PROSKAUER ROSE LLP

Wealth Management Update

A monthly report for wealth management professionals.

November 2009

As part of our ongoing efforts to keep wealth management professionals informed of recent developments related to our practice area, we have summarized below some items we think would be of interest. Please let us know if you have any questions.

November Interest Rates for GRATs, QPRTs, Sales to Defective Grantor Trusts, Intra-Family Loans and Split Interest Charitable Trusts

The November applicable federal rate ("AFR") for use with CRTs, CLTs, QPRTs and GRATs is 3.2%. This rate is unchanged from October. The rate for use with a sale to a defective grantor trust, SCIN or intra-family loan, with a note of a 9-year duration (the mid-term rate, compounded annually), is 2.59%, down from last month. Remember that lower rates work best with GRATs and CLATs, sales to defective grantor trusts, private annuities, SCINs and intra-family loans. And, because of a special rule in the Internal Revenue Code, a taxpayer can elect to use the most favorable rate for a three-month period with respect to a CLAT. The combination of a still low AFR and a decline in the financial and real estate markets presents a potentially rewarding opportunity to fund GRATs with depressed assets you expect to perform better in the coming years.

Clients also should continue to consider "refinancing" existing intra-family loans. The November AFRs (based on annual compounding) used in connection with intra-family loans are .71% for loans less than 3 years, 2.59% for loans less than 9 years and 4.01% for long-term loans. Thus, for example, if a nine-year loan is made to a child and the child can invest the funds and obtain a return in excess of 2.59%, the child will be able to keep any returns over 2.59%. These same rates are used in connection with sales to defective grantor trusts.

IRS Friendly Family Limited Partnership Case – *Malkin v. Commissioner*, T.C. Memo 2009-212

Robert Malkin formed two family limited partnerships (the "FLPs") and transferred stock to each FLP and entity interests in limited liability companies to one of the FLPs. Mr. Malkin was the initial general partner and limited partner of each FLP and he subsequently sold limited partnership interests in each FLP to trusts for the benefit of his children. Negative factors evidenced in this case showed that Mr. Malkin continued to retain the enjoyment of the property transferred to the FLPs, warranting the inclusion of such assets in Mr. Malkin's gross estate. The Tax Court recognized that Section 2036 of the Internal Revenue Code of 1986, as amended, applied to include the FLPs assets in Mr. Malkin's gross estate for the following reasons: (1) there was an implied agreement whereby Mr. Malkin would retain the present economic benefit of the stock transferred to the FLPs as such stock was applied toward the discharge of Mr. Malkin's legal obligations; (2) no evidence was presented to show the pledge of the stock to secure Mr. Malkin's personal debts was a business decision made at arm's-length; (3) no explanation was presented to show that the decision to allow the pledge of the stock was in the best interests of the FLPs, so no business purpose existed; (4) because Mr. Malkin contributed all of the assets to the FLPs, the argument that the FLPs were formed to pool family wealth and centralize management fell short; and (5) the transfers of the stock did not fall within the Section 2036(a) exception for "bona fide" sales for "adequate and full consideration in money or money's worth" as there was no legitimate and significant nontax reason for creating the FLPs.

Delaware Court of Chancery Decision Has Implications for Trustee Accounting Actions – *Merrill Lynch Trust Company, FSB v. Mary F.C. Campbell, et al.*, C.A. 1803-VCN, V.C. Noble (Delaware Court of Chancery, September 2, 2009)

At age 74, Mary Campbell established a charitable remainder unitrust ("CRUT") for her benefit with Merrill Lynch Trust Company as Trustee. The CRUT was required to distribute 10% of the net value of the CRUT's assets each year to Mrs. Campbell during her lifetime, then to her husband, if living, and then to her children. Upon the last child's death, the balance of the CRUT would be distributed to charity. The projected term of the CRUT was 50 years. Based upon an increase in Mrs. Campbell's financial needs and a desire for additional distributions, the Trustee changed the investment strategy of the CRUT to greater growth and a higher percentage of equities. The change in investment philosophy caused a significant decrease in the value of the CRUT. Mrs. Campbell sought to replace the Trustee but refused to release it from liability. Merrill Lynch brought an action in the Delaware Court of Chancery seeking judicial approval of its conduct. Mrs. Campbell counterclaimed and alleged fraud, misrepresentation and breach of fiduciary duties. The court focused on the CRUT's unusual structure with a high percentage payout, and a long-term and recognized competing pressures surrounding the needs of the current and remainder beneficiaries. Although 58% of the value of the CRUT was lost, the Court determined that the Trustee had not breached its fiduciary duties with respect to the CRUT administration.

IRS Issues Proposed Rules Affecting Type III Supporting Organizations – IRS Proposed Regulations (REG-155929-06)

Extensive proposed regulations have been issued by the Treasury Department regarding the requirements to qualify as a Type III supporting organization that is operated in connection with one or more supported organizations. The proposed regulations are consistent with changes to the law made by the Pension Protection Action of 2006.

Take Care in Drafting Estate Tax Apportionment Clauses – *Boulis v. Blackburn*, 34 Fla. L. Weekly D1567b (Fla. 4th DCA August 5, 2009)

The Florida Fourth District Court of Appeal addressed the issue of whether the Federal estate taxes payable by the decedent's estate were to be apportioned solely to the residue of the estate or whether the surviving spouse's share would bear a portion of the estate taxes owed.

Upon the death of the decedent, his surviving spouse elected to take her elective share of the estate pursuant to the Florida Statutes. However, because the surviving spouse was not a citizen of the United States, the unlimited estate tax marital deduction was not available with respect to this share.

The surviving spouse argued that the section of the Florida Statutes governing the apportionment of estate taxes exempted her elective share of any liability for estate taxes. Alternatively, she argued that even if her share of the estate was taxable, the terms of the decedent's Will trumped the application of the Florida Statutes with respect to tax allocation.

Both arguments were rejected by the court. With respect to the first argument, the court determined that since she was not entitled to a marital deduction on the elective share, her elective share was subject to tax. With respect to the second argument, under Section 733.817(5) of the Florida Statutes, if all taxes (whether applicable to property passing under the governing instrument or not) are to be paid from the property passing under the instrument, the instrument must expressly refer to the Statute, or must expressly indicate that property passing under the instrument is to bear the burden of taxation for property not passing under the governing instrument. Because the tax clause under the decedent's Will did not satisfy either of these requirements under the Florida Statute, the surviving spouse was required to bear a portion of the estate taxes owed with respect to the decedent's estate.

IRS Issues Guidance on 2009 Required Minimum Distribution Waiver – Notice 2009-82

Under the 2008 Worker, Retiree, and Employer Recovery Act law, minimum distributions for 2009 for IRAs and defined contribution plans (such as 401(k)s) are waived. Notice 2009-82 provides that, with respect to individuals who have already received a 2009 required minimum distribution, they have until the later of November 30, 2009 or 60 days after the date the distribution was received to roll over the distribution into an IRA or other retirement plan, thus avoiding income tax that would be attributable to an IRA distribution. The Notice also provides guidance for retirement plan sponsors, and two sample plan amendments are provided. Both sample amendments provide that participants and beneficiaries can choose whether or not to receive 2009 required minimum distributions and allow the employer to offer rollover options of certain 2009 distributions.

2009 Connecticut Estate and Gift Tax Legislation

Legislation with respect to Connecticut estate and gift tax was passed on September 6, 2009. Under the legislation, for deaths occurring and gifts made on or after January 1, 2010, the tax threshold is raised from $2 million to $3.5 million with a reduction in marginal rates on estates and gifts valued in excess of $3.5 million. In addition, for deaths occurring after July 1, 2009, the due date for filing a Connecticut estate tax return (and the payment of any Connecticut estate tax that may be owed) has been decreased from nine months to six months from date of death.

Wealth Management Update Newsletter
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The Personal Planning Department at Proskauer Rose LLP is one of the largest private wealth management teams in the country and works with high net worth individuals and families to design customized estate and wealth transfer plans, and with individuals and institutions to assist in the administration of trusts and estates.

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