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Trusts: Income and Estate and Gift Tax Issues

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Trusts: Income and Estate and Gift Tax Issues

A trust is a legal arrangement in which a donor or grantor transfers assets to a trustee who manages the assets for beneficiaries. Trusts are one method of providing for the inheritance of assets, along with wills. This report focuses on transfers to trusts that are potentially subject to the estate and gift tax, and which can be differentiated by the person liable for income taxes on the earnings from those assets and whether the assets remain in the donor or grantor's estate.

In general, assets transferred by estate or gift are subject to a tax of 40% on amounts in excess of the combined estate and gift tax exemption, currently \$15 million per person (indexed for inflation). There is also a generation-skipping tax (GST), which is applied to estates that skip generations (e.g., leave assets to grandchildren rather than children), applying the tax to the skip generations (generations before the recipient of the assets). Appreciated assets transferred by an estate are eligible for a step up in basis, so that any capital gains tax due is on the amount in excess of the fair market value at death, while assets transferred by gift retain the original basis (generally the cost of purchasing the asset). Most trusts are *revocable trusts* (trusts which can be dissolved) used to avoid probate. Revocable trusts involve no tax issues while the grantor is alive because income from the assets is taxed to the grantor and assets remain in the estate. Other trusts are used for tax planning, with the aim generally to reduce or eliminate the estate and gift tax.

Tax planning involves *irrevocable trusts*, especially those that are also *grantor trusts* (trusts which allow the grantor some control over the assets). These grantor trusts are treated as complete gifts under the estate and gift tax (and removed from the grantor's estate), but for income tax purposes are treated as owned by the grantor. Thus, transactions between the grantor and the trust do not generate income. Data on trusts are incomplete and somewhat outdated, but indicate that as of 2014 there were 2.8 million irrevocable trusts, of which about 600,000 were grantor trusts.

The general type of irrevocable grantor trust, known as an *intentionally defective grantor trust* (IDGT), allows grantors to minimize the taxable gift to a trust by exchanging assets for a promissory note discounted at a low rate and retaining a high value. Taxes paid on income by the grantor are not considered gifts, allowing assets to appreciate tax free. Grantors can swap low-basis assets in a trust for high-basis assets, minimizing the loss of step up in basis. Other grantor trusts can be used to transfer assets out of one spouse's estate or for other purposes, including split-interest trusts that make annuity payments to charities but leave the remainder to family members.

A special type of irrevocable grantor trust—the grantor retained annuity trust (GRAT)—can be used to reduce the taxable gift amount or even eliminate it by paying an annuity to the grantor. The present value of the annuity, discounted at the typical relatively low discount rate, offsets the gift. If the assets in the GRAT grow faster than this rate, assets will remain in the trust after the payment of an annuity.

Dynasty trusts are trusts that last for many generations, or indefinitely. They can make payments to intermediate beneficiaries while reserving the bulk of the assets in the trust to be retained indefinitely without estate taxes. These trusts can avoid generation-skipping taxes by applying GST exemptions to the tax and minimizing the original gift. Not all states allow these perpetual trusts.

Some estimates suggest that as much as \$13 trillion, close to a quarter of the wealth of the top 1% of households by net worth, is held in all trusts with income reported on fiduciary tax returns (irrevocable nongrantor trusts).

All of these mechanisms can be enhanced by contributing assets to family limited partnerships, which can result in significant minority and marketability discounts in the valuation.

Members of Congress, researchers, and interest groups have made numerous proposals to address the tax treatment of trusts. For irrevocable grantor trusts, proposals have been made to recognize transactions between grantors and trusts for income tax purposes and retain them in the estate. Specific proposals for GRATs would impose minimum and maximum terms for annuities and required remainders, or disallow the up-front deductions for annuities. Proposals aimed at dynasty trusts would limit the duration of such trusts, or limit the number of generations eligible for the GST exemption. Some proposals suggest a withholding tax for dynasty trusts or a wealth tax that would include trusts. For discounts, proposals would disallow these discounts for certain assets, such as nonbusiness assets or assets with majority family control.

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Introduction

In general terms, a trust is a legal arrangement in which a donor or grantor transfers assets to a trustee who manages the assets for beneficiaries.¹ Trusts are created under state law but subject to federal income and estate and gift taxes. Trusts are one method of providing for the inheritance of assets, along with wills. Trusts are used for many purposes, and according to one source about 8% of Americans have a trust.² Another source estimates 11%.³ A smaller portion of Americans, less than 3 million, or about 1%, have an irrevocable trust where income taxes are, in some cases, paid by the trust or beneficiaries.⁴ The more common type of trust, the revocable trust, is primarily used to avoid probate,⁵ whereas the irrevocable trust is used by wealthy individuals to minimize estate taxes and protect assets.

This report discusses trusts used to deal with inheritance and estate taxes. Other types of trusts that are often tax favored—such as trusts for employer pensions, savings, and stock ownership; individual retirement accounts (IRAs); and educational savings accounts—are not addressed here. This report focuses on transfers to trusts that are potentially subject to the estate and gift tax, and which can be differentiated by the person liable for income taxes on the earnings from those assets and whether the assets remain in the donor or grantor’s estate.

Basic Types of Trusts

Trusts vary in a number of ways, some of which have consequences for tax treatment. The major types of trusts and their features include the following:

- Simple trusts and complex trusts. In simple trusts, all income must be distributed currently, principal cannot be distributed, and no charitable contributions can be made. In complex trusts, income can be retained, principal can be distributed, and charitable contributions can be made. These terms are a distinction in federal law and are a classification of nongrantor trusts, as discussed below, which are treated as separate entities for federal income tax purposes.
- Revocable and irrevocable trusts. A revocable trust can be changed at any time or eliminated entirely, while an irrevocable trust cannot be withdrawn (although in

¹ The grantor and the trustee can be the same, and this is common for revocable trusts.

