Proskauer

newsletter

September 2011
in this issue

A monthly report for wealth management professionals.

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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.

IRS issues Notice 2011-76 Modifying Filing Due Date for Form 8939 and Automatic Extension Rule for Form 706 for Decedents Dying in 2010

On September 13, 2011 the IRS issued Notice 2011-76 which modified certain dates for IRS forms for decedents who died in 2010. First, the new due date for filing Form 8939 (to opt out of the Federal estate tax and allocate basis to assets for decedents dying in 2010) has been extended from November 15, 2011 to January 17, 2012. Second, the due date for filing Form 706 for 2010 decedents dying before December 17th remains September 19, 2011, but if a timely filed extension request is made on or before September 19, 2011, then an automatic extension of the time to both file the return and pay the tax is granted until March 19, 2012. If the 2010 decedent died on or after December 17, the timely filed extension will be granted until 15 months after the date of death.

September Interest Rates 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 2.0%. This is down from the August rate of 2.2%. 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 9-year duration (the mid-term rate, compounded annually) also is down slightly, to 1.63%. 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 a decline in the financial and real estate markets presents a potentially rewarding opportunity to fund GRATs in September with depressed assets you expect to perform better in the coming years. However, the Obama administration, in its 2012 fiscal budget, has proposed to curtail significantly short-term and zeroed-out GRATs. Therefore, GRATs should be funded as soon as possible in order to be grandfathered from the effective date of any law 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 0.26% for loans with a term of 3 years or less, 1.63% for loans with a term of 9 years or less, and 3.57% for loans with a term longer than 9 years.

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 1.63%, the child will be able to keep any returns over that amount. These same rates are used in connection with sales to defective grantor trusts.

New York Tax Appeals Tribunal Reverses Itself in Holding That Property Rights to a New York Residence, Not Regular Use as a Dwelling, Is Determinative in New York Income Tax Residency – *In the Matter of the Petition of John Gaied*, Decision DTA No. 821727, Tax Appeals Tribunal, New York

In *Gaied*, the taxpayer lived in New Jersey and commuted daily to his business in Staten Island, New York. He also owned an apartment in Staten Island that was occupied by his elderly parents. He occasionally slept overnight on his parents' couch when his parents requested assistance. The issue was whether the taxpayer was a resident of New York for income tax purposes.

The Administrative Law Judge initially sustained the taxpayer's Notice of Deficiency on the basis that the taxpayer maintained a permanent place of abode for his parents and occasionally stayed overnight during the years in question. In the Tax Appeals Tribunal's first review of the taxpayer's case, it initially reversed the ALJ's decision and found that the taxpayer's restricted access to the apartment, the fact that he did not have a bed at the premises, and the fact that he only stayed there when requested by his parents did not constitute a permanent place of abode. However, the Tribunal decided that its initial decision was improper and requested reargument. The Division of Taxation argued that the taxpayer's subjective use of the premises should not be determinative for purposes of establishing a permanent place of abode where the taxpayer has a legal relationship to the property and continually maintains the premises, and the property meets the physical attributes of an abode. Upon rehearing the case, the Tribunal reversed its original decision and agreed with the Division of Taxation that the taxpayer's property rights to the subject premises were sufficient to determine that he was a resident subject to tax in New York.

This decision substantially departs from the existing test for residence as outlined in *Matter of Evans* (Tax Appeals Tribunal, June 18, 1992, *confirmed* 199 AD2d 840, 1993). Under *Evans*, the test involved fact-intensive analysis of a taxpayer's use and relationship to the particular dwelling in order to determine whether it was a permanent place of abode. Under the new test set forth in *Gaied*, if a taxpayer has any property rights to a dwelling in New York and is present for the requisite number of days, the taxpayer may be subjected to income taxation on that basis regardless of subjective intent or use.

Hirchert Family Trust v. Johnee Ann Alle Hirchert (District Court of Appeal of Florida, Fifth District, June 17, 2011)

The District Court of Appeal of Florida upheld an exception to the Florida homestead exemption in a case where a trustee/deceased husband of the defendant breached his fiduciary duty as trustee in California, and the defendant later used the proceeds resulting from this breach to purchase real property in Florida. Ordinarily the Florida homestead exemption law prevents the creditor of a Florida homeowner from taking the homeowner's residence in satisfaction of a monetary claim. In *Hirchert*, the defendant's deceased husband had been the beneficiary of a trust of which he was the trustee and was permitted to withdraw principal for his own benefit only if his personal assets had been fully dissipated. After his marriage to the defendant, he withdrew a 75% interest in a California residence from the trust despite having other assets, sold the residence, and purchased a new California residence with the defendant. After the trustee's death, the defendant sold this residence and purchased a residence in Florida.

