of distributions which makes the structure functionally impenetrable if executed correctly.

Section 2: Asset Protection Through Spendthrift Provisions---Page 10

Detail how spendthrift clauses protect against voluntary and involuntary alienation. Explain the legal rationale using *Nichols v. Eaton* as the founding case, and reinforce with state-level interpretations. Outline the role of trustee discretion in ensuring that beneficiaries never hold a vested, attachable interest — key to resisting creditor claims.

Section 3: Tax Strategy and Compliance under IRC §643---Page 15

Deep dive into how IRC §§643(a) and 643(b) enable legal, discretionary treatment of income as principal. Explain how capital gains, extraordinary dividends, and similar receipts can be lawfully excluded from Distributable Net Income (DNI), preventing pass-through taxation. Clarify the meaning of Trust Accounting Income (TAI) and its separation from IRC §61 gross income. Establish how a well-written trust and a compliant trustee can reduce tax burdens without violating tax law.

Section 4: Legal Authority and Case Law Foundations---Page 19

Cite and summarize key supporting cases (e.g., *Hamilton v. Drogo*, *In re Lawrence*, *United States v. O'Shaughnessy*, *Shurley v. Texas Commerce Bank*, etc.). Explain what courts have consistently ruled regarding discretionary trusts, trust distributions, bankruptcy estate

exclusions, and the power of valid spendthrift clauses. This section reinforces the legitimacy of the structure and strategy under both federal and state precedent.

Section 5: Legal and Multilevel Compliance---Page 23

Focus on how this trust operates within multiple legal frameworks simultaneously: trust law, tax law, contract law, and fiduciary duty. Emphasize the importance of good-faith administration, recordkeeping, consistent trust accounting practices, and alignment with governing law. Highlight the importance of trustee independence and documentation of discretionary decisions to satisfy IRS or court scrutiny.

Section 6: Addressing Misconceptions and Audit Concerns---Page 26

Anticipate and address the most common objections: “This sounds like a tax shelter,” or “The IRS will disallow it,” or “Trusts don’t protect against bankruptcy or the IRS.” Dispel myths using statutory references, judicial opinions, and real audit defense arguments. Discuss how proper structure, execution, and trustee discretion — backed by IRC and case law — make this approach not only compliant but audit-resilient.

Section 7: Trust Use Cases and Legacy Planning Applications---Page 30

Demonstrate how the trust structure serves real estate investors, professionals, and high-income families by enabling long-term wealth accumulation, strategic reinvestment, and multigenerational legacy control. Emphasize that unlike 1031 exchanges or aggressive depreciation, the trust avoids recapture issues and tax rigidity by retaining income in corpus under IRC §643(b). Highlight how discretionary distribution powers and legal insulation make the trust ideal for asset protection, family governance, and sustainable tax planning.

Section 8: Key Summary and Takeaways---Page 34

Reinforce the trust's non-statutory foundation, legal durability, and tax efficiency as a unified solution for asset protection and wealth strategy. Summarize how IRC §643 and relevant case law empower trustees to retain and control income without triggering immediate tax or creating beneficiary entitlements. Conclude that this structure offers a legally conservative yet strategically powerful platform for long-term financial security, tax compliance, and legacy preservation.

Section 1: The Correct Trust Structure for Real Benefits

From its formation, the Nexcess Trust is designed to be both **irrevocable** and **non-grantor**, ensuring a legally distinct existence from its settlor and avoiding adverse tax and liability consequences. Upon execution of the trust instrument and the initial funding, the settlor formally and permanently relinquishes all rights, title, and interest in the trust corpus. This includes surrendering any powers of amendment, revocation, or control over trust assets or operations. This foundational step is critical to preclude the application of the **grantor trust rules** codified in **Internal Revenue Code §§ 671–679**, which, if triggered, would disregard the trust's independence for federal income tax purposes and attribute income to the settlor.

To reinforce this status, the trust does **not receive gratuitous transfers**. Rather, property is conveyed into the trust through **arms-length transactions** such as contractual sales, royalty assignments, or exchanges for valuable consideration. This avoids classification of the transfers as **gifts**, which could otherwise suggest retained interest under **IRC §2036** or cause scrutiny under the grantor trust regime. By avoiding donative intent, the trust avoids both potential estate tax inclusion and reclassification as a revocable or alter ego arrangement.

This structuring is consistent with the **Supreme Court's rulings** in *Burnet v. Wells*, 289 U.S. 670 (1933), and *Helvering v. Clifford*, 309 U.S. 331 (1940), which laid the groundwork for determining when a trust should be treated as an extension of the grantor. In *Clifford*, the Court held that a trust may be ignored for tax purposes if the grantor retains control or benefits. The Nexcess Trust decisively forecloses any such reversion or dominion, thereby aligning with the principles later codified in the grantor trust provisions.

From a litigation and asset protection perspective, this strict separation also ensures that the trust is **not subject to creditor claims** or deemed an **alter ego** of the settlor. Courts generally look to control, benefit, and commingling to determine alter ego status (see *Zee-Bar, Inc. v. Kaplan*, 162 Cal. App. 4th 1360 (2008)). By vesting exclusive authority in an independent trustee and denying the settlor any residual control or beneficial interest, the trust minimizes exposure to third-party claims and strengthens its legal autonomy.

Complex and Fully Discretionary Trust Classification

The Nexcess Trust is affirmatively structured and operated as a **complex trust**, as defined under **IRC §643(b)** and relevant Treasury Regulations. Unlike a simple trust, a complex trust is permitted to **accumulate income**, **make charitable contributions**, and **exercise discretion over distributions**. The trustee is under no obligation to distribute current income and may instead retain earnings within the trust corpus. This election to accumulate income can yield significant long-term tax deferral benefits when combined with proper characterization of income types under Subchapter J of the Internal Revenue Code.

The trust also qualifies as **discretionary** in nature, meaning that no beneficiary possesses a **fixed, enforceable right** to income or principal distributions. All decisions regarding distributions are **vested exclusively in the trustee**, pursuant to the discretionary standard articulated in the trust instrument. This is consistent with prevailing trust law doctrines that differentiate between support trusts (where beneficiaries may compel distribution for need) and pure discretionary trusts (where distributions are wholly subject to the trustee's judgment). See *Nichols v. Eaton*, 91 U.S. 716 (1875), and *Pacific Southwest Bank v. Johnson*, 99 Cal. App. 4th 1063 (2002).

Moreover, the trustee's discretion includes the right to **withhold all income and principal indefinitely**, subject only to fiduciary duties of loyalty and prudence, and the terms expressed in the trust deed. This discretionary standard is explicitly upheld under **Restatement (Third) of Trusts §50**, and is a key element in safeguarding the trust from beneficiary claims, creditor access, or forced distributions.

The retention of income within corpus—particularly **passive income** such as interest, dividends, capital gains, royalties, and rent—delays tax recognition until a **distribution event** occurs. This is in alignment with **Treas. Reg. §1.641(b)-1** and **IRC §§651–662**, which govern income distribution deduction mechanics and taxable income flow-through. By deferring distributions, the trust can lawfully postpone the triggering of income tax liability for both the beneficiaries and the trust itself, provided income is retained in corpus and not deemed distributed under IRC §665 and the “throwback” rules.