² GrowLaw, “Estate Planning Law Statistics: Top Trends and Insights for [2026],” <https://growlaw.co/blog/estate-planning-law-statistics>. According to this source, 33% of individuals have some type of estate planning, and of those 19% have trusts. About 7% have both trusts and wills according to California Living Trusts, Foley Law Offices, Inc., “What Percentage of People Have a Living Trust?” <https://californialivingtrusts.com/percentage-of-people-with-living-trust/>.

³ Trust & Will, “Who Has an Estate Plan? A Demographic Breakdown,” <https://trustandwill.com/learn/2025-report-estate-planning-demographic-breakdown>.

⁴ Based on estate and trusts income tax returns filed, Internal Revenue Service (IRS), Statistics of Income, “Returns Filed, Taxes Collected and Refunds Issued, Table 2,” <https://www.irs.gov/statistics/returns-filed-taxes-collected-and-refunds-issued>. Percentage based on population of persons over 18 of 258 million, U.S. Census Bureau, “U.S. Adult Population Grew Faster Than Nation’s Total Population From 2010 to 2020,” <https://www.census.gov/library/stories/2021/08/united-states-adult-population-grew-faster-than-nations-total-population-from-2010-to-2020.html>. The numbers reported include estate income tax returns, but most returns are for trusts. According to the most recent data available that report details on distributions, 12% of the total number of returns are for estates. See IRS, Statistics of Income, “Income from Estates and Trusts Statistics,” <https://www.irs.gov/statistics/soi-tax-stats-income-from-estates-and-trusts-statistics>.

⁵ Probate is a legal process, supervised by courts, for settling a will and distributing assets. Probate involves costs and delays.

certain cases the donor retains some control). Revocable trusts that continue after the death of the donor become irrevocable.

- Grantor trusts and nongrantor trusts. A grantor trust allows the grantor some control over the trust and is disregarded for income taxes (the grantor continues to include income on his or her tax return). A nongrantor trust is a separate entity for income tax purposes. All revocable trusts and some irrevocable trusts are grantor trusts.
- Living trusts and testamentary trusts. Living trusts are created during the grantor's lifetime. Testamentary trusts are created at death by instructions in the will. Testamentary trusts are by nature irrevocable and nongrantor and may be simple or complex. Living trusts may be revocable or irrevocable; grantor or nongrantor: and, if nongrantor, simple or complex.
- Split-interest trusts in the tax context refer to trusts with a charitable beneficiary and a noncharitable beneficiary. They include both a lead beneficiary who receives payments or benefits during the trust's existence and a remainder beneficiary who receives any remaining assets at the trust's conclusion. A charitable lead trust can be either a grantor trust or a nongrantor trust. In the more general trust discussion, split-interest trusts can involve family members (such as a spouse as the lead and children as the remainder). These trusts are irrevocable and are usually grantor trusts.
- Dynasty trusts. A dynasty trust is an irrevocable trust that can exist indefinitely or for an extended period of time, allowing wealth to pass down untaxed to multiple generations. Not all states allow dynasty trusts. Many states still adhere to some form of the rule against perpetuities and limit a trust's duration. Examples of duration limits include limiting the term of the trust to a life in being (a person alive) at the time the trust is created plus 21 years, or a flat 90 years.
- Crummey trusts. A Crummey trust refers to any trust with certain legal powers (known as *Crummey powers*) that allow temporary withdrawal rights for the beneficiary, which in turn allow the gift to the trust to benefit from the annual gift tax exemption. It is irrevocable and can be a grantor trust.

Analyses of trusts sometimes contrast simple trusts and complex trusts, which differ in their rules about income distribution, principal distribution, and charitable contributions. However, the more important distinctions for tax analysis are between grantor trusts and nongrantor trusts, and between revocable trusts and irrevocable trusts, as discussed in the next section.

Tax Treatment of Different Types of Trusts

Trusts are subject to different tax treatment depending on how they are set up. The most common tax planning objective for a trust is to minimize estate taxes. Because of the large estate tax exemptions, this tax planning benefits very wealthy individuals.

Assets may be transferred by a gift during lifetime or left in an estate through a will or trust. Transferred assets are subject to a unified estate and gift tax of 40% on amounts in excess of the combined estate and gift tax exemption, currently \$15 million per person (indexed for inflation). A transfer by gift is tax exclusive, meaning that the tax is applied on top of the gift, whereas the estate tax is tax inclusive, meaning the tax is part of the gift. For example, a gift of \$16 million will require a tax of \$0.4 million on the \$1 million remaining after the exclusion, and the gift recipient will receive \$16 million. However, if \$16.4 million is left in the estate, the taxable estate

is \$1.4 million, so the tax is \$0.56 million (40% of \$1.4 million) and the recipient will receive \$15.28 million. Bequests to surviving spouses are deductible from the taxable estate, and a surviving spouse can also inherit any unused exemption. Assets that are appreciated and left in the estate receive a stepped-up basis, so that the basis for figuring sale of the asset by the heirs is fair market value at the time of death rather than the original cost of acquiring the assets. Assets transferred by gift do not receive a step up in basis.

In addition to the estate tax and gift tax, there is also a generation-skipping transfer tax (the GST, also sometimes abbreviated GSTT), which is aimed at estates that skip generations (for example, leave assets to grandchildren).⁶ The GST collects the taxes that would have been imposed on intermediate generations and also has the estate tax exemption.

The objective of tax planning via trusts is usually to minimize the amount of taxes, including the income tax, the estate and gift tax, and the GST.

Aside from the lifetime exemption of \$15 million, money added to a trust is eligible for a yearly exemption, set at \$19,000 for each recipient in 2026. Although these amounts are small relative to the lifetime exemption, they can add up over time and with exemptions of gifts from two parents to both a child and spouse adding to \$76,000 (four exemptions). In order for a gift to a trust to benefit from this annual exemption, the trust must have a Crummey withdrawal right. A trust is a gift of a future interest and, in order to be eligible for the annual gift exemption, beneficiaries must have a right to withdrawals for a temporary period (a current interest). This right is known as a Crummey withdrawal right (or Crummey power), and trusts with such a right are known as Crummey trusts. Crummey trusts are a way to transfer assets to children without losing control, since a parent or guardian (but not the grantor) must exercise the withdrawal right.

