Proskauer

newsletter

September 2010
in this issue

A monthly report for wealth management professionals.

Edited by **Henry J. Leibowitz**
Contributor: **Ilise S. Alba**

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.

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

The September applicable federal rate ("AFR") for use with estate planning techniques such as CRTs, CLTs, QPRTs and GRATs is 2.4%. That is lower than the August rate of 2.6% which, until then, had been the lowest rate so far this year. The rate for use with a sale to a defective grantor trust, self-cancelling installment note ("SCIN") or intra-family loan with a note of a 9-year duration (the mid-term rate, compounded annually) is also down, to 1.94%. Remember that lower rates work best with GRATs, CLATs, sales to defective grantor trusts, private annuities, SCINs and intra-family loans. The combination of a low AFR and the bear market environment presents a potentially rewarding opportunity to fund GRATs in September with depressed assets that you expect to perform better in the coming years. However, legislation currently remains pending in Congress that would significantly curtail short-term and zeroed-out GRATs. Therefore, GRATs should be funded immediately in order to be grandfathered from the effective date of any new legislation that may be enacted.

Clients also should continue to consider "refinancing" existing intra-family loans. The AFRs (based on annual compounding) used in connection with intra-family loans are .46% for loans with a term of 3 years or less, 1.94% for loans with a term of 9 years or less and 3.66% for loans with a term of longer than 9 years.

Thus, for example, if a 9-year loan is made to a child and the child can invest the funds and obtain a return in excess of 1.94%, the child will be able to keep any returns over 1.94%. These same rates are used in connection with sales to defective grantor trusts.

Retroactive Amendments to New York Power of Attorney Law

After much outcry from the Bar, the New York legislature passed, and, on August 15, 2010 Governor Patterson signed, amendments to the New York Power of Attorney Law in which a new statutory form and framework were implemented effective September 1, 2009.

The motive for the 2009 change was the perceived abuse of powers of attorney by the appointed agents. However, the cure for that concern carried with it a new set of problems. Among other things, the 2009 law required that all powers of attorney executed in New York include a verbatim recitation of a cautionary statement and an agent notice related to the powers given to, and responsibilities of, appointed agents. The law also provided that any existing power of attorney automatically would be revoked by the execution of a new power of attorney.

What engendered opposition to the 2009 law was the extraordinarily broad range of instruments that fell under its rubric. In particular, the definition of a power of attorney subject to the 2009 law includes *any* written instrument signed in New York in which someone appoints an agent to act on his or her behalf. Thus, before the 2010 amendments, common commercial and business documents in which an individual grants an agent the power to act on his or her behalf, such as stock powers, voting proxies and limited liability company agreements, were not be valid if they are not in compliance with the 2009 law.

The 2010 amendments, which will become effective on September 13, 2010 and apply retroactively to powers of attorney executed on or after September 1, 2009, narrow the definition of a power of attorney by specifying that the law will not apply to:

- 1. a power of attorney given primarily for a business or commercial purpose, including without limitation:

  (a) a power to the extent it is coupled with an interest in the subject of the power;

  (b) a power given to or for the benefit of a creditor in connection with a loan or other credit transaction;

  (c) a power given to facilitate transfer or disposition of one or more specific stocks, bonds or other assets, whether real, personal, tangible or intangible;
- 2. a proxy or other delegation to exercise voting rights or management rights with respect to an entity;
- 3. a power created on a form prescribed by a government or governmental subdivision, agency or instrumentality for a governmental purpose;
- 4. a power authorizing a third party to prepare, execute, deliver, submit and/or file a document or instrument with a government or governmental subdivision, agency or instrumentality or other third party;
- 5. a power authorizing a financial institution or employee of a financial institution to take action relating to an account in which the financial institution holds cash, securities, commodities or other financial assets on behalf of the person giving the power;

- 6. a power given by an individual who is or is seeking to become a director, officer, shareholder, employee, partner, limited partner, member, unit owner or manager of a corporation, partnership, limited liability company, condominium or other legal or commercial entity in his or her capacity as such;
- 7. a power contained in a partnership agreement, limited liability company operating agreement, declaration of trust, declaration of condominium, condominium bylaws, condominium offering plan or other agreement or instrument governing the internal affairs of an entity authorizing a director, officer, shareholder, employee, partner, limited partner, member, unit owner, manager or other person to take lawful action relating to such entity;
- 8. a power given to a condominium managing agent to take action in connection with the use, management and operation of a condominium unit;
- 9. a power given to a licensed real estate broker to take action in connection with a listing of real property, mortgage loan, lease or management agreement;
- 10. a power authorizing acceptance of service of process on behalf of the principal; and
- 11. a power created pursuant to authorization provided by a federal or state statute, other than this title, that specifically contemplates creation of the power, including without limitation a power to make health care decisions or decisions involving the disposition of remains."