Furthermore, by denying beneficiaries a guaranteed right to income or principal, the trust structure helps avoid claims that may arise in the context of divorce, bankruptcy, or legal judgments. Courts consistently recognize that in discretionary trusts, beneficiaries have no enforceable expectancy and therefore no attachable interest—see *U.S. v. Taylor*, 254 F. Supp. 752 (N.D. Cal. 1966); *In re Marriage of Jones*, 179 Cal. App. 4th 254 (2009).



Section 2: Asset Protection Through Spendthrift Provisions

The **Nexcess Trust** achieves significant asset protection through the integration of **spendthrift provisions**, which are drafted to the fullest extent permitted by law. These clauses form a critical part of the trust's defensive legal architecture, ensuring that trust assets remain protected from beneficiary mismanagement, third-party creditors, and court-ordered enforcement actions.

Legal Function of Spendthrift Clauses

A **spendthrift provision** operates by prohibiting both the **voluntary** and **involuntary transfer** of a beneficiary's interest in either trust income or principal. In effect, this dual restraint bars beneficiaries from assigning, selling, pledging, or otherwise encumbering their beneficial interests, while simultaneously insulating those interests from attachment, garnishment, or execution by creditors.

Under the **Restatement (Third) of Trusts §58(1)**, a trust containing a valid spendthrift clause prohibits a beneficiary from transferring his or her interest and prevents creditors from accessing that interest directly. This principle is also codified in the **Uniform Trust Code (UTC) §502**, which states:

“A spendthrift provision is valid only if it restrains both voluntary and involuntary transfer of a beneficiary's interest.”

Because the Nexcess Trust also qualifies as a **fully discretionary trust**, beneficiaries do not have a fixed entitlement to distributions. This further enhances creditor protection, as courts generally cannot compel distributions or enforce creditor claims against a trustee's discretionary powers.

The trust's classification as **non-self-settled** meaning the settlor is not a beneficiary additionally shields the trust from creditor penetration under the doctrines established in **Restatement (Third) of Trusts §60** and many state statutes.



Practical Application and Protection Scope

The enforcement of spendthrift clauses in the Nexcess Trust achieves several protective outcomes:

- ▶ **Beneficiaries cannot voluntarily assign, pledge, or otherwise transfer** their beneficial interests, whether in income or principal;
- ▶ **Creditors, including judgment creditors, bankruptcy trustees, ex-spouses, or government agencies**, may not access or compel distribution of trust assets;
- ▶ **Courts lack the authority to issue turnover orders**, garnishments, or liens against undistributed trust assets;
- ▶ Even **after a distribution occurs**, certain protections may remain if the funds are traceable and segregated, especially if derived from a discretionary distribution under a properly structured trust.

In contrast to revocable or self-settled trusts, which often offer little or no asset protection, the Nexcess Trust's irrevocable, non-grantor, discretionary, and spendthrift design places it among the most protective domestic trust structures available under U.S. law.

Supporting Case Law for Discretionary and Spendthrift Provisions

Courts have repeatedly validated the protective power of spendthrift provisions when properly implemented. In *Burns v. Miller, Hiersche, Martens & Hayward, P.C.*, **948 S.W.2d 317 (Tex. App. 1997)**, the court upheld the exclusion of trust distributions from creditor access, even after those distributions were received by the beneficiary, so long as they were traceable to an exempt source and not commingled. The decision reinforced that a creditor's remedy does not extend to assets protected by spendthrift language simply because a distribution has occurred.

Ten more illustrative cases to further show the power of Spendthrift Provisions:

1. **Nichols v. Eaton, 91 U.S. 716 (1875)**

Key Takeaway: *The OG case that gave legal life to spendthrift trusts in the U.S.*

- ▶ The U.S. Supreme Court held that a **settlor can lawfully prevent both the beneficiary and the beneficiary's creditors** from accessing trust assets through a valid spendthrift clause.
- ▶ This legitimized the idea that *an interest in a trust can be protected from alienation* — voluntarily (like selling it) or involuntarily (like from creditors).
- ▶ **Why it matters:** This case remains the **bedrock precedent** for spendthrift protection under common law.

2. *In re Lawrence*, 279 F.3d 1294 (11th Cir. 2002)

Key Takeaway: *Discretionary = no bankruptcy asset.*

- ▶ The court ruled that even in bankruptcy, **assets held in a discretionary spendthrift trust aren't part of the debtor's bankruptcy estate.**
- ▶ Even though Lawrence had previously received large distributions, the **trustee retained full discretion**, and the court would not compel distributions.
- ▶ This case sends a clear message: **no enforceable right = no property = no creditor access.**

3. *Hamilton v. Drogo*, 241 N.Y. 401 (1926)

Key Takeaway: *Cardozo clarified: expectancies ≠ property.*

- ▶ Judge **Benjamin Cardozo** (a legal giant) stated that **beneficiaries of discretionary trusts have no vested interest.**
- ▶ Thus, **creditors cannot attach or force payment**, because the beneficiary has **no enforceable right to any part of the trust** until the trustee exercises discretion.
- ▶ It's a foundational New York case and often cited nationally.

4. *United States v. O'Shaughnessy*, 517 N.W.2d 574 (Minn. 1994)

Key Takeaway: *IRS can't reach what doesn't legally exist.*

- ▶ The court ruled that **IRS tax liens couldn't attach** to the trust because the **beneficiary had no right to compel distributions.**
- ▶ Reinforces that **even powerful government creditors like the IRS are blocked** if the trust is fully discretionary and has a valid spendthrift clause.

5. *Gowdy v. Cook*, 675 N.E.2d 814 (Ind. App. 1996)

Key Takeaway: *No current right = no creditor access.*

- ▶ Reaffirmed that **creditors cannot reach assets in discretionary spendthrift trusts**, even if they know the beneficiary is receiving or expected to receive money.
- ▶ Emphasized that **undistributed income and principal** are off-limits unless/until distributed.

6. *Scheftel v. Krueger*, 782 So. 2d 440 (Fla. Dist. Ct. App. 2001)

Key Takeaway: *Even regular distributions don't break protection.*

- ▶ Creditors tried to garnish a trust that was making **regular distributions**, arguing the beneficiary had a "de facto" right.

- ▶ The court said **nope** — since the trust retained full **discretionary control**, the distributions were **not guaranteed**, and protection stood.