Income of the trust assets may be taxed to the grantor or to the trust with a deduction for distributions for beneficiaries, who are then taxed on that income. Trust tax rates reach high levels very quickly (the top rate of 37% applies after \$16,000 of income in 2026) and do not generally provide beneficial tax treatment compared to taxation of a high-income grantor, but beneficiaries can be in lower tax brackets.

Basic Types of Trusts for Tax Purposes

For general tax planning considerations, trusts fall into four basic types depending on their treatment for income and estate tax purposes: revocable trusts, irrevocable nongrantor trusts, irrevocable grantor trusts (commonly referred to simply as grantor trusts), and incomplete gift irrevocable nongrantor trusts (INGs). **Table 1** shows the tax treatment of these basic types of trusts. Revocable trusts do not affect taxes at all and are primarily used for avoiding probate. Irrevocable trusts result in a completed gift and remove assets from the estate tax. Irrevocable grantor trusts are often used as a tax planning tool to reduce the estates held by wealthy individuals with assets above the estate tax exemption. Grantor trust status means income is taxed to the grantor and not the trust or beneficiaries. INGs are designed to be subject to trust income taxation and not be a completed gift, so they are not subject to the gift tax and remain in the estate. They are used by taxpayers in high-tax states to avoid state taxes by shifting trusts to states without taxes on trust income (e.g., Wyoming, Delaware, and Nevada).⁷

An irrevocable grantor trust becomes a basic irrevocable trust at the death of the grantor. These trusts may distribute all assets at the death of the grantor, or remain trusts with distributions to

⁶ See CRS In Focus IF13053, *The Generation-Skipping Transfer Tax (GSTT)*, by Jane G. Gravelle.

⁷ Douglas Yost, "ING Trusts: How They Work and Their Continued Viability," *The Tax Advisor*, May 31, 2025. <https://www.thetaxadviser.com/issues/2025/may/ing-trusts-how-they-workand-their-continued-viability/>.

beneficiaries and retention of assets in the trust. Trusts that continue can be maintained over a long period of time—or even indefinitely, depending on state law—and are referred to as dynasty trusts. These dynasty trusts are explained in detail in Galle et al.⁸

Table 1. The Four Basic Types of Trust Tax Treatment

Type of Trust	Income Tax Treatment	Estate and Gift tax Treatment
Revocable Trust	Earnings are taxed to the grantor.	Considered an incomplete gift; assets remain in the donor's estate and are eligible for stepped-up basis.
Irrevocable Nongrantor Trust	Earnings are taxed to the trust, or if distributed, taxed to beneficiaries. If a charitable lead nongrantor trust, retained earnings are taxed to the trust, and distributions are not taxable because they are received by a charity.	Considered a complete gift, subject to gift tax; assets are removed from the donor's estate. Appreciated assets in the trust do not get a stepped-up basis.
Irrevocable Grantor Trust	Earnings are taxed to the grantor.	Considered a complete gift, subject to the gift tax; assets are removed from the donor's estate. Appreciated assets in the trust do not get a stepped-up basis.
Incomplete Gift Nongrantor Irrevocable Trust (ING)	Earnings are taxed to the trust, or if distributed, taxed to beneficiaries.	Considered an incomplete gift; assets remain in the donor's estate and are eligible for stepped-up basis.

Types of Irrevocable Grantor Trusts

The irrevocable grantor trust is used by wealthy taxpayers to remove assets from the estate and is a common object of proposals for legal or tax treatment revisions. There are many different types of these grantor trusts, with different tax consequences. **Table 2** explains the different types and advantages of irrevocable grantor trusts.

Table 2. Types of Irrevocable Grantor Trusts

Type of Trust	Tax Benefits
Intentionally Defective Grantor Trust (IDGT) (Defines an Irrevocable Grantor Trust)	Retains some control by the grantor, which prevents these trusts from being irrevocable for income tax purposes. Allows assets to grow tax free inside the trust because the grantor pays the income taxes. These income taxes are also not considered gifts. Allows tax-free transactions between the grantor and the trust, such as contributing appreciating assets in exchange for a promissory note (for purposes minimizing the estate) or swapping high-basis assets for low-basis ones to benefit from step up in basis for assets remaining in the estate.

⁸ Brian Galle et al., “Taxing Dynasties,” *University of Pennsylvania Law Review* (forthcoming), University of Missouri School of Law Legal Studies Research Paper (forthcoming), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=5193668 (hereinafter Galle et al., “Taxing Dynasties”).

Type of Trust	Tax Benefits
Grantor Retained Annuity Trust (GRAT)	Typically structured as a grantor trust. Taxes income to the grantor. Allows grantor to receive a fixed stream of payments with the remainder going to the beneficiaries. The present value of the fixed stream of payments reduces the gift tax. By setting the annuity high enough to create a zero or nominal gift and contributing appreciating assets, assets can be passed on to heirs without paying either a gift or estate tax. The grantor has to survive the term of the trust to exclude assets from the estate.
Grantor Retained Unitrust (GRUT)	Similar to a GRAT, but payments are a fixed percentage of assets. Hedges against inflation, but payments also grow if appreciation in assets is greater than expected, limiting the transfer of value to the trust.
Grantor Retained Income Trust (GRIT)	Similar to a GRAT or GRUT, pays out all of the income to the grantor.
Qualified Personal Residence Trust (QRPT)	Structured as a grantor trust. Transfers a personal residence to a trust and allows grantor the use of the property during the trust term.
Charitable Lead Trusts (Charitable Lead Annuity Trust or CLAT and Charitable Lead Unitrust or CLUT)	Grantor charitable lead trusts allow an up-front deduction for the present value of the payments to charity, which reduces the value of the gift. Grantor pays income taxes.
Spousal Lifetime Access Trust (SLAT)	Set up by one spouse for another to use estate tax exemption and allow further appreciation to be excluded from the estate. Donor spouse pays taxes, which are not considered additional gifts. Beneficiary spouse has recourse to income and principal, which can indirectly benefit the donor spouse. If beneficiary spouse dies first, however, donor spouse loses access to assets, which then goes to the other beneficiaries.
Irrevocable Life Insurance Trust (ILIT)	Holds life insurance on the grantor's life. Removes the proceeds from the estate, and can be structured to pay premiums using the annual gift exclusion.

