Proskauer

newsletter

Wealth Management Update

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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.

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

The May applicable federal rate ("AFR") for use with estate planning techniques such as CRTs, CLTs, QPRTs and GRATs remains the same, at 3.0%. 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 down slightly, to 2.44%. 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 May with depressed assets you expect to perform better in the coming years. However, the Obama Administration, in its 2012 fiscal budget, has proposed to significantly curtail 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 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 0.56% for loans with a term of 3 years or less, 2.44% for loans with a term of 9 years or less and 4.19% for loans with a term of 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 2.44%, the child will be able to keep any returns over 2.44. These same rates are used in connection with sales to defective grantor trusts.

IRS postpones due date for Form 8939; further guidance announcing new filing date to be issued soon – IR-2011-33 (March 31, 2011)

On March 31st, the IRS announced that Form 8939, Allocation of Increase in Basis for Property Acquired from a Decedent, was not due on April 18th and that it should not be filed with the decedent's final Form 1040. Treasury and the IRS plan to issue further guidance regarding the new deadline, and they will allow reasonable time for preparation and filing of the form after the guidance is issued. The guidance will also explain the manner in which an executor may elect out of the estate tax. Form 8939 will be made available shortly after the guidance is issued.

Neither the attorney-client privilege nor the work-product doctrine protects the entire work file of an appraiser who was hired by an attorney – *U.S. v. Richey,* 632 F.3d 559 (9th Cir. January 21, 2011)

In *Richey*, the Ninth Circuit held that neither the attorney-client privilege nor the work product doctrine protected all of an appraiser's work file, even though the appraiser was hired by the taxpayer's attorney, rather than the taxpayer himself. A taxpayer owned partnership interests in a limited partnership which was the 50% owner of certain real estate. The partnership granted a conservation easement on the property to a charity. The law firm which advised the taxpayer with respect to the conservation easement retained a certified appraiser to value the easement. The appraiser's report was filed with the taxpayer's income tax return. The report specifically stated that the report did not include a full discussion of the data and analysis that were used in the appraisal process, and that supporting documentation was retained in the appraiser's work file. In connection with an audit of the taxpayer's return, the IRS sent a summons to the appraiser instructing him to appear before an IRS agent and to provide testimony, documents and information regarding the appraisal. The law firm directed the appraiser not to comply with the summons, and the IRS filed a petition to enforce the summons. The District Court issued an order quashing the summons, and the IRS appealed.

The Ninth Circuit reversed, holding that the appraiser's entire work file was not necessarily protected. It concluded that any communication relating to the preparation and drafting of the appraisal was not made for the purpose of providing legal advice, but, rather for the purpose of determining the value of the easement. In addition, to the extent the files contained documents that were not communications, the files would not be protected by the attorney-client privilege. Moreover, the Ninth Circuit concluded that the work-product doctrine did not protect the appraiser's work file, because the file was not prepared in anticipation of litigation. Accordingly, the Ninth Circuit remanded the case to the District Court to determine which data and materials, if any, were protected by the attorney-client privilege.

Estate not entitled fractional interest discounts on value of ranch – *Estate of Adler v. Comm'r*, T.C. Memo 2011-28 (January 31, 2011)

In *Adler*, a decedent's estate was not entitled to fractional interest discounts on the value of a ranch that the decedent had gifted to his five children years before his death. In 1965, a father executed a deed transferring an undivided one-fifth interest in his ranch to each of his five children. According to the terms of the deed, the father retained the right to possess, enjoy and receive income from the ranch during his life. The father also paid all expenses of the ranch and did not pay any rent. Upon the father's death, his executors included the ranch in his gross estate, but applied fractional interest discounts to its value. The Tax Court disallowed the discount, finding that because the decedent retained a life estate, it was as though his ownership interest in the ranch was split upon his death. Therefore, fractional interest discounts were inappropriate because they would have allowed the estate to discount the ranch based on the number of beneficiaries of the property.