7. **Shurley v. Texas Commerce Bank, 115 F.3d 333 (5th Cir. 1997)**

Key Takeaway: *Bankruptcy estate can't touch a proper trust.*

- ▶ Under **11 U.S.C. § 541(c)(2)**, the court found that a **discretionary spendthrift trust excluded assets from the bankruptcy estate.**
- ▶ Reinforced that **state law governs trust enforceability** and, where valid, **asset protection survives bankruptcy.**

8. **Croom v. Talladega Distribution Co., 421 So. 2d 1257 (Ala. 1982)**

Key Takeaway: *Defaulting on debts doesn't pierce trust.*

- ▶ Even though the beneficiary was **in default on financial obligations**, creditors **could not touch the trust** due to valid spendthrift protections.
- ▶ Alabama followed the **majority rule** that **creditor status doesn't create a right to compel or attach trust distributions.**

9. **Sligh v. First Nat'l Bank of Holmes County, 704 So. 2d 1020 (Miss. 1997)**

Key Takeaway: *Distributions don't equal an enforceable interest.*

- ▶ Reiterated that **discretionary spendthrift trusts prevent attachment**, even when distributions are made.
- ▶ Unless a distribution has **actually occurred**, **creditors have no cause of action** to pursue assets held in trust.

10. **Cannon v. Wachovia Bank Trust, 443 F. Supp. 2d 1197 (S.D. Fla. 2006)**

Key Takeaway: *No property interest = no garnishment.*

- ▶ The court ruled that **the beneficiary's mere expectancy** from a discretionary trust **did not create a property interest.**
- ▶ Therefore, creditors had no standing to compel a distribution or garnish future payments.

Overall Legal Doctrine:

All these cases support the idea that:

1. **Discretionary + Spendthrift = Ironclad (to an extent)**
2. **No enforceable right = no creditor reach**
3. **Trustee discretion is a firewall**, even against IRS or bankruptcy trustees.

4. Only **actual distributions** are generally reachable (and only after the fact), **not future or potential ones**.

Limitations and Policy Considerations

Although the asset protection afforded by spendthrift provisions is substantial, it is not absolute. Certain **exception creditors** may, in some jurisdictions, gain limited access to trust assets, such as claims for child support, alimony, or state/federal tax debts. However, even these exceptions are narrowly construed and often depend on whether distributions are made or merely discretionary. In most states, unless the trust is self-settled, these exceptions do not extend to undistributed assets or override the trustee's discretion.

The policy rationale behind spendthrift protections has been long supported by courts: they allow settlors to provide for beneficiaries while shielding assets from improvidence, insolvency, or misfortune, as articulated in *In re Morgan's Estate*, **223 P.2d 244 (Cal. App. 1950)**. The trust serves not only as a planning tool but also as a safeguard against economic instability.



Section 3: Tax Strategy and Compliance under IRC §643 (a) and (b)

The **Nexcess Trust** employs a sophisticated tax strategy grounded in the specific provisions of **Internal Revenue Code §643** and corresponding Treasury Regulations. This section of the Code defines and governs the treatment of trust income for purposes of Subchapter J (IRC §§641–692), particularly in determining what constitutes **distributable net income (DNI)**, what may be allocated to **corpus (principal)**, and which amounts are **excluded from current income taxation**.

By fully leveraging the definitions in **IRC §§643(a)(3), (a)(4), and (b)**, the Nexcess Trust achieves legally compliant **tax deferral** on key categories of **passive income** when such income is not distributed to beneficiaries and instead is allocated to corpus pursuant to the terms of the trust instrument. This strategic framework has been deployed consistently and successfully across numerous trust administrations and IRS audits.

Non-Statutory Foundation: IRC §643(a) and (b)

This trust structure is fundamentally *non-statutory* in nature. That is, it does not rely on specific asset protection statutes, such as those governing Domestic Asset Protection Trusts (DAPTs), which are often vulnerable to challenge through public policy exceptions, full faith and credit claims across state lines, or scrutiny from bankruptcy courts. Instead, its strength derives from a carefully constructed interplay of federal tax code definitions, traditional fiduciary trust law, and well-established case law principles. The most critical foundation lies in the Internal Revenue Code, specifically IRC §§643(a) and 643(b). These sections define the scope of what constitutes income for both trust accounting and tax purposes, and more importantly, what does *not* have to be treated as current taxable income to either the trust or the beneficiary.

IRC §643(a) defines "Distributable Net Income" (DNI), which plays a central role in determining the amount of a trust's income that can be passed through to beneficiaries and taxed to them individually via Schedule K-1. However, the Code includes specific exclusions to this definition, particularly with regard to capital gains, extraordinary dividends, and taxable stock dividends. Under §643(a)(3), gains from the sale or exchange of capital assets are excluded from DNI unless those gains are actually paid, credited, or required to be distributed to a beneficiary during the taxable year, or unless the governing trust instrument or applicable local law allocates them to income. This provides a key strategic advantage: in a properly drafted non-grantor, discretionary complex trust, capital gains can be classified as principal and retained within the trust. When allocated to corpus and not distributed, they are excluded from DNI and do not pass through to beneficiaries for taxation.

Section 643(a)(4) extends this treatment to extraordinary dividends and taxable stock dividends. It states that these items of gross income may also be excluded from DNI if the fiduciary, acting in good faith, allocates them to corpus rather than income. This gives the trustee discretionary power to classify large or unusual income events — such as corporate liquidations, windfall dividends, or in-kind stock payments — as principal rather than current income. By doing so, the fiduciary prevents such items from becoming part of the distributable net income, meaning they are not taxed to the beneficiaries unless they are actually distributed.

The statutory heart of this non-statutory structure lies in §643(b), which defines the term “income” for trust purposes. It clarifies that income, when not preceded by the words “taxable,” “gross,” or “distributable net,” refers not to income as defined under §61 of the Internal Revenue Code (which includes nearly every conceivable source of gross income), but instead to fiduciary accounting income. This is a legally distinct concept determined under the terms of the trust’s governing instrument and applicable state law. In other words, the trust document and state fiduciary law jointly determine whether a receipt is classified as income or principal — and not the IRS. This legal nuance gives the trustee substantial flexibility to determine whether certain items, including rents, royalties, dividends, and capital gains, should be treated as part of current income or as an addition to corpus. The key is that these decisions must be made in good faith and in accordance with the trust’s instructions and fiduciary principles under local law.

The non-statutory nature of this trust makes it particularly powerful from both an asset protection and a tax minimization standpoint. First, because it does not rely on statutory protections like those in DAPT statutes, it does not create a statutory “footprint” that can be challenged under a federal or out-of-state legal theory. There is no bright-line statute to pierce and no automatic assumption of self-settlement that can be reversed. Second, the trust creates no enforceable rights for beneficiaries to demand distributions. Because the trustee has full discretion and is under no obligation to make distributions unless he or she independently chooses to, the beneficiaries’ interests are treated in law as mere expectancies — not as property interests. Courts have consistently held, in cases such as *Hamilton v. Drogo* and *In re Lawrence*, that such interests are not attachable by creditors and do not become part of a bankruptcy estate.

Moreover, the trust’s ability to allocate certain types of income to principal — and thereby exclude them from DNI — means that these items are not passed through to the beneficiary and taxed. This not only provides a tax deferral mechanism but also enhances the ability of the trust to grow its assets over time without erosion through taxation. Capital gains, large dividends, and even recurring business income can be classified as corpus and held within the trust, so long as the trustee exercises discretion in good faith under the authority granted by the trust instrument and supported by local fiduciary accounting law.