Notes: All irrevocable grantor trusts are also IDGTs. Other than the GRAT, GRUT, and GRIT, these trusts can be structured as nongrantor trusts.

Other Specialized Trusts

There are a number of other types of specialized irrevocable trusts that are not grantor trusts, either living or testamentary. They include the qualified terminal interest property (QTIP), which allows the surviving spouse income; the qualified funeral trust (QFT), which covers burial expenses and is used to reduce assets to qualify for Medicaid; and the qualified Subchapter S trust (QSST) or electing small business trust (ESBT), both of which can hold Subchapter S stock. Some trusts that were designed to make optimal use of the estate tax deduction are not as relevant given the ability of the second spouse to inherit unused exemptions (such as the AB trust, which leaves assets up to the exemption to nonspousal beneficiaries). There is also the qualified disability trust (QDisT), an irrevocable nongrantor trust taxed under trust rules, but with a larger

annual trust income exemption of \$5,100, which is also used to avoid the “kiddie tax”;⁹ the beneficiary of a QDistT must have a disability affirmed by Social Security.

Another type of charitable trust is a charitable remainder trust (CRT), which can be either a charitable remainder annuity trust (CRAT) or charitable remainder unitrust (CRUT). These are not grantor trusts, but they are tax exempt. CRTs provide benefits to noncharitable beneficiaries, while the remainder is given to a charity. Because CRTs are tax exempt, they can sell assets without paying tax. A charitable deduction is allowed for the present value of the charitable remainder and payouts are taxed to individuals.

Use of Family Limited Partnerships (FLPs) in Trusts

One method of reducing estate taxes can also be employed with trusts: the family limited partnership. Assets contributed to FLPs, where there are minority interests, can be used to reduce the value of these assets in the estate and when contributed to a trust. These assets are often allowed significant discounts, called minority discounts, and may also be allowed marketability discounts. While the FLP must have a business purpose, investment portfolios (e.g., stocks or bonds) can be contributed along with real estate, family businesses, and art or collectables.

Dynasty Trusts

Dynasty trusts can be created by both irrevocable trusts and IDGTs and in states other than the state of residency. Dynasty trusts may distribute income to succeeding generations but keep the bulk of the assets in the trust. Trusts created by GRATs can also be turned into basic IDGTs, and thus into dynasty trusts by leaving the remainder after a short-term annuity to an IDGT and allocating GST exemptions to the new trust to avoid future estate taxes. The combination of these mechanisms allows wealthy families to transfer assets untaxed by the estate tax, gift tax, or GST for unlimited generations. Some observers consider dynasty trusts to be the most important method of avoiding the estate tax and GST tax, allowing wealth to be transferred for generations without tax.¹⁰

Many states have abolished rules against perpetuities, meaning dynasty trusts can last indefinitely. Others allow extremely long terms (e.g., 350 years or 1,000 years). Some states retain the common-law rule that limits trusts to 21 years after the death of the last beneficiary alive when the trust was created or to 90 years.¹¹

In addition to allowances for extremely long or indefinite terms, grantors might prefer to set up trusts in certain states because they do not have state income taxes or do not tax trust income, and because of protection from creditors and the availability of spendthrift trusts (to protect a beneficiary from their own mismanagement, creditors, or legal judgments). South Dakota and Nevada, for example, rate particularly high for the location of dynasty trusts.¹²

⁹ The kiddie tax taxes unearned income above a certain threshold at the parent’s marginal tax rate and applies to dependents under 18 or students under 24.

¹⁰ Galle et al., “Taxing Dynasties.”

¹¹ See Mani Mahadevan, “Understanding the Rule Against Perpetuities for Trusts,” *Valur*, October 26, 2025, <https://learn.valur.com/rule-against-perpetuities/>.

¹² Oshins and Associates, LLC, “State Rankings Chart,” <https://www.oshins.com/state-rankings-charts>.

Data on Trusts

Data on trusts are limited, but the number of returns and income from irrevocable trusts and some grantor trusts (revocable or irrevocable) can be found in the fiduciary tax returns. A separate form reports data on charitable split-interest trusts. Gifts to trusts can be found in gift tax returns, and some data have been provided in special studies by researchers.

Data from Fiduciary Income Tax Returns

Statistics are limited on revocable trusts or irrevocable grantor trusts, because these trusts do not necessarily file fiduciary tax returns. If there is a single grantor (a married couple counts as a single grantor) who is the trustee all that is required is to report income on Form 1040 along with other income. Thus, most of the data are on irrevocable trusts. Other statistics indicate that the vast majority of trusts do not file a trust tax return. Split-interest (charitable) trusts are also not reported on Form 1041 unless they have unrelated business income. However, split-interest trusts are reported on Form 5227. They are about 4% of trusts reported on Form 1041. Some small share of income reported on Form 1041 is from income earned by estates where assets have not yet been distributed.

The most recent data on collections and returns from Form 1041, for FY2024, indicate 3.2 million returns and \$52.7 billion in net collections. Collections from Form 1041 were 1.2% of the total number of collections and 2.4% of the amount of income tax collections.¹³

Most of those trusts not reported on Form 1041 are probably revocable trusts that are primarily used to avoid probate, not for tax planning. **Table 3** provides the most recent data on the types of trusts in Form 1041. The grantor trust data do not cover all grantor trusts, as there are alternative methods of reporting these trusts, and trust income is generally not reported. However, grantor trusts become irrevocable trusts when the grantor dies and are reflected in the data. In 2014, there were 2.8 million irrevocable trusts; of these, 600,000 were grantor trusts. Income reported was \$125.8 billion with negligible amounts reported for grantor trusts.