Ninth Circuit reverses District Court on deductibility of palimony claim – *Estate of Shapiro v. Comm'r*, 107 AFTR 2d 2011-942 (9th Cir. February 22, 2011)

In *Shapiro*, the Ninth Circuit determined that an estate was entitled to a deduction for a palimony suit filed against the decedent. The decedent and the claimant lived together for 22 years. During that time, they resided together in the decedent's home. The decedent paid for all of the claimant's living expenses and gave her a weekly allowance. The claimant cooked, cleaned and managed the household. After the claimant discovered that the decedent was involved with another woman, she filed suit, asserting breach of contract. The decedent died while the suit was pending. The estate won the case against the claimant. She appealed, and the estate ultimately settled for $1 million. Sometime after the settlement, the estate filed for an estate tax refund, claiming that it was entitled to a deduction of $8 million for the value of the claim. The IRS disallowed any deduction for the claim.

The estate brought suit in the U.S. District Court of Nevada seeking a refund of approximately $2 million, based on their expert's valuation of the claim at just over $5 million as of the date of the decedent's death. The District Court held that the claimant's homemaking services did not provide sufficient consideration to support a cohabitation contract between them, and that therefore, an estate tax deduction for the value of the claim was properly disallowed. The District Court also determined that the estate was estopped from claiming a deduction greater than the amount it paid in the settlement.

The Ninth Circuit reversed. It agreed that a claim founded on a contact or agreement is only deductible to the extent it is contracted for adequate and full consideration. However, the Ninth Circuit disagreed with the District Court's finding that the claimant's services had a zero value as a matter of law. Instead, it found that the claimant's homemaking services could be quantified, and it remanded the case to the District Court to determine the appropriate amount. In addition, the Ninth Circuit found that the estate was not estopped from claiming a deduction in excess of the settlement amount. The court stated that the estate was within its rights to deduct the value of a yet-to-be determined claim without waiving the right to contest the validity of the claim in state court.

Estate entitled to deduct amount paid to charitable trust in settlement of dispute over decedent's Will – *Estate of Palumbo v. U.S.*, 107 AFTR 2d 2011-1274 (W.D. Pa. March 9, 2011)

In *Palumbo*, an estate was entitled to deduct over $11 million paid to a charitable trust in settlement of a dispute over the decedent's Will, which failed to include a residuary clause. During the decedent's lifetime, the decedent executed a number of testamentary documents, under which the residue of his estate was to pass to the decedent's previously created charitable trust. However, in the decedent's final Will, the decedent's attorney forgot to include the residuary clause, which the attorney admitted in a malpractice suit against him. The decedent's son claimed that he was entitled to the residuary estate through state intestacy laws. The son and the charitable trust eventually settled. According to the terms of the settlement agreement, the charitable trust received approximately two-thirds of the estate.

The estate claimed a charitable deduction for the trust's share of the settlement, but the IRS disallowed it, arguing that a deduction was not warranted because the charitable trust had no legally enforceable right to the residuary estate. The court disagreed, focusing on the fact that the decedent repeatedly manifested his intent to leave his residuary estate to the trust, and his attorney admitted to committing the scrivener's error. The court also noted that the settlement was the result of a good faith adversarial dispute between the charitable trust and the decedent's son. In other words, there was no evidence of collusion between the parties. Therefore, the court held that the amount passing to the charitable trust was deductible.

Continued use of residence after termination of QPRT did not result in estate taxation – *Estate of Riese v. Comm'r*, T.C. Memo 2011-60 (March 15, 2011)

In *Riese*, a decedent's continued use of a residence after the termination of her qualified personal residence trust ("QPRT") did not result in the residence being included in her estate, even though she did not pay rent. In April 2000, the decedent created a 3-year QPRT. Under the terms of QPRT, if the decedent survived the 3-year term, the residence was to pass to separate trusts for her daughters. When the QPRT terminated in April of 2003, no deed was executed to transfer the residence to the continuing trusts. One of the daughters contacted the attorney who drafted the QPRT to inquire about calculating the fair market rent on the residence. The attorney explained that before the end of the year, the rent could be established by contacting a local real estate broker. However, in the interim, the decedent died. The fair market rent had not yet been established, and a lease agreement had not been executed.

The court noted that although nothing actually changed after the QPRT expired, there was intent to enter into a lease. The court cited several instances where it was explained to the decedent that, after the termination of the QPRT, it would be necessary for her to pay rent in order to remain in the residence. Taking into account that the decedent was informed about the requirement, and that the daughter requested information concerning the rent calculation, the court determined that there was an agreement among the parties that a lease would be established before the end of 2003. The court found this to be reasonable under the circumstances. In addition, the court found that the estate was entitled to a deduction for the decedent's accrued but unpaid rent at the time of her death.

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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