Wealth Management Update

October 2025

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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.

October 2025 AFRs and 7520 Rate

The October 2025 Section 7520 rate for use with estate planning techniques such as CRTs, CLTs, QPRTs and GRATs is 4.60%, down from 4.80% in September. The October applicable federal rate ("AFR") for use with a sale to defective grantor trust or intra-family loan with a note having a duration of:

- 3 years or less (the short-term rate, compounded annually) is 3.81%, down from 4.00% in September;
- 3 to 9 years (the mid-term rate, compounded annually) is 3.87%, down from 4.04% in September; and
- 9 years or more (the long-term rate, compounded annually) is 4.73%, down from 4.83% in September.

In re Peters, OTA Case No. 2025-OTA-489 (Cal. Office of Tax Appeals, June 27, 2025)

A recent decision by the California Office of Tax Appeals (the "OTA") in *In re Peters* underscores how aggressively California applies its residency rules in determining who is subject to California's income tax. Although the case is "nonprecedential," it provides insight into the analysis and factors considered for defining residency in such broad terms. With California imposing the highest state-level personal income tax rate nationwide (currently 14.4%) and its taxation of non-grantor trust income based on the residency of the fiduciaries and beneficiaries, residency status has significant implications for the taxation of trust income, whether the trust is structured as a grantor trust or a non-grantor trust.

Peters, a Canadian-born comedian and U.S. tax resident, maintained Canadian citizenship while residing part-time in both California and Nevada. He married in Nevada in 2010 and later separated in California in 2012, where a custody order required his daughter to remain. Peters owned and leased properties in both states, held a Nevada driver's license, and operated Nevada businesses, yet regularly stayed in California. IRS records showed that Peters was physically present in California between 120 and 143 days versus 9 to 21 in Nevada during each of the years at issue. The question before the OTA was whether Peters was domiciled and resident in California for the tax years 2012 through 2014.

The OTA held Peters was a California resident, finding that (1) once established, California domicile is presumed to continue unless clearly rebutted; (2) Peters' familial abode and custody obligations in L.A. tied him permanently to the state; (3) physical presence evidence overwhelmingly favored California; and (4) Nevada ties, though existent, were outweighed by California real property holdings, family connections, and greater time spent in California.

The OTA reached its conclusion by applying *Appeal of Bracamonte* (2021-OTA-156P), emphasizing that Peters bore the burden to disprove residency. His declarations of Nevada domicile were of little probative value. Rather, the "closest connections" test confirmed California as his primary abode, as evidenced by greater property, family, and personal presence outweighing Nevada business registrations and nominal ties. As such, Peters' absences from California were deemed temporary and transitory. He remained domiciled in California throughout the years at issue, rendering him subject to California income tax on his entire income.

Rulings and Cases Involving Tax Elections and GST Exemption Allocation Relief

Failure to properly make appropriate tax elections and allocate GST tax exemption on information returns can result in substantial tax liabilities which could otherwise be avoided. Taxpayers who attempt to correct such failures may be awarded relief by the IRS under certain circumstances. The following Private Letter Rulings and Tax Court Memo provide some insight into the IRS's considerations for determining whether a taxpayer is entitled to relief.

1. PLR 202532003 (August 8, 2025)

In PLR 202532003, an estate's executors requested an extension of time to make a QTIP election and a reverse QTIP election for a revocable trust set up by the decedent. Following the decedent's death, pursuant to the terms of the trust instrument, a separate Trust A was established for the benefit of the surviving spouse which qualified for the marital deduction. Additionally, the decedent had sufficient GST exemption to allocate to Trust A. However, the accountant who prepared the timely filed estate tax return failed to make both a QTIP election and a reverse QTIP election. The accountant also failed to advise the executors of the ability to make such elections. The IRS found that the executors had, pursuant to Treas. Reg. § 301.9100-3(b)(3), acted in good faith in their reliance on the advice of a qualified tax professional and granted a 120-day extension to file the elections.