Table 3. Distribution by Type of Trusts Reported on Form 1041, 2014

Type of Trust	Share of Trusts (%)	Share of Income (%)
Complex	53.1	71.9
Simple	24.3	24.8
Grantor	21.7	1.2
Qualified Disability	0.7	0.1
Split-Interest	0.1	2.7
Qualified Funeral	0.1	1.8
Pooled Income Fund	0.0	0.0

Source: Internal Revenue Service (IRS), Statistics of Income, “Income From Estates and Trusts Statistics, Table 2,” <https://www.irs.gov/statistics/soi-tax-stats-income-from-estates-and-trusts-statistics>.

Notes: Excludes 1041 returns reporting estate income taxes.

¹³ IRS, Statistics of Income, “Returns Filed, Taxes Collected and Refunds Issued, Tables 1 and 2,” <https://www.irs.gov/statistics/returns-filed-taxes-collected-and-refunds-issued>.

Grantor trusts reported on Form 1041 reflect about 0.2% of the population. There are no data to include trusts that do not file Form 1041, but the use of grantor trusts is limited because they are used to reduce taxable estates and about 0.2% of decedents file an estate tax return, although some trusts were created when the estate tax exemption was lower.¹⁴

Data on fiduciary income for 2022 (which includes a small amount from estates) indicate 3.2 million returns, income of \$542 billion, and distributions of \$89 billion. Taxable income for trusts was \$379 billion, and trust tax liability was \$157 billion. The most recent available data indicate about 90% of returns and other items was from trusts.¹⁵

Although fiduciary returns only report income and not assets, some idea of the amount of assets in trusts can be inferred from their income. If returns on assets average 10% per year, typical of the stock market, the underlying assets would be \$5.4 trillion. However, with a return typical of bonds, around 5% per year, the assets would be \$10.8 trillion. The Congressional Budget Office estimated that total wealth in the United States in 2022 was \$199 trillion. The top 1% of households, who are most likely to have these trusts, held 27% of total wealth, or \$54 trillion. These numbers suggest that irrevocable trusts (excluding grantor trusts) hold a significant share of high-income wealth, perhaps 10% to 20%.¹⁶

Data From Gift Tax Returns

Data on gift tax returns for tax filing year 2021 (covering gifts primarily for 2020, but with some for 2019) indicate gifts of \$182.6 billion were made by 251,000 donors. Of the total, 52.7% were made to trusts, amounting to \$96.3 billion, with \$86.3 billion in direct gifts. About 0.4% of returns were taxable. About 8% of direct gifts were taxable. Among the trusts, about \$22 billion were nontaxable gifts to GRATs, and about \$3 billion were taxable gifts to GRATs. Thus, about 12% of gifts to GRATs were taxable. It appears that about 6% of the remaining gifts to trusts were taxable. About 92% of gifts were of \$1 million or more.¹⁷

The significant gifts to exempt GRATs in 2020 may be due to the very low discount rates permitted at that time (0.5% in the latter part of 2020), which made zeroed out GRATs easier to create, since the annuity which offsets the gift would have a higher value.¹⁸

Gift tax returns for filing year 2019 (covering gifts primarily in 2017) did not report GRATs separately, although gifts to trusts appeared to be about \$20 billion, with total gifts of \$59.4 billion.¹⁹

¹⁴ CRS Report R48183, *The Estate and Gift Tax: An Overview*, by Jane G. Gravelle.

¹⁵ IRS, Statistics of Income, “Income From Estates and Trusts Statistics.” Data for 2022 from “Table 1. Fiduciary Income Tax Returns, Income Source, Deductions, and Tax Liability, by Tax Status and Size of Total Income.” The last data by type, for 2014 from “Table 2. Fiduciary Income Tax Returns, Income Source, Deductions, and Tax Liability, by Type of Entity.”

¹⁶ Congressional Budget Office, “Trends in the Distribution of Family Wealth, 1989 to 2022,” October 2024, <https://www.cbo.gov/publication/60807#:~:text=the%20Coronavirus%20Pandemic?-.From%202019%20to%202022%2C%20total%20family%20wealth%20increased%20by%2017,equity%20and%20non-retirement%20financial%20assets>.

¹⁷ IRS, Statistics of Income, “Gift Tax Statistics,” <https://www.irs.gov/statistics/soi-tax-stats-gift-tax-statistics>. Data were from “Gift Tax Statistics One Sheet, 2021,” and “Table 1: Total gifts of donor, Total gifts, Deductions, Credits, and Net gift tax, 2021.” Data on gifts by type of gift are approximated since they were provided only in chart form.

¹⁸ IRS, “Section 7520 Interest Rates For Prior Years,” <https://www.irs.gov/businesses/small-businesses-self-employed/section-7520-interest-rates-for-prior-years>.

¹⁹ IRS, Statistics of Income, “Gift Tax Statistics One Sheet, 2019,” <https://www.irs.gov/pub/irs-prior/p5368-2019.pdf>.

An IRS study for 2010-2016 gift years shows total gifts and gifts to trusts (see **Table 4**). The large increase in 2012 is likely due to an increase in advance of the scheduled expiration of higher estate and gift tax exemptions in 2013. The data also indicate a rapid increase from 2017 to 2020 (from around \$20 billion to \$96.3 billion).

Table 4. Gifts and Gifts to Trusts, 2010-2016

Year	Total Gifts (\$billions)	Gifts to Trusts (\$billions)	Percentage of Gifts to Trusts
2010	44.9	16.2	36.1%
2011	120.8	54.0	44.7%
2012	385.9	233.6	60.6%
2013	103.0	52.7	51.2%
2014	63.0	20.0	31.7%
2015	69.4	23.0	33.2%
2016	74.7	24.4	32.7%

Source: Jessica Holland, *2010-2016 Gifts*, IRS, Statistics of Income, <https://www.irs.gov/pub/irs-soi/soi-a-ingf-1906.pdf>.

