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.

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

The March § 7520 rate for use with estate planning techniques such as CRTs, CLTs, QPRTs and GRATs is 1.4%. This is the same as the January and February rates. The applicable federal rate ("AFR") for use with a sale to a defective grantor trust, self-canceling 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 1.08%. 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 § 7520 rate and a decline in the financial and real estate markets presents a potentially rewarding opportunity to fund GRATs in March with depressed assets you expect to perform better in the coming years.

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 0.19% for loans with a term of 3 years or less, 1.08% for loans with a term of 9 years or less and 2.65% 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 1.08%, the child will be able to keep any returns over 1.08%. These same rates are used in connection with sales to defective grantor trusts.

In re Grube (January 19, 2012)

The U.S. Bankruptcy