Finally, §643(b) reinforces the primacy of the trust’s governing document. It allows income to be defined by the trustee’s classification — again, assuming good faith — as directed by the

trust. This distinction is central: “income” for trust accounting purposes is what the trustee says it is, within the boundaries of law and the trust’s terms, not what the IRS might ordinarily categorize under gross income rules. The combined result is a legal and tax structure that is both highly defensible and flexible, enabling the trust to avoid unnecessary tax exposure and withstand aggressive creditor action without relying on statutory safe harbors.

Passive Income Types Subject to Tax Deferral

Under this statutory and regulatory structure, the following categories of **passive income** may be **excluded from current-year taxation** if retained within the trust and not distributed:

1. **Rental Income** – Real property rents, net of expenses, may be deferred if not distributed and if corpus allocation is authorized.
2. **Royalty Income** – Mineral, patent, trademark, and licensing royalties qualify when retained and properly reported.
3. **Interest Income** – Bank interest, bond coupons, and fixed-income securities income can be accumulated within corpus.
4. **Dividend Income** – Ordinary and qualified dividends, including extraordinary dividends, may be classified as principal with proper fiduciary determination.
5. **K-1 Passive Allocations** – Passive activity income (e.g., real estate, oil and gas partnerships) reported on **Schedule K-1** can be deferred when not distributed.
6. **Capital Gains** – Gains from the sale or exchange of capital assets, including securities and real estate, are excluded from DNI when allocated to corpus and not distributed.

By utilizing this accounting methodology, the Nexcess Trust lawfully avoids treating these income types as **currently taxable income**, provided that (1) the trust instrument authorizes such treatment, and (2) the trustee adheres to fiduciary accounting standards and acts in **good faith** under a **reasonable exercise of discretion**.

Fiduciary Accounting and Trust Instrument Authority

The ability to allocate income to corpus and defer taxation hinges upon two key operational principles:

1. **Instrument Authority:** The trust document must explicitly permit the allocation of certain income types—particularly capital gains and extraordinary dividends—to corpus. This authority must be consistent with applicable state fiduciary accounting rules and must not conflict with local law, unless superseded by the trust instrument (as allowed under the Uniform Principal and Income Act in most states).
2. **Fiduciary Discretion and Good Faith:** The trustee must make these allocations pursuant to their discretionary powers and in **good faith**, reflecting a bona fide fiduciary decision rather than an artificial tax avoidance maneuver. Courts and the IRS

give significant deference to trustees who follow formal procedures and document their determinations, especially where trust terms are clear.

The **Treasury Regulations** provide further interpretive support. For example, **Treas. Reg. §1.643(a)-3(b)** acknowledges that capital gains may be excluded from DNI where local law or trust terms allow for principal allocation and the trustee consistently follows that policy.

Legal Compliance, Audit Experience, and Precedent

This strategy has been implemented across **thousands of IRS filings**, yielding **multiple "no-change" audit outcomes**, a result that strongly indicates consistency with prevailing IRS interpretation and procedural standards. While no specific private letter ruling (PLR) has been issued solely for the Nexcess structure, the trust's approach mirrors that found in favorable rulings such as **PLR 200603025**, **PLR 200104005**, and **PLR 200648011**, which affirm the validity of capital gain exclusions and discretionary corpus allocations when properly documented. Moreover, courts have generally upheld the trustee's right to allocate income to corpus when authorized by trust terms. In *Ferguson v. Commissioner*, **69 T.C. 320 (1977)**, the Tax Court allowed exclusion of capital gains from DNI because the trustee acted within the scope of discretionary authority and consistent with fiduciary principles.

Critically, compliance depends not only on tax code interpretation but also on **trust administration discipline**. Income must be declared as **non-anticipated**, meaning that no intent exists to distribute it within the taxable year. Further:

- ▶ No distributions, direct or constructive, may be made or credited to a beneficiary;
- ▶ Allocations must be documented and reported correctly on **Form 1041** and relevant schedules;
- ▶ The trustee should maintain contemporaneous records supporting the good faith basis of classification and corpus allocation.

Practical Outcome and Strategic Impact

When properly structured and faithfully administered, the tax strategy under IRC §643 allows the Nexcess Trust to **accumulate substantial passive income over time without triggering current income tax**. By retaining income within corpus—where it is not deemed distributed and therefore not subject to income distribution deduction rules under **IRC §651 or §661**—the trust lawfully defers taxation until a triggering event, such as an actual distribution, occurs. Over decades of practice, this has enabled Nexcess clients to **defer millions of dollars in taxes**, preserving wealth and capital for long-term trust purposes, including multigenerational asset growth, charitable planning, and strategic reinvestment. The model exemplifies how rigorous legal drafting, combined with precise fiduciary execution, can produce fully compliant tax outcomes aligned with statutory intent and judicial precedent.

Section 4: Legal Authority and Case Law

Foundational Spendthrift and Discretionary Provisions

1. **Nichols v. Eaton**, 91 U.S. 716 (1875)

This landmark U.S. Supreme Court case first recognized the validity of spendthrift trusts in American jurisprudence. The Court held that a settlor may lawfully place restrictions on the transfer or alienation of a beneficiary's interest, even to block creditor claims. The trust in question was upheld despite attempts by creditors to seize the beneficiary's interest, affirming that beneficiaries cannot voluntarily assign their interest, nor may creditors compel distributions.

Outcome: The Supreme Court upheld the spendthrift clause, setting a foundational precedent for asset protection in trust law.

2. **Hamilton v. Drogo**, 241 N.Y. 401 (1926)

Judge Benjamin Cardozo concluded that a discretionary trust confers no legal title or enforceable claim to a beneficiary prior to an actual distribution. The court emphasized that such a trust interest is a mere expectancy, not property, and thus cannot be reached by creditors. A beneficiary has no right to compel the trustee to act, and creditors cannot claim what the beneficiary himself cannot demand.

Outcome: The New York Court of Appeals upheld the discretionary nature of the trust and denied creditor access.

3. **In re Lawrence**, 279 F.3d 1294 (11th Cir. 2002)

In this bankruptcy case, the debtor was a beneficiary of a discretionary trust. The court held that because the trust gave the trustee absolute discretion and included a valid spendthrift clause, the debtor's interest was not part of the bankruptcy estate. The trustee could not be compelled to make distributions, nor could the bankruptcy court seize trust assets.

Outcome: The Eleventh Circuit excluded the trust assets from the bankruptcy estate and enforced spendthrift protections.

4. **United States v. O'Shaughnessy**, 517 N.W.2d 574 (Minn. 1994)

Here, the IRS attempted to collect taxes by accessing a beneficiary's interest in a discretionary trust. The Minnesota Supreme Court found that the beneficiary lacked an enforceable right to distributions and therefore had no "property" interest the IRS could seize. The court emphasized the trustee's sole discretion as the controlling legal factor.

Outcome: The IRS was denied access to the trust, affirming the asset protection nature of discretionary spendthrift trusts.