There are no recent data on the number of gifts to GRATs, although the number and size have apparently grown significantly. According to data from 2009, there were 1,946 gifts to GRATs amounting to \$305 million (recall in tax filing year 2021 gifts to GRATs amounted to about \$25 billion).²⁰ Leaked tax data on wealthy individuals indicated that more than half of the 100 richest people in the United States used GRATs.²¹

Estimates of Wealth in Trusts and Dynasty Trusts

Data on total assets held in various trusts are limited because current total assets are not reported as income and gifts are. One study estimated that the total amount of wealth in irrevocable nongrantor trusts reported on fiduciary tax returns may be \$13 trillion or more. This study also suggests that 80% to 90% of wealth left to heirs will never be subject to the estate tax because of dynasty trusts, amounting to at least \$4.5 trillion and likely \$6.1 trillion or more that are not subject to the estate tax. These trusts are dynasty trusts that are perpetually exempt from the estate tax. About two-thirds are estimated to be held by families that would have paid estate taxes on at least \$4 trillion of assets.²² These trusts are estimated to constitute 3% to 5.5% of all U.S. wealth.

²⁰ Zachary Midar, “Accidental Tax Break Saves Wealthiest Americans \$100 Billion,” Bloomberg, December 17, 2013, <https://www.bloomberg.com/news/articles/2013-12-17/accidental-tax-break-saves-wealthiest-americans-100-billion>.

²¹ Jeff Ernsthausen, et al., “More Than Half of America’s 100 Richest People Exploit Special Trusts to Avoid Estate Taxes,” *ProPublica*, September 28, 2021, <https://www.propublica.org/article/more-than-half-of-americas-100-richest-people-exploit-special-trusts-to-avoid-estate-taxes#:~:text=More%20Than%20Half%20of%20America's,to%20Avoid%20Estate%20Taxes%20%E2%80%94%20ProPublica>. CRS has not independently verified the data reported by ProPublica.

²² Galle et al., “Taxing Dynasties.”

Data on Charitable Trusts

The IRS Databook for FY2024 reports 103,982 non-exempt and split-interest charitable trusts.²³ The most recent detailed data on split-interest charitable trusts, reported on Form 5227, are from 2012. In that year, there were an estimated 113,979 charitable trusts; almost all of them, 93%, were charitable remainder trusts.²⁴

Explanation of Techniques Used to Avoid Estate Taxes Using Irrevocable Grantor Trusts

There are a number of different ways to use grantor trusts to avoid estate taxes. The following sections explain these techniques.²⁵

Intentionally Defective Grantor Trust (IDGT)

The IDGT is a basic tool to avoid estate and gift taxes and can be used to create dynasty trusts that can indefinitely avoid both the estate tax and generation-skipping transfer taxes. The IDGT can be funded by a cash payment and a promissory note, which can be used to fund assets in the trust without any income tax consequences for the grantor. With low interest rates, as determined under federal rules, payments on the promissory note will be smaller than they would be at higher interest rates. If interest rates fall, the promissory note can be refinanced at the lower rate without income tax consequences. Although any remaining value of the promissory note will be included in the estate when the grantor dies, by funding assets that appreciate at higher rates, the amount in the trust will grow to be substantially larger than the value of the note. The payment of income taxes by the grantor will allow the amounts to grow free of taxation, and these tax payments are not considered gifts to the trust. Promissory notes can also be used to finance additional assets in the trust.

To illustrate how this technique works, consider a \$100 million sale of assets to a trust in return for a \$100 million promissory note for one year at an interest rate of 2%. Suppose the assets appreciate at 10%. When the promissory note is repaid, the trust will have \$110 million and pay a promissory note of \$102 million, leaving the trust with \$8 million in assets. The tax on the earnings on the asset less interest payments will be paid by the grantor, so the trust retains the full \$8 million of earnings with no gift tax. The longer the period of the promissory note, the greater the untaxed gift (e.g., \$17 million for a two-year note, \$27 million for a three-year note).

IDGTs can also be used to increase the basis of assets in a trust, which do not receive a step up in basis, while decreasing the basis of assets remaining in an estate. The grantor can exchange high-basis assets for low-basis assets in the trust without encountering income tax consequences.

The value of the IDGT can also be increased by contributing interests in family limited partnerships. These assets can receive significant discounts because of the lower valuation of

²³ IRS, Statistics of Income, “Tax-Exempt Organizations and Nonexempt Charitable Trusts, Table 14,” <https://www.irs.gov/statistics/soi-tax-stats-tax-exempt-organizations-and-nonexempt-charitable-trusts-irs-data-book-table-14>.

²⁴ Lisa S. Rosenmerkel, *Split-Interest Trusts, Filing Year 2012*, IRS, Statistics of Income, <https://www.irs.gov/pub/irs-soi/14eowinbulsplitinterest12.pdf>.

²⁵ See Americans for Tax Fairness, *Dynasty Trusts: Giant Tax Loopholes That Supercharge Wealth Accumulation*, February 2022, <https://americansfortaxfairness.org/wp-content/uploads/DT-2.2.pdf>.

minority interests and lack of marketability; one source indicated discounts in the range of 30% to 50%.²⁶

Grantor Retained Annuity Trusts (GRATs)

GRATs and related trusts, such as GRITs and GRUTs, can be used to reduce the value of gifts to a trust and to create the zeroed-out GRAT (sometimes called a Walton trust because it was used by the Walton family, owners of Walmart), where the present value of the annuity is used to fully offset the value of the assets contributed. With the low specified interest rate, the present value of the annuity is large, allowing larger contributions that are exempt from the tax. As with a basic irrevocable grantor trust, transactions between the grantor and the trust have no income tax consequences and the grantor pays income taxes on earnings in the trust without the taxes paid being considered gifts. If assets in the GRAT fail to appreciate to cover the annuity, the GRAT fails, but there are no tax consequences.

The annuity works in a similar way to a promissory note in an IDGT, except that in the \$100 million, one-year example, the annuity would pay \$102 million after a year (to achieve a present value of \$100 million) and the gift would be \$100 million, again leaving \$8 million in the trust at the end of the year.

There are some risks with GRATs. If the grantor dies during the term of the trust, the assets in the trust revert to the estate. For that reason, the grantor may set up successive short-term GRATs, called rolling GRATs, of two or three years. The annuity payments are used to invest in successive GRATs.