2. Private Letter Ruling 202532007 (August 8, 2025)

In PLR 202532003, an estate's executors requested an extension of time to allocate GST exemption to trusts created and funded by the decedent ("Husband") during his lifetime. During Husband's lifetime, he and his wife ("Wife") created joint trusts for each of their three sons. A year after the trusts' creation, Husband made taxable gifts to the three trusts, which he and Wife elected to treat as made one-half by each. An accounting firm prepared and timely filed a gift tax return reporting these gifts. Wife and then Husband subsequently died. The executors of Husband's estate hired a law firm to prepare the estate tax return. The law firm notified the executors of the accounting firm's failure to allocate GST exemption to the trusts. The IRS found that, pursuant to Treas. Reg. § 26.2742-7(d)(2), the executors had acted in good faith in their reliance on the advice of a qualified tax professional and granted a 120-day extension to allocate the exemption to the gifts to the trusts.

3. PLR 202535001 (August 29, 2025)

Similarly, in PLR 202535001, an estate's executors requested an extension of time to allocate GST exemption to a trust created by the decedent's husband ("Husband") during decedent's ("Wife's") lifetime. Prior to Wife's death, Husband established and funded a trust. Husband and Wife retained a tax preparer to file gift tax returns and elected to split the gifts to the trusts. Although Wife had sufficient available GST tax exemption, the tax preparer did not allocate GST tax exemption to the trust. Wife's estate requested an extension under I.R.C. §2642(g) to allocate GST tax exemption to the trust. The IRS found that, pursuant to Treas. Reg. § 26.2742-7(d)(2), Wife had acted in good faith in her reliance on the advice of a qualified tax professional and granted a 120-day extension to allocate the exemption to the gifts.

4. *Est. of Rowland v. Comm'r of Internal Revenue*, T.C.M. 2025-076 (T.C. 2025)

In contrast to the Private Letter Rulings, above, in *Estate of Rowland*, the U.S. Tax Court granted partial summary judgment to the IRS, disallowing the executors of Billy Rowland's estate to port the Deceased Spouse Unused Exemption (DSUE) from Billy's predeceased wife, Fay Rowland, because the executors of Fay's estate failed to file the estate tax return by the required deadline to elect portability, and the safe harbor time extension only applies to returns that are complete and properly prepared.

In this case, Fay Rowland died in 2016. Her executor filed an estate tax return ("Fay's Return") after the extended deadline and reported only the gross value of the estate, omitting itemized valuations of assets. Fay's Will provided for specific bequests, percentage distributions to her spouse, Billy, and a family charitable foundation, with the remainder to be distributed to trusts for her grandchildren. Fay's Return reflected a gross estate of $3 million and calculated a DSUE of approximately $3.7 million. Upon Billy's later death, his estate sought to apply this DSUE, but the IRS disallowed the portability election, citing the untimely and incomplete filing of Fay's Return.

The issue before the Tax Court was whether Billy's estate could indeed rely on Fay's Return to claim portability of Fay's DSUE amount despite the late and incomplete filing. The Tax Court held that it could not. The Tax Court reasoned that under I.R.C. § 2010(c)(5)(A), portability requires (1) a filed estate tax return computing the DSUE, (2) an election on that return, and (3) a timely filed return. Although Fay's Return met the first two prongs, it failed the third. Moreover, to qualify under the safe harbor of Rev. Proc. 2017-34 allowing for an extension of time, the return had to be "complete and properly prepared," which it was not.

The absence of itemized valuations, particularly of residuary property, made the return deficient under Treas. Reg. § 20.2010-2(a)(7)(ii). The Tax Court rejected arguments of substantial compliance, finding that the omissions prevented the IRS from verifying the DSUE amount, and dismissed equitable estoppel, noting that there was no affirmative misconduct.

The takeaway from the above cases is that the IRS is more likely to provide relief for election/allocation errors where the taxpayer timely files the appropriate information return and can demonstrate satisfactorily that reasonable, good faith efforts were made to comply with IRS's requirements for filing.

The Private Client Services 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:

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