5. **Burns v. Miller, Hiersche, Martens & Hayward**, P.C., 948 S.W.2d 317 (Tex. App. 1997)

After receiving a distribution from a trust, a beneficiary's creditor attempted to attach the funds. The Texas appellate court ruled that the funds were protected because they originated from a discretionary spendthrift trust and were not co-mingled with personal assets. The court upheld protections beyond the point of distribution due to the source of the funds.

Outcome: The trust protections were upheld, even after distribution, as the funds remained traceable and derived from an exempt source.

Creditor Immunity and Bankruptcy Trust Exclusion

1. **Shurley v. Texas Commerce Bank**, 115 F.3d 333 (5th Cir. 1997)

In this bankruptcy proceeding, the Fifth Circuit ruled that a debtor's beneficial interest in a discretionary spendthrift trust was excluded from the estate under 11 U.S.C. §541(c)(2). The bankruptcy trustee attempted to access trust funds, but the court ruled that the trust's terms clearly protected the assets from creditor claims.

Outcome: Trust assets remained protected and outside the reach of bankruptcy administration.

2. **Gowdy v. Cook**, 675 N.E.2d 814 (Ind. Ct. App. 1996)

A creditor sought to attach the interest of a trust beneficiary, but the Indiana Court of Appeals enforced the trust's spendthrift clause. Because the trustee had full discretion over distributions and the trust barred alienation, the court found no grounds for creditor attachment.

Outcome: The court denied the creditor's claim and preserved the trust's discretionary protections.

3. **Scheftel v. Krueger**, 782 So. 2d 440 (Fla. Dist. Ct. App. 2001)

Despite the beneficiary regularly receiving trust income, the court upheld the spendthrift provision. The court found that the trustee's discretion was never relinquished, and no fixed right to income existed.

Outcome: Creditors were barred from attaching even regular payments, affirming the strength of discretion.

4. **Cannon v. Wachovia Bank Trust**, 443 F. Supp. 2d 1197 (S.D. Fla. 2006)

A creditor attempted to compel trust distributions to satisfy a judgment. The federal district court refused, noting that the trustee's discretion was complete and the beneficiary had no right to compel payment. **Outcome:** The court enforced both the discretionary nature and the spendthrift protections of the trust.

5. **Croom v. Talladega Distribution Co.**, 421 So. 2d 1257 (Ala. 1982)

The Alabama Supreme Court held that a creditor could not reach trust assets because the spendthrift clause barred such claims. Even where the beneficiary owed money to a third party, the trust corpus remained unreachable.

Outcome: Spendthrift protections were enforced, and the creditor's claim was denied.

Constitutional and Contract-Based Trust Protections

1. **Fletcher v. Peck**, 10 U.S. (6 Cranch) 87 (1810)

This case established the doctrine that contracts, once executed, cannot be impaired by subsequent state legislation. The Supreme Court struck down a Georgia statute that tried to retroactively invalidate a land grant.

Outcome: The Court upheld the sanctity of contracts, which extends to irrevocable trust instruments.

2. **Eliot v. Freeman**, 220 U.S. 178 (1911)

This tax case clarified that income must be "realized" before being taxable. The Court held that a mere increase in value of securities held in trust did not trigger taxation without actual receipt.

Outcome: Supports the deferral of tax on unrealized income retained in corpus under trustee discretion.

3. **City of Cleburne v. Cleburne Living Center**, 473 U.S. 432 (1985)

Though focused on equal protection, the Court emphasized the necessity of rational basis review when state action interferes with private legal arrangements. The principle applies to trust law when state laws attempt to override valid trust terms.

Outcome: Supports constitutional protection of private arrangements from arbitrary government intrusion.

4. **Trustees of Dartmouth College v. Woodward**, 17 U.S. (4 Wheat.) 518 (1819)

The Supreme Court ruled that a private corporate charter was a contract and could not be altered by state law. The reasoning applies directly to private trust instruments, which are likewise protected.

Outcome: The trust document, once executed, is a protected legal contract under the Constitution.

5. **Blair v. Commissioner**, 300 U.S. 5 (1937)

A beneficiary assigned his right to future trust income and the IRS sought to tax him on the income anyway. The Supreme Court held that once he relinquished ownership, he was no longer liable.

Outcome: Reinforces the principle that beneficial ownership, not mere linkage to a trust, determines tax liability.

Non-Vested Interests and Discretionary Control

6. *Sligh v. First Nat'l Bank of Holmes County*, 704 So. 2d 1020 (Miss. 1997)

A creditor attempted to garnish a discretionary trust interest, but the court held that no enforceable right existed. Because distributions were purely discretionary, no claim could attach.

Outcome: Trust protections upheld; no garnishment permitted.

7. *Estate of German v. United States*, 7 Cl. Ct. 641 (1985)

The court ruled that trust assets were not includable in the decedent's gross estate because he had no right to compel distribution. This supports estate planning strategies using discretionary trusts.

Outcome: Trust was excluded from the estate, validating separation of legal control and beneficial interest.

8. **U.S. v. Taylor**, 254 F. Supp. 752 (N.D. Cal. 1966)

The IRS attempted to levy taxes on discretionary trust assets but failed. The court held that the assets were not "property" of the beneficiary for tax purposes.

Outcome: The levy was denied, protecting trust assets from federal enforcement.

9. **Pacific Southwest Bank v. Johnson**, 99 Cal. App. 4th 1063 (2002)

A creditor sought to attach trust distributions. The court held that because the trust was discretionary and the beneficiary had no right to compel payment, there was no attachable interest.

Outcome: Creditor's efforts failed, trust protection prevailed.

10. **Estate of Baggett v. Baggett**, 825 So. 2d 477 (Miss. 2002)

In a divorce proceeding, an ex-spouse tried to claim trust assets owed to the beneficiary. The court enforced the trust's discretionary and spendthrift terms, blocking the claim.

Outcome: Trust was protected even in a family law context.

Section 5: Legal and Multilevel Compliance

The **Nexcess Trust** is deliberately structured to comply with an interlocking framework of legal authorities, blending **federal law, uniform statutes, common law doctrine, and constitutional protections**. This multi-tiered legal compliance is not superficial—it is foundational, ensuring that the trust is enforceable, tax-compliant, asset-protected, and jurisdictionally adaptable for long-term private administration.

The trust's design reflects adherence to **at least eight major legal frameworks**, while also invoking the **Supremacy Clause, Sixteenth Amendment, and Contract Clause** to shield its structure and operation from both judicial and legislative overreach.

Eight Primary Legal Frameworks Supporting the Trust

1. Internal Revenue Code (IRC)

The trust complies with **Subchapter J of the Internal Revenue Code (IRC §§641–692)**, which governs fiduciary taxation. Its structure avoids classification as a grantor trust (IRC §§671–679) and leverages IRC §643 to defer taxation on passive income retained in corpus. Treasury regulations and court rulings such as *Ferguson v. Commissioner*, 69 T.C. 320 (1977), affirm that capital gains and extraordinary dividends can lawfully be excluded from DNI when allocated to principal.