When the successor trustee of the trust learned that the defendant's husband had breached his fiduciary duty by withdrawing the 75% interest in the residence from the trust, he sued the defendant in California to recoup the proceeds received upon the sale of the residence. The successor trustee received a California judgment in his favor and sought to force the defendant to convey her Florida residence to a receiver to force a sale of the residence in satisfaction of his California judgment. The Florida court found that, while the Florida homestead exemption ordinarily protects a homeowner's equity from creditor claims, the exemption would not apply in this case because the trustee's original breach of his fiduciary duty was a "constructive fraud" that allowed for the application of an exception to the homestead protection. The Florida court then remanded the case to the trial court with instructions to enforce the injunction to convey title to the receiver and force the sale of the property. Although rare, this case illustrates one of the few exceptions in which an individual can lose the protection of the Florida homestead exemption despite no actual wrongdoing on their part.

Tax Court Holds That Trustee/Beneficiary's Power to Invade Trust Principal for Her "Welfare" Is Limited by an Ascertainable Standard and Trust Principal Not Includible in Her Estate under IRC §2041(b)(1)(A) – *Estate of Ann R. Chancellor, et al. v. Commissioner* (TC Memo 2001-172 July 14, 2011)

Frequently, trust agreements ensure that the principal invasion power held by a trustee who is also a beneficiary is limited to distributions for the beneficiary's "health, education, maintenance and support." This limitation ensures that the trust's assets are not included in the beneficiary's estate for estate tax purposes upon the beneficiary's death. Many cases have found that principal invasion powers for a beneficiary's "happiness" or "comfort" fall outside the standard and will cause estate tax inclusion if the beneficiary holds this power as the trustee.

After a review of Mississippi law, the Tax Court in *Chancellor* held that the trustee/beneficiary who held the right to make distributions for "necessary maintenance, education, health care, sustenance, welfare or other appropriate expenditures needed by [the decedent]" did not hold a general power of appointment over the trust's assets upon her death. The Tax Court concluded that a Mississippi court would construe the power narrowly and only authorize principal invasion for expenditures that were within the ascertainable standard requirement of IRC §2041(b)(1)(A).

New York expands EPTL §10-6.6 to Further Liberalize Trust "Decanting"

On August, 17, 2011, New York Governor Andrew Cuomo signed into law Bill A8297 which expands the State's decanting statute (Estates, Powers and Trust Law §10-6.6). Under the prior version of the statute, the assets of an irrevocable trust could be appointed (or "decanted") into a new irrevocable trust with different terms. The ability to appoint the assets of an old trust into a new trust is a useful tool that has long provided flexibility in trust administration by allowing trustees to deal with changed circumstances despite the irrevocability of the trust instrument. The new law applies to any trust governed by New York law and any trust that has a New York trustee (so long as a majority of the trustees select New York as the location for the primary administration of the trust).

Some of the most significant provisions of the new law are as follows:

1. The trustee can now decant the principal of an existing trust to a new trust even though the trustee lacks absolute discretion to invade trust principal. As long as the trustee has the power to invade principal for any purpose, the trustee is authorized to decant to a new trust. Depending on the trustee's level of discretion regarding principal distributions in the existing trust agreement, the current and remainder beneficiaries of the new trust may or may not need to be the same as those of the old trust.
2. If a trustee has unlimited discretion to invade principal under the old trust, the trustee may decant to a new trust that grants a power of appointment to the beneficiary as long as the beneficiary who is granted the power was eligible to receive property outright under the old trust. The provision of a broad power of appointment to the beneficiary can thus be used to expand the class of beneficiaries provided for under the old trust and may allow for the postponement of the generation-skipping transfer tax.
3. The new appointed trust can have a term that is longer than the term of old trust, including a term measured by the lifetime of a current beneficiary.
4. A trustee must exercise a fiduciary duty when deciding whether to decant. The use of the decanting power must be in the best interests of one or more proper objects of the exercise of the power and as a prudent person would exercise the power under the prevailing circumstances. If there is substantial evidence of the creator's contrary intent, and it cannot be established that the creator would be likely to have changed his intent under the circumstances existing at the time of the exercise of the power, then the trustee should not decant.
5. The trustee is required to exercise the power in a writing, signed and acknowledged, and provided to all persons interested in the old trust. Notice also must be provided to the creator (if living) and to any individual with power to remove the trustee of the old trust. For inter-vivos trusts, the new law eliminates the existing requirement that the trustee file the instrument exercising the power with the court (as long as the trust has not been the subject of a previous court proceeding).

