PROSKAUER ROSE LLP

# Wealth Management Update

A monthly report for wealth management professionals.

May 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.

### May Interest Rates Fall 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 is 2.4%. 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 2.05%. These are decreases from April's rates. 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 markets presents a potentially rewarding opportunity to fund GRATs in May with depressed assets you expect to perform better in the coming years.

Clients should also continue to consider "refinancing" existing intra-family loans. The AFRs (based on annual compounding) used in connection with intra-family loans are .76% for loans less than 3 years, 2.05% for loans less than 9 years and 3.58% for long-term loans. Thus, if a $1 million loan is made to a child and the child can invest the funds and obtain a 5% return, the child will be able to keep any returns over the mid-term AFR of 2.05%. These same rates are used in connection with sales to defective grantor trusts.

### IRS Wins Another Family Limited Partnership ("FLP") Case

In *Estate of Jorgensen v. Comm'r*, T.C. Memo 2009-66 (Mar. 26, 2009), the IRS continued its success in attacking FLPs under I.R.C. § 2036(a). In another egregious case, decedent transferred cash and marketable securities to two separate FLPs formed at different times. Agreeing with the IRS, the Tax Court held that the assets decedent transferred to the FLPs (as opposed to the FLP interests) were includable in her gross estate for Federal estate tax purposes. In so holding, the Tax Court determined that the bona fide sale exception under I.R.C. 2036(a) did not apply since (i) decedent's estate failed to establish a legitimate and significant non-tax reason for forming the FLPs (the FLPs held primarily an untraded portfolio of marketable securities), (ii) there was a disregard of partnership formalities (neither FLP properly maintained books and records, the FLPs were not treated as separate entities and decedent used FLP assets to pay personal expenses) and (iii) the transfers to the FLPs were not at arm's length (the decedent stood on both sides of the transaction at formation). Having found that there was no bona fide sale exception, the Tax Court then concluded that decedent retained an interest in the FLP assets since she used the assets to make cash gifts to family members and to pay personal expenses. As a result, the Tax Court found that the FLP property was includable in decedent's gross estate for Federal estate tax purposes under I.R.C. § 2036(a).

### Five-percent Discount for Interest in Art collection Found Proper

In *Stone v. United States*, 2009-1 USTC ¶60,572 (9th Cir. Mar. 24, 2009), the Ninth Circuit upheld a district court's finding that decedent's estate was entitled to claim only a 5% fractional interest discount when valuing decedent's undivided one-half interest in a nineteen-painting collection. Initially, decedent's estate had claimed a 44% fractional interest discount. The district court rejected the larger discount, finding that a hypothetical seller would not sell a fractional interest in a collection at a discount. Instead, it reasoned that that the joint owners of the collection would sell the entire collection and split the sale proceeds. The district court's determination of a 5% discount recognized that some reduction in value should be available to allow for expenses attributable to a potential partition of the collection and for the uncertainties involved in waiting to sell the collection. The Ninth Circuit agreed and concluded that decedent's estate did not meet its burden of proving the value of the collection and that its evidence was unconvincing and insufficient to reverse the lower court's decision.

### IRS Announces New Voluntary Disclosure Program for Unreported Foreign Accounts

On March 23, 2009, the IRS announced the creation of a new settlement initiative for undeclared foreign accounts. This initiative is available only for six months (until September 23, 2009) and provides that eligible taxpayers will not be subject to criminal prosecution or a civil fraud penalty if they make voluntary disclosure. The IRS issued three memoranda in connection with the initiative explaining who is eligible, what penalties will be imposed and how cases should be handled. In general, a taxpayer is eligible for the initiative if the taxpayer makes voluntary disclosure of the unreported foreign account before (i) the IRS begins a civil examination or criminal investigation of the taxpayer, or has notified the taxpayer that it intends to initiate such an examination or investigation; (ii) the IRS receives information from a third party (for example, an informant) alerting the IRS about the unreported account; (iii) the IRS commences a civil examination or criminal investigation that is directly related to the taxpayer's liability; or (iv) the IRS obtains information directly related to the specific liability of the taxpayer from a criminal enforcement action. Taxpayers should be aware that if they make the appropriate disclosure under the initiative but do not qualify, criminal prosecution may result. As to penalties, taxpayers will not only be required to pay all tax and interest due for a six-year period (unless the foreign account was opened within six years), but also a 20% accuracy related penalty under I.R.C. § 6662 for income previously omitted from a tax return, or a 25% delinquency penalty under I.R.C. § 6651 for failure to file timely for each of the six years in which the omission occurred. In addition, a one-time 20% penalty for the year with the highest foreign account balance (which is reduced to 5% in certain circumstances) will be imposed. Taxpayers should give serious consideration to making a voluntary disclosure under the initiative as the alternative could be criminal prosecution and imposition of the civil fraud penalty.

### Florida Appellate Court Reviews Proper Will Execution Formalities

In *Price v. Abate*, 2009 WL 559908 (Fla. 5th DCA Mar. 6, 2009), a Florida appellate court was asked to determine the definition of the word "presence" as used in the Florida statutes outlining the specific requirements for the proper execution of a Will. The facts of the case indicate that neither of the witnesses signed the Will in the same room as the other. The Will's proponent claimed that the physical proximity of the two witnesses was enough to satisfy the "presence " requirement under Florida law. The appellate court disagreed and held that the mere fact that the witnesses were in the vicinity of one another at the time one of them signed the Will did not amount to "presence." Rather, the witnesses must be in the same room as the testator and each other when the Will is signed and must watch each other sign the Will. Practitioners should take note of this decision and ensure that proper formalities are adhered to when supervising a Will's execution.

### Supreme Court Finds Former Spouse is Beneficiary of Retirement Plan

In *Kennedy v. Plan Admin'r for DuPont Sav. & Inv. Plan*, 129 S. Ct. 865 (2009), the Supreme Court held that decedent's former spouse was entitled to the benefits of a retirement plan as the beneficiary, notwithstanding her waiver of those rights under a divorce decree. According to the Court, ERISA obligates a plan administrator to manage ERISA plans pursuant to the plan documents, without exception. Here, under the terms of the retirement plan, the former spouse was the beneficiary. The plan provided a simple method for the decedent to change his designation, which he did not do. Further, the plan provided a method for the former spouse to disclaim her interest in the account, which was not followed. Therefore, the plan administrator properly disregarded the waiver under the divorce decree and did exactly what the terms of the plan required in paying the benefits to the former spouse. Although not discussed, query whether decedent's estate has a claim against the former spouse based in contract.

### Treasury Issues Tax Guidance on Madoff Losses

The IRS has issued Rev. Rul. 2009-09 and Rev. Proc. 2009-20, both of which are designed to help taxpayers with the income tax issues associated with the Madoff and other so-called "Ponzi" schemes and investment theft losses. If a client of yours has suffered losses in these types of cases, you should review this guidance.

**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 individuals and institutions to assist in the adminsitration of trusts and estates.

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