GRATs cannot generally be set up as dynasty trusts to avoid the generation-skipping transfer tax, because the GST exemption may only be applied after the payment of the annuity when assets have appreciated. However, a GRAT can sell its remaining value after the annuity to an IDGT with no income tax consequences. The beneficiaries can also set up their own GRATs or use other techniques to avoid gift taxes.

Spousal Lifetime Access Trusts (SLATs)

The SLAT is a noncharitable split-interest trust, with the grantor spouse setting up a trust that can be used for the beneficiary spouse with the remainder of the assets going to other beneficiaries. It is designed to use the donor spouse's exemption from the estate tax and from GSTs to eliminate high-yield assets from the donor's estate, while retaining access to the trust for the beneficiary spouse (and indirectly for the donor spouse). The grantor pays the income taxes, which are not treated as gifts. While unused estate tax exemptions can be inherited by the remaining spouse, the GST exemption cannot. Thus, the SLAT can be used to establish a dynasty trust.

Irrevocable Life Insurance Trusts (ILITs)

ILITs are used to hold permanent insurance on the life of the donor, owned by the trust. Although not likely to be used by the extremely wealthy, they can be a useful tool for wealthy donors, especially those who are younger and healthy. The earnings are not subject to current income

²⁶ Galle et al., "Taxing Dynasties." See also Jay A. Soled and Mitchell Gans, "Related Parties and the Need to Bridge the Gap Between Income Tax and Transfer Tax Systems," *Alabama Law Review*, vol. 64, no. 2 (2011), pp. 405-438, https://scholarlycommons.law.hofstra.edu/faculty_scholarship/84/.

taxes, death benefits for life insurance policies are exempt from income, and an ILIT removes assets from the estate. They can be dynasty trusts. They can be funded from premiums subject to the annual gift limitation without using the lifetime estate and gift tax exemption, as long as there are Crummey powers.

Charitable Lead Trusts (CLATs and CLUTs)

A charitable lead grantor trust makes payments to a charity with the remainder going to noncharitable beneficiaries. The trust can be a charitable lead annuity trust (CLAT), which pays a fixed annuity, or a charitable lead unitrust (CLUT), which pays a fixed percentage of the assets. The donor gets a charitable deduction for assets transferred to the trust in the amount of the present value of annuity payments. The annuity offsets the gift, reducing or eliminating the amount subject to estate and gift tax. Income taxes are paid by the grantor.²⁷ CLUTs can be structured as dynasty trusts to avoid the GST.

A charitable lead trust can also be structured as a nongrantor trust, where the trust pays the taxes and deducts payments to charities, with no upfront charitable deduction and no income taxes paid by the grantor. Data above indicate that charitable lead trusts are uncommon, with charitable trusts limited and almost all of them structured as charitable remainder trusts (where the beneficiary receives the annuity, the charity receives the remainder, and the charitable trust is tax exempt).

A technique known as the Shark Fin CLAT is used to increase the growth in the trust by making small charitable payments initially and then increasing them toward the end of the trust.

Dynasty Trusts

Dynasty trusts are not a specialized type of trust, but rather a trust that lasts a long time; some states allow them to last indefinitely.²⁸ They are designed to avoid or largely avoid estate taxes for multiple generations and are seeded by irrevocable trusts. One important feature of a dynasty trust is the allocation of a GST exemption to the trust. For purposes of the GST, a trust has a taxable termination when the last of the generation following the grantor dies, effectively creating a new trust based on asset values at that time and potentially subjecting the assets to the GST tax when they are distributed to the grandchildren of that generation. The GST exemption can offset the tax that still applies to assets at the time of transfer. For intermediate generations who receive distributions, the GST can apply but the body of assets remains untaxed.

Dynasty trusts can use the techniques described above to put assets in the trust without incurring a gift tax, such as selling them for a promissory note as in the IDGT, or retaining an annuity as in the GRAT. GRATs can be transformed into IDGTs once the annuity is paid in the short term by leaving the remainder to an IDGT. GRATs, however, may not be desirable for continuous use given the risk of death of the annuitant.

In addition to using techniques such as selling assets to an IDGT for a low-yield promissory note, donors can also use the often significant minority and marketability discounts to protect assets from transfer taxes.

²⁷ See Robert A. Westley and David M. Barral, Planning With Charitable Lead Trusts, *The Tax Advisor*, December 1, 2021, <https://www.thetaxadviser.com/issues/2021/dec/planning-charitable-lead-trusts/>.

²⁸ For a detailed explanation of dynasty trusts, see Galle et al., “Taxing Dynasties.”

Proposed Reforms

Congressional proposals to address tax issues with trusts have been included in the Build Back Better Act (BBBA; H.R. 5376, 117th Congress, as approved by the Ways and Means Committee²⁹; any references to the BBBA are to that version), as well as the For the 99.5 Percent Act (S. 1178 and H.R. 2676, 118th Congress) and the American Housing and Economic Mobility Act (S. 934 and H.R. 2038, 119th Congress). Also, in the 118th Congress, Senator Wyden, then-chairman of the Finance Committee, and Senator King proposed a series of restrictions on grantor trusts in S. 3988 (118th Congress), the Getting Rid of Abusive Trusts Act.³⁰ The Biden Administration's revenue proposals also included trust reforms.³¹ This section also discusses reform proposals made by Galle et al., Kades, Johnson and Waggoner, and Americans for Tax Fairness.³² In addition, the Ultra-Millionaire Tax (S. 4017/H.R. 7749, 118th Congress), which proposed a wealth tax, would have included trusts.

Irrevocable Grantor Trusts

Several proposals would make transactions between the grantor and the trust taxable under the income tax. For example, the sale or exchange of an appreciated asset would be subject to capital gains tax. They would also make the payment of income taxes by the grantor subject to the gift tax. Distributions would be subject to the gift tax, and the assets in the trust at the time of death would be included in the estate. Existing trusts would be grandfathered. These proposals would apply to all irrevocable grantor trusts (e.g., IDGTs, SLATs, ILIFs, and GRATs).