Former Trustee of Private Foundation Found Not To Be a "Disqualified Person" for the Purpose of Subsequent Sale to Foundation - Private Letter Ruling 201130008 (July 29, 2011)

In PLR 200130008, a former trustee of a private foundation, who was also the spouse of another former trustee of the private foundation, was determined not to be a disqualified person under IRC §4941(a) upon her and spouse's resignations as trustees. The trustees were original trustees of the foundation, and both resigned as such in 2008.

The foundation proposed to exchange a parcel of real property it owned with another parcel owned by one of the former trustees. The exchange would increase the value of other adjacent land owned by the former trustee. The IRS noted that there were no discussions of the proposed property exchange while the former trustee and her husband were acting as trustees.

The IRS found that neither the former trustee nor her spouse were disqualified persons for any other reason after their resignations in 2008 because former trustees cannot be presumed able to exert any influence over a foundation after they resign (including influence over the decision, in this instance, to exchange the parcels of real property). In addition, even though the former trustee may become a "substantial contributor" (and therefore a disqualified person) to the foundation after the property exchange, the term "self-dealing" does not include a transaction between a foundation and a disqualified person where the disqualified person status arises only as a result of the transaction. Therefore, the proposed sale of the trustee's house to the foundation was not subject to the self-dealing rules under Section 4941.

Differing Results Regarding IRA Rollover Extensions – Private Letter Ruling 201130013 (July 29, 2011) and Private Letter Ruling 201130014 (July 29, 2011)

Two Private Letter Rulings ("PLR's") regarding requests for extension of the 60-day IRA rollover period arrive at different results based on emotional and financial difficulties faced by the taxpayers. In PLR 201130013, a taxpayer withdrew an amount from his IRA and deposited it into an account he believed to be a new IRA account. He subsequently got divorced and experienced severe depression and emotional distress. Almost one year later, after he realized he had not properly rolled over his IRA account into a new IRA, he requested a waiver of the rule requiring that rollovers be completed within 60 days of the initial withdrawal. The IRS granted this waiver under IRC §408(d)(3)(I), permitting waiver where the failure to waive the requirement would be against equity or good conscience, including events beyond the reasonable control of the individual requesting the waiver, on account of the emotional difficulties faced by the taxpayer.

In contrast, in PLR 201130014, the taxpayer withdrew an amount from his IRA after losing his job. Although he intended to roll over the account to a new IRA pending a new job or sale of his home, within a month of the withdrawal he suffered a fire in his house, further exasperating his financial situation. He then used some of the proceeds from the IRA account during the pending insurance settlement and deposited the full amount into a new IRA six months after the initial withdrawal. Here the IRS denied the taxpayer's request for a waiver because it perceived the IRA withdrawal as effectively a short-term loan to cover personal living expenses. The IRS stated that use of IRA proceeds as a loan is not consistent with the IRA rollover requirements and did not, therefore, justify the waiver in this case.

New York Clarifies Same-Sex Marriage Effect on Tax Filings

The New York State Department of Taxation and Finance issued its initial guidance on the new same-sex marriage laws to clarify the law's impact on state income, estate, withholding and sales taxes. Same-sex couples must file New York state income tax returns as though they are married, even though their marital status is not recognized for Federal income tax purposes. For couples married as of December 31, 2011, they will be considered married for the entire year. Same-sex couples also can make the same elections and deductions on their estate tax returns as allowed for opposite-sex couples (which will involve the completion of two separate Federal estate tax returns, one of which is to be used for New York State estate tax purposes). The guidance published by New York also provides for certain withholding and sales tax rules in conformity with the rules applicable to opposite-sex couples.

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.

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