2. Uniform Trust Code (UTC)

Adopted in over 30 U.S. jurisdictions, the **UTC** governs trust creation, fiduciary duties, modification, and enforcement. The Nexcess Trust's spendthrift and discretionary provisions comply with UTC §§105 and 502–504, which explicitly authorize creditor protection and flexible income retention. These provisions are judicially upheld unless expressly overridden by statute or local law—neither of which apply to private contract trusts in most states.

3. Uniform Prudent Investor Act (UPIA)

UPIA introduces modern fiduciary investment standards based on diversification, total return, and prudent delegation. The Nexcess trustee operates under these principles, maintaining documented justification for asset retention or reinvestment. Compliance with UPIA §2 (Standard of Care) and §5 (Diversification) ensures the trustee is acting in a manner consistent with fiduciary best practices.

4. Uniform Commercial Code (UCC)

The UCC governs transactions involving commercial contracts, negotiable instruments, security interests, and title transfer. Nexcess uses UCC Articles 2, 3, and 9 to support its legal position in asset acquisitions, debt instruments, and contract enforcement. For

example, trust-owned real estate or royalty contracts may be secured and enforceable under these commercial rules without conflicting with trust law.

5. Restatement (Third) of Trusts

Widely cited by courts, the **Restatement** provides a comprehensive restatement of common law trust principles. Sections such as §50 (discretionary powers) and §58 (spendthrift protections) directly support the Nexcess Trust's refusal to grant beneficiaries a fixed right to distributions, reinforcing that no enforceable property interest exists until the trustee acts.

6. Scott on Trust Law

As the most authoritative academic treatise on American trust doctrine, **Scott on Trusts** affirms the separation of legal and equitable title, and legitimizes irrevocable, non-grantor structures. Scott emphasizes that beneficiaries of discretionary trusts hold only a "mere expectancy," and courts generally refuse to override trustee discretion except for gross abuse, which is prevented by Nexcess's procedural governance.

7. Statute of Frauds

All trust documents and asset transfers are executed in writing, satisfying the **Statute of Frauds** in every U.S. jurisdiction. This ensures the enforceability of trust obligations, assignments, and ownership claims over property, especially when real estate, royalties, or multi-year agreements are involved.

8. Rule Against Perpetuities (RAP)

Nexcess is structured to comply with the common-law RAP (typically 21 years after a life in being) or modern statutory extensions up to 90 or 100 years. In jurisdictions like Nevada or South Dakota, where the RAP has been repealed or significantly extended, the trust's terms may legally persist for up to 365 or even 1,000 years depending on venue selection.

Constitutional Protections Supporting Private Trust Contracts

1. Contract Clause – Article I, Section 10, Clause 1

The **Nexcess Trust is a private contract**—not a statutory entity. Under the **Contract Clause**, "No state shall... pass any... Law impairing the Obligation of Contracts." This guarantees that state legislatures cannot nullify or alter the trust's provisions once executed. In *Fletcher v. Peck*, 10 U.S. (6 Cranch) 87 (1810), the Supreme Court affirmed that contracts executed in good faith are immune from state interference—even when politically inconvenient.

2. Supremacy Clause – Article VI, Clause 2

The **Supremacy Clause** provides that the Constitution and federal law override any conflicting state laws. The Nexcess Trust is compliant with federal tax law (IRC), and federal courts have consistently upheld the supremacy of IRS classification rules, common-law

discretionary trust protections, and contractual rights. As such, no state agency, court, or statute may lawfully invalidate the trust's provisions when they are in accordance with superior federal law.

3. Sixteenth Amendment – Federal Taxing Power Defined

The **Sixteenth Amendment** authorizes Congress to tax income “from whatever source derived,” but **only when the income is realized** and properly attributed. The Nexcess Trust does not distribute income to grantor or beneficiary, nor is income constructively received. Case law such as *Eliot v. Freeman*, 220 U.S. 178 (1911), and *Blair v. Commissioner*, 300 U.S. 5 (1937), affirms that **ownership and receipt—not mere potential interest—govern tax liability**. Income retained in corpus per IRC §643(b) is not subject to current taxation until a distribution event occurs.

Legal Standing as a Private, Non-Statutory Entity

The **Nexcess Trust is not created by state statute**, nor is it subject to corporate charter or public registration. It is a **private contractual relationship** recognized under common law and federal supremacy. Unlike corporations or LLCs, it does not owe continuing duties to a Secretary of State, and no public disclosure of assets, beneficiaries, or trustee actions is required.

The trust's **governing law can be situs-optimized**, choosing favorable jurisdictions (e.g., Nevada, South Dakota, Wyoming) for maximum protection, longevity, and legal insulation. Judicial precedent has consistently recognized these private trust contracts as fully valid when executed in accordance with proper legal form.



Section 6: Addressing Misconceptions and Audit Concerns

Despite its deep legal foundation and decades of operational history, the **Nexcess Trust** is occasionally met with skepticism particularly from CPAs, enrolled agents, or attorneys who are unfamiliar with the nuances of **fiduciary tax law under Subchapter J** or the unique authority conveyed in a properly drafted **non-grantor, discretionary, irrevocable trust instrument**. Most professional concerns stem not from substantive flaws in the trust, but from a **lack of exposure** to:

- ▶ **IRC §643(b)** and how it defines fiduciary accounting income;
- ▶ The legal weight of **“the terms of the governing instrument and applicable local law”** in determining tax treatment;
- ▶ The difference between **realized income and distributable net income (DNI)**; and
- ▶ The role of **discretionary trustee authority** in deferring income taxation under well-established federal principles.

When understood within the correct legal and tax framework, the Nexcess Trust is not only valid, but also **routinely upheld under IRS scrutiny** and **fully compliant with both fiduciary accounting and federal income tax law**.



The Legal and Administrative Track Record

The accountants with Nexcess have a proven, audit-tested track record extending over **35 years**, involving the filing of **over 150,000 fiduciary tax returns** (Form 1041) through licensed tax professionals.

These filings span a variety of passive income types including rents, royalties, interest, dividends, capital gains, and passive K-1 allocations and consistently utilize **IRC §643(a)(3)-(4)** and **§643(b)** to exclude income properly allocated to **corpus** from current taxation.

Importantly, **multiple IRS audits** of both the trust itself and its associated entities or trustees have resulted in **“no-change” letters**, indicating that the Service, upon review of trust structure, documents, and filings, found **no basis to adjust or invalidate** the trust’s tax treatment.

These audit outcomes strongly support the **lawful implementation** and **technical defensibility** of the Nexcess model when executed according to legal standards.

To date, **no IRS bulletin, Tax Court decision, private letter ruling, or revenue ruling** has declared the structure unlawful when properly established. This includes scrutiny of tax reporting related to discretionary accumulation of income, capital gain exclusion from DNI, and fiduciary compliance with trust instrument authority.

Some professionals mistakenly cite an **IRS Memorandum (AM-2023-006)** issued in recent years to suggest that discretionary trust structures like Nexcess are problematic or disallowed. However, this is a **misapplication** of the memo for several key reasons:

1. **IRS Memos (such as Chief Counsel Advice or internal memoranda) are explicitly non-precedential.**
2. Per IRS regulations and the IRS Manual, internal memoranda are not binding on taxpayers or the IRS itself in future cases. They **cannot be cited as authority** under **IRC §6110(k)(3)** and are intended only to advise IRS personnel in resolving specific, fact-bound disputes—not to establish legal standards.
3. **The memorandum does not address the Nexcess Trust model.**
4. The fact pattern under review in the memo involved **grantor trust dynamics, active business income**, or mischaracterization of self-employment income—none of which apply to the Nexcess Trust, which is **irrevocable, non-grantor**, and strictly limited to **passive income streams**.
5. **Extraordinary Dividends Were Explicitly Excluded from Analysis.**
6. Most notably, **on page 3** of the memo, the IRS explicitly states that it is **not addressing the treatment of extraordinary dividends under IRC §643(a)(4) and §643(b)**. This omission is significant: extraordinary dividends (such as large, one-time corporate

payouts) are a key category of income that trustees may lawfully allocate to **corpus** rather than income, so long as they act in good faith under the trust's terms.

7. By omitting this analysis, the memo confirms that it **does not provide guidance, approval, or disapproval** of corpus allocation of extraordinary dividends—a critical component of the Nexcess tax strategy.

Root of Professional Misunderstandings

Professional hesitation typically arises from **misapplication of corporate or individual tax norms** to a **fiduciary entity**, especially in relation to:

1. IRC §643(b) Discretionary Income Treatment

Many CPAs and tax attorneys are unfamiliar with how **IRC §643(b)** separates “**fiduciary accounting income**” from **gross income under IRC §61**, and how the trust instrument's terms override default accounting rules. Under federal law, if the governing instrument and applicable local law permit it, and the trustee acts in good faith, certain income items such as capital gains and extraordinary dividends **may be lawfully allocated to principal and excluded from distributable net income (DNI)**.

2. Misunderstanding of Trustee Discretion and Separation of Powers

Critics often overlook that the trust's legal design **separates the settlor, trustee, and beneficiaries**, in compliance with **non-grantor trust principles under IRC §§671–679**. The trustee's authority to retain or distribute income is a core legal power that, when exercised prudently and documented properly, defers income taxation until an actual or constructive distribution occurs.

3. Confusion with Abusive Trust Schemes

Some professionals mistakenly associate the Nexcess Trust with abusive or “pure” trust schemes that promise illegal tax avoidance, use nominee structures, or fail to separate beneficial and legal ownership. Unlike such schemes, the Nexcess Trust is founded on established legal principles, clear accounting guidelines, and does not promote secrecy, evasion, or mischaracterization of income.

Common Missteps That Lead to IRS Red Flags

When disputes or penalties do arise, they typically involve **misuse**, not the structure itself. The two most common causes of exposure are:

1. Improper Classification or Funding (Violating Non-Grantor Status)

- ▶ This includes using gift transfers instead of legitimate sales or exchanges, failing to sever the settlor's rights, or making the grantor a trustee or beneficiary. Such actions trigger **IRC §675** or **§2036**, reclassifying the trust as a **grantor trust** and causing attribution of income to the individual.

2. Mischaracterization of Income Types (Violating §643)

- ▶ Attempting to classify **active business income, wages, or self-employment earnings** as “passive” to benefit from corpus deferral violates both the **spirit and letter** of the law. Only passive income—such as **rents, royalties, portfolio interest, dividends, capital gains, and passive K-1 items**—qualifies under this model. Mislabeling earned income triggers audit scrutiny and invalidates the trust’s deferral strategy.

The Solution: Lawful Implementation and Oversight

When the Nexcess Trust is implemented correctly—with proper funding procedures, trustee separation, passive income classification, and professional oversight—it operates as a **fully compliant fiduciary structure**, not a tax shelter or evasion tool.

Key compliance safeguards include:

- ▶ Written trust terms that authorize income-to-corporus allocations;
- ▶ Trustee discretion backed by fiduciary accounting standards;
- ▶ Separation of grantor, trustee, and beneficiary roles;
- ▶ Accurate income classification on **Form 1041** and supporting schedules;
- ▶ Documentation of sales or exchanges into the trust (not gifts); and
- ▶ Active avoidance of constructive receipt or nominee arrangements.

The result is a **legally defensible trust that stands up to audit**, adheres to fiduciary best practices, and provides long-term asset protection and tax deferral within the bounds of established federal law.



Section 7: Use Cases and Legacy Planning Applications

The **Nexcess Trust** is not a one-size-fits-all instrument—it is a **versatile, high-functioning fiduciary structure** designed to serve a broad array of strategic needs, particularly for individuals and families focused on **asset preservation, tax efficiency, legal insulation, and multigenerational wealth continuity**. Its unique blend of **irrevocability, discretionary income control, and spendthrift protections** makes it especially well-suited for both **dynamic business operations** and **long-term legacy planning**.

Here are several key use cases that highlight how the Nexcess Trust can be deployed with precision and maximum benefit:

Business Owners Seeking Legal and Tax Separation

Entrepreneurs and business owners often face exposure to liability, litigation, and unpredictable tax burdens. The Nexcess Trust offers a means of **legally separating ownership** of passive income-producing business assets (e.g., royalties, licensing, real estate) from the operational risks of active business entities.

- ▶ By transferring **intellectual property, brand assets, goodwill, or customer lists** into the trust through a **formal value-for-value sale or assignment**, business owners can insulate those assets from operating liabilities.
- ▶ This approach can **shield valuable intangibles from lawsuits, creditors, and operational failure**, without triggering gift tax or loss of control, so long as the terms comply with IRC §643 and §671–679.

It's particularly powerful in conjunction with operating companies structured as S corps or LLCs, where income may flow passively into the trust while operations remain elsewhere.

Real Estate Investors Managing Passive Income and Capital Gains

For real estate professionals and passive investors, the **Nexcess Trust** offers a structurally superior vehicle for accumulating, reinvesting, and protecting rental income, capital gains, and proceeds from real estate sales — without resorting to common strategies that often backfire, such as 1031 exchanges or excessive depreciation.

Contrary to popular belief, **1031 exchanges and aggressive depreciation deductions** can create **long-term tax traps**. While these tools may defer tax in the short term, they also **drive down book value**, resulting in massive **depreciation recapture** and capital gain recognition upon eventual disposition or death. Additionally, layering 1031 exchanges over time locks the investor into a fragile, inflexible portfolio where any liquidation or change in investment direction triggers compounded tax exposure.

The Nexcess Trust provides a more intelligent and controllable alternative. By **holding title to rental properties** or receiving **passive partnership income (K-1)**, the trust may lawfully **retain taxable income in corpus** — including capital gains — without triggering immediate tax to beneficiaries. This is authorized under **IRC §643(b)**, which allows the trustee, acting in good faith and in accordance with the trust instrument, to **allocate income and gains to principal**, thereby **excluding them from Distributable Net Income (DNI)**.

This means that rental income, sale proceeds, and capital appreciation can be **retained, layered, and strategically reinvested** within the trust without annual tax leakage. In **high-tax states** or for those approaching **estate tax thresholds**, this accumulation strategy can drastically reduce personal income exposure while expanding long-term portfolio value. Unlike a 1031, there is no forced reinvestment timeline or property replacement requirement. The trustee controls the timing of recognition and distribution, allowing wealth to grow tax-efficiently within a protected legal envelope.

Distributions to family members or successors may be deferred indefinitely at the trustee's discretion, creating powerful **timing control** and aligning tax recognition with actual cash flow needs or generational planning milestones. Meanwhile, the trust also acts as an **asset protection shield**, safeguarding real estate equity against future legal claims, probate disputes, divorce proceedings, or creditor attacks. Equity cannot be reached by third parties, as beneficiaries have no enforceable rights and the trust retains full discretion over both income and principal.

For real estate investors seeking to **escape the limitations and liabilities of conventional tax strategies**, the Nexcess Trust offers an unmatched solution: **no depreciation recapture, no rigid 1031 timelines, no taxable distributions unless elected**, and complete insulation from external threats. It is the foundation for sustainable real estate wealth, legally fortified and tax-optimized for generational success.

Entrepreneurs Monetizing Intellectual Property or Royalty Streams

The Nexcess Trust is a powerful structure for inventors, creators, authors, and IP holders who generate long-tail **passive royalty income** from licenses, patents, books, digital assets, or software.

- ▶ Rather than personally holding these assets—exposing them to liability or tax acceleration—they can be **assigned to the trust in exchange for consideration** and then monetized under trustee control.
- ▶ Royalty income retained in corpus is **not taxed until distributed**, assuming proper classification under IRC §643 and no constructive receipt, which creates **multi-year tax deferral opportunities**.

For entrepreneurs who wish to extract value from their innovations while protecting the underlying IP, the Nexcess Trust offers an elegant legal container that preserves both ownership and control without sacrificing tax compliance.

Families Planning Generational Wealth Transfers

Unlike revocable living trusts—which offer convenience but little asset protection or tax planning—the Nexcess Trust is specifically engineered for **multigenerational wealth preservation**.

- ▶ Because the trust is **irrevocable and non-grantor**, assets placed within it are removed from the settlor's estate, limiting exposure to **estate taxes under IRC §2031–2042**.
- ▶ Beneficiaries have **no fixed entitlement**, meaning they cannot force distributions and creditors cannot claim their interests. This is ideal for high-conflict families, special needs planning, or protecting immature heirs.
- ▶ The trust's **100-year lifespan** (or longer in certain jurisdictions) allows it to act as a **multi-generational vault**, retaining capital gains, inheritance wealth, or cash-flowing assets in perpetuity under trustee control.

When integrated into broader family office or dynastic planning strategies, the Nexcess Trust acts as a cornerstone for preserving wealth, control, and values across multiple generations.

High-Net-Worth Individuals Seeking Privacy, Tax Efficiency, and Control

For individuals with substantial holdings in securities, private equity, oil and gas, or other passive investments, the Nexcess Trust provides a superior level of control and discretion.

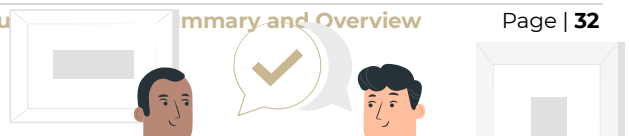
- ▶ Assets can be **accumulated without triggering income tax at the individual level**, allowing for compound growth and future liquidity events to be strategically timed.
- ▶ The trust offers **strong privacy advantages**, as it is not publicly filed or registered. Beneficiaries' identities, trustee decisions, and asset holdings are **shielded from public record and legal discovery**.
- ▶ It creates a **legally distinct ownership layer**, separating personal and trust assets—ideal for protection against litigation, marriage dissolution, or political scrutiny.

For affluent clients seeking a legal, constitutional, and tax-advantaged asset container, the Nexcess Trust meets the highest standards of discretion, legality, and financial strategy.

Summary: A Versatile Planning Vehicle Beyond Traditional Tools

The Nexcess Trust outperforms traditional tools like revocable trusts, LLCs, and corporations in long-term planning because of its:

- ▶ **Irrevocability** (ensuring permanence and asset separation)
- ▶ **Discretionary distribution authority** (delaying or denying income distribution)
- ▶ **Non-grantor tax posture** (avoiding attribution of income to the creator)



- ▶ **Spendthrift protection** (shielding assets from creditors and courts)
- ▶ **Extended lifespan** (up to 100 years or more depending on situs)
- ▶ **Private contract basis** (operating independently of state-chartered registration)

Whether the goal is privacy, protection, preservation, or planning, the Nexcess Trust provides the **legal infrastructure** to achieve it—rooted in law, tested by audit, and tailored for complexity.

Section 8: Summary and Strategic Takeaways

This framework outlines a sophisticated, compliant, and litigation-resilient trust strategy rooted in centuries of legal doctrine, modern tax code interpretation, and fiduciary trust law. Unlike structures that rely on statutory privileges subject to policy reversal or judicial challenge, the trust model presented here is **non-statutory, discretionary, and non-grantor** by design. Its power derives from legal precision — not legislative loopholes.

The trust is structured to maximize autonomy, asset protection, and tax control. It operates under well-established principles that have been repeatedly upheld by courts at every level, including the United States Supreme Court. Spendthrift provisions, when coupled with discretionary powers and no enforceable rights in the hands of beneficiaries, render trust assets effectively unreachable by creditors, courts, or government agencies — including in bankruptcy and IRS enforcement contexts.

From a tax standpoint, the trust leverages IRC §§643(a) and 643(b) to legally exclude capital gains, extraordinary dividends, and other income items from current-year Distributable Net Income (DNI) when allocated to principal in good faith. This mechanism allows the trust to accumulate income without triggering taxation to the beneficiaries or, in many cases, to the trust itself — depending on how and when distributions occur. Because the definition of “income” under §643(b) is based on trust accounting principles and not gross income under §61, the fiduciary has considerable discretion — supported by law — to determine how receipts are treated for tax purposes.

This structure has the advantage of operating outside the restrictive boundaries of asset protection statutes like those found in DAPTs or state-specific estate codes. It avoids the statutory landmines and claw back periods those structures face, while simultaneously remaining compliant with federal tax rules and fiduciary accounting standards. Courts across jurisdictions have upheld the integrity of discretionary, spendthrift trusts that follow this format, confirming their immunity from third-party claims and adverse legal outcomes.

Practical applications range from tax deferral for high-net-worth individuals and business owners, to multi-generational wealth preservation and family governance. The trust can hold real estate, business interests, intellectual property, and investment portfolios while maintaining control, privacy, and protection. It allows for tailored distribution conditions, future-proofing against divorce, addiction, financial mismanagement, and economic downturns.

In sum, the non-statutory, irrevocable, complex, discretionary spendthrift trust is not a gimmick or fringe asset shelter. It is a highly refined legal instrument built on conservative principles and robust precedent. When drafted properly and administered in good faith, it stands as one of the most effective tools available for individuals and families seeking long-term wealth security, privacy, and lawful tax strategy.