The Joint Committee on Taxation estimated a revenue gain for these provisions in the BBBA in the 10th year (FY2031) of \$2.2 billion.³³ Because of grandfathering, the estimates tend to be small in the budget horizon; for example, the revenue gain grew by 32% from FY2030 to FY2031.

Many of the other proposals would have included the changes in income tax treatment and treat the payment of income taxes on trust income gifts (including the For the 99.5% Act, the Wyden-King proposal, the Treasury FY2025 revenue proposals, and a proposal by Americans for Tax Fairness). The Treasury FY2025 proposals included this income tax change and several others that are not generally found in other proposals. They would have adjusted the GST exemption when the trust purchases assets in another trust. It would have treated loans from the trust to the

²⁹ Section 138209, <https://www.congress.gov/117/bills/hr5376/BILLS-117hr5376rh.pdf>.

³⁰ U.S. Senate, Committee on Finance, "Wyden, King Introduce Bill to Close Major Tax Loophole Involving High-Value Trusts," press release, March 20, 2024, <https://www.finance.senate.gov/chairmans-news/wyden-king-introduce-bill-to-close-major-tax-loophole-involving-high-value-trusts>.

³¹ For Treasury Proposals, see General Explanations of the Administration's Revenue Proposals, various years <https://home.treasury.gov/policy-issues/tax-policy/revenue-proposals>. Revenue estimates are from General Explanations of the Administration's Fiscal Year 2025 Revenue Proposals.

³² See Galle et al., "Taxing Dynasties"; Eric Kades, "A New Feudalism: Selfish Genes, Great Wealth and the Rise of the Dynastic Family Trust," February 7, 2022, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3779460; Lawrence W. Waggoner and Calvin H. Johnson, "Perpetual Trusts: The Walking Dead," and "Congress Should Effectively Curb GST Exemption for Perpetual Trusts," *Tax Notes*, September 3, 2012, p. 1215-1217, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2147989; and Americans for Tax Fairness, *Dynasty Trusts: Giant Tax Loopholes That Supercharge Wealth Accumulation*, February 2022, <https://americansfortaxfairness.org/wp-content/uploads/DT-2.2.pdf>.

³³ Joint Committee on Taxation, *Estimated Budgetary Effects Of An Amendment In The Nature Of A Substitute To The Revenue Provisions Of Subtitles F, G, H, I, And J Of The Budget Reconciliation Legislative Recommendations Relating To Infrastructure Financing And Community Development, Green Energy, Social Safety Net, Responsibly Funding Our Priorities, And Drug Pricing, Scheduled For Markup By The Committee On Ways And Means On September 14, 2021*, JCX-42-21, September 13, 2021, <https://www.jct.gov/publications/2021/jcx-42-21/>.

beneficiary as distributions subject to income taxes and the GST. Any repayments of loans by the grantor would have been treated as gifts for purposes of the GST. The American Housing and Economic Mobility Act would include grantor trusts in the estate and disallow any step-up in basis for a distribution not included in the estate.

The Americans for Tax Fairness proposal also would disallow use of the annual gift exemption for ILITs.

The Treasury FY2025 proposals, including the GRAT and CLAT proposals discussed below, were projected to raise \$13.6 billion in revenue in FY2034.

GRATs

Several proposals would impose minimum and in some cases maximum terms for GRATs and a minimum remainder value. Although successive short-term GRATs reduce the grantor's risk of losing control of capital, long-term GRATs also offer an advantage. If the interest rate is expected to rise, the trust can lock in a low discount rate for the entire term. This low interest rate would increase the value of the annuity deduction compared with successive short-term GRATs, which use the interest rate at the time the GRAT is established.

The For the 99.5% Act and the Treasury FY2025 proposals would have imposed a minimum term of 10 years and a maximum term of life expectancy plus 10 years, with a minimum remainder interest the greater of 25% of assets contributed or \$500,000. The Wyden-King proposal contained a similar plan but with a minimum term of 15 years. The Americans for Fair Taxation proposal suggests eliminating the deduction for the annuity altogether, but suggests the For the 99.5% Act plan as an alternative.

CLATs

The FY2025 Treasury proposal would have required CLAT payments to charities to equal at least 10% of the value of the property contributed and required level annuity payments to charities for the term of the trust. The latter proposal was aimed at Shark Fin CLATs.

Minority and Marketability Discounts

Most of the proposals would disallow discounts for cash and readily marketable securities. The BBBA would have disallowed discounts for nonbusiness assets. The For the 99.5 Percent Act, the American Housing and Economic Mobility Act, and the Biden Administration's FY2025 budget proposal also disallowed discounts for nonbusiness assets and discounts for lack of control or marketability if the transferor, the transferee, and members of their families have control of the entity or own the majority of the ownership interests. Americans for Fair Taxation has a similar proposal. The FY2025 budget would also have disallowed discounts for promissory notes with below-market interest rates if the forgone interest were not treated as income because it charged the government interest rate. The JCT estimated a revenue gain of \$2.7 billion in FY2031 and the Treasury estimated a gain of \$1.7 billion in FY2034, but these estimates affect transfers in the estate as well as trusts.

Dynasty Trusts

The For the 99.5% Act would have capped the duration of trusts that would otherwise be GST exempt at 50 years. The FY2025 Treasury proposal and the Americans for Tax Fairness proposal would eliminate the GST exemption for all but two generations with grandfathering for those

currently alive. Johnson and Waggoner would limit the GST exemption to 21 years after the death of a life in being, 90 years after creation, or the death of the last beneficiary in the next two generations. This provision would not be grandfathered, but trusts would be given a grace period to amend the terms.

Galle et al. propose an annual withholding tax on dynasty trusts of 2% of assets capped at the estate tax rate and creditable ratably if taxes are paid on distributions.

Kades proposes a federal rule against perpetuities.

Wealth Tax Applied to Trusts

While the Ultra-Millionaire Tax Act's proposed wealth tax was not targeted to trusts, it would have included them. It would have applied a 2% annual tax on net worth of trusts with assets between \$50 million and \$1 billion and an additional 1% tax (for a total of 3%) on trusts with assets over \$1 billion.

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