In addition, previously executed powers of attorney will no longer automatically be deemed to have been revoked by the execution of new ones. New powers of attorney must explicitly state that the principal intends to revoke pre-existing powers of attorney.

The 2009 law also introduced a new Statutory Major Gifts Rider that principals must sign if they want to grant their agents the power to make gifts in excess of $500 per year. The Bar has voiced many objections to that rider (now renamed the Statutory Gifts Rider) as well. The Law Review Commission is reviewing the related issues and will be issuing preliminary and final reports of its findings on September 1, 2010 and January 1, 2012, respectively.

Finally, under the 2009 law, there existed some uncertainty as to whether a power of attorney executed in another jurisdiction in compliance with that jurisdiction's law would be deemed valid. The 2010 amendments make it clear that it will be, as will a foreign power of attorney executed in New York in accordance with the foreign jurisidiction's law.

New York and Florida Joins Sixteen Other States in Enacting Formula Clause Fixes

State legislatures are catching the ball that the Federal legislature dropped in permitting the Federal estate and generation-skipping transfer ("GST") taxes to lapse in 2010. New York and Florida are now among eighteen states that have enacted legislation that addresses the interpretation of dispositive instruments that include formula clauses. In New York, for decedents who die in 2010, any bequest that is based on the amount that can pass free of Federal estate or GST taxes shall be read as though the Federal law in effect on December 31, 2009 still applied. In Florida, a fiduciary or any beneficiary can bring an action to have a Court construe the document in accordance with the Settlor's intent.

Florida Enacts New Florida Statutes Section 736.0902, Nonapplication of Prudent Investor Rule, that Limits Duties and Liabilities of Trustees with Respect to Life Insurance

Florida has enacted a new statute that virtually eliminates trustee liability with respect to (1) insurable interest issues related to the ownership of life insurance and (2) investing in life insurance policies.

Under the Nonapplication of Prudent Investor Rule, a trustee will have no duty to ensure that there exists an insurable interest in a life insurance policy if:

- 1. the trust owns insurance on the life a "qualified person" which is a new statutory concept defined as the "insured or a proposed insured, or the spouse of that person, who has provided the trustee with funds used to acquire or pay premiums with respect to a policy of insurance" on the life of any of those individuals;
- 2. the trust agreement does not opt out of the application of statute;
- 3. the insurance policy is not purchased from a trustee affiliate nor will the trustee or any trustee affiliate receive commissions related to the policy purchase unless trustee investment duties were delegated to another person;
- 4. the trustees did not know that the beneficiaries lacked an insurable interest when the policy was purchased; and
- 5. the trustee did not have knowledge of a STOLI (stranger-owned life insurance) arrangement.

Moreover, under the new statute, a trustee has no duty to determine whether the life insurance policy is a proper investment, to diversify with respect to any policy, to investigate the financial strength of the issuing company, to decide whether to exercise any policy options nor to examine the financial and physical health of the insured if the first three criteria above apply and either:

- 1. the trust agreement affirmatively opts in to the application of the statute or
- 2. the trustee gives notice to the trust beneficiaries of the trustee's intention to opt in to the statute, and no beneficiary objects within 30 days of receipt of that notice or any written objections are withdrawn.

The statute is effective July 1, 2010, as of which date Florida joins Delaware, West Virginia, North Dakota, Wyoming, South Carolina, Pennsylvania, and, to a limited extent Alabama in providing such trustee protections.

New Jersey Federal District Court Finds that the IRS Abused its Discretion in Disallowing Extension of Time to File Estate Tax Return

In *Estate of Proske v. United States*, Civil Action No. 09-CV-670 (DMC) (USDC D.N.J. May 25, 2010), the New Jersey District Court found that the IRS abused its discretion in disallowing the estate an extension of time to file its Federal estate tax return.

The executor of the estate failed to file an estate tax return and a request for an automatic six-month extension of time to file the return within nine months of the

decedent's date of death. The extension request was filed approximately one month after the estate tax return due date, together with payment in the amount of $1,800,000 for the estimated tax. The attachments to the Form 4768 extension request explained that the filing delay was due to the (1) the estate's lack of sufficient liquid assets to make payment, (2) a difficulty in calculating the marital deduction and, thus, the taxable estate, and (3) a delay in obtaining appraisals for certain estate assets. During the course of litigation, the executor of the estate further explained that she was concerned that she could not certify, under penalty of perjury, the information required to be reported in Form 4768.

The IRS denied the extension request simply because the "application was filed after the due date for the return." When the estate did file the return, the IRS assessed a $305,130 late filing penalty with interest which the estate paid but then sought to have refunded to it. The case came before the District Court upon cross-motions for summary judgment which the Court ultimately granted to the estate. In so doing, the Court noted that, pursuant to Treasury Regulation Section 20.6091-1(c), the IRS has the discretion to grant an extension of time to file a return even if an automatic extension request is not timely filed if, *inter alia*, it was impossible or impracticable to file a reasonably complete return when due.

The Executor argued that the estate had shown good cause for the delay which the IRS, in an abuse of its discretion, failed to consider. The Court agreed, noting that there was no record of whether or how the IRS had considered the estate's explanation for the filing delay. As a result, the Court stated that the estate tax return is to be treated as having been timely filed and the refund request is to be granted.

New York Court of Appeals Finds that Legal Fees Incurred by Fiduciaries in the Defense of Actions Related to an Estate or Trust are to be Equitably Allocated Among Beneficiaries

In *Matter of Hyde*, 2010 NY Slip Op 05676 (June 29, 2010), the New York Court of Appeals held that New York Surrogate's Court Procedure Act ("SCPA") Section 2110 "grants the trial court discretion to allocate responsibility for payment of a fiduciary's attorney's fees for which the estate is obligated to pay either from the estate as a whole or from shares of individual estate beneficiaries." The Court's holding overruled its 1971 statutory construction in *Matter of Dillon* (28 NY2d 597) (1971) which led to a customary charge of such fees against the entire estate.

The *Hyde* case was brought before the court as a result of objections filed by certain, but not all, of the beneficiaries to trust accountings. The Surrogate's Court dismissed all objections and determined that *Dillon* required that the non-objecting beneficiaries, who had not even stood to gain from the success of the accounting objections, were responsible for over $700,000 in legal fees. Those beneficiaries filed an appeal of the decision which was affirmed by the Appellate Division.

SCPA Section 2210 (2) provides that attorney's fees incurred by a fiduciary in the execution of his or her fiduciary duties can, by court direction, "be paid from the estate generally or from the funds in the hands of the fiduciary belonging to any legatee, divisee, distributee or person interested." The Court of Appeals stated that the *Dillon* decision, in which SCPA 2110 was interpreted as requiring that the entire estate be charged with

legal fees “seems to have ignored the plain meaning of the statute . . . . [and] did not focus on considerations of fairness . . . .”

The Court then found that the trial court should engage in a multi-factored assessment of the facts that includes considerations of “1) whether the objecting beneficiary acted solely in his or her own interest or in the common interest of the estate; 2) the possible benefits to individual beneficiaries from the outcome of the underlying proceeding; 3) the extent of an individual beneficiary’s participation in the proceeding; 4) the good or bad faith of the objecting beneficiary; 5) whether there was a justifiable doubt regarding the fiduciary’s conduct; 6) the portions of interest in the estate held by the non-objecting beneficiaries relative to the objecting beneficiaries; and 7) the future interests that could be affected by reallocation of fees to individual beneficiaries instead of to the corpus of the estate generally . . .”

The Court remitted the case to the trial court for that purpose.

The Personal Planning Department at Proskauer 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.

If you have any questions regarding the matters discussed in this newsletter, please contact any of the lawyers listed below:

BOCA RATON

Elaine M. Bucher
561.995.4768 — ebucher@proskauer.com

Albert W. Gortz
561.995.4700 — agortz@proskauer.com

George D. Karibjanian
561.995.4780 — gkaribjanian@proskauer.com

David Pratt
561.995.4777 — dpratt@proskauer.com

LOS ANGELES

Mitchell M. Gaswirth
310.284.5693 — mgaswirth@proskauer.com

Andrew M. Katzenstein
310.284.4553 — akatzenstein@proskauer.com

NEW YORK

Henry J. Leibowitz
212.969.3602 — hleibowitz@proskauer.com

Lawrence J. Rothenberg
212.969.3615 — lrothenberg@proskauer.com

Lisa M. Stern
212.969.3968 — lstern@proskauer.com

Philip M. Susswein
212.969.3625 — psusswein@proskauer.com

Ivan Taback
212.969.3662 — itaback@proskauer.com

Jay D. Waxenberg
212.969.3606 — jwaxenberg@proskauer.com

Boca Raton | Boston | Chicago | Hong Kong | London | Los Angeles | New Orleans | New York | Newark | Paris | São Paulo | Washington, D.C.

www.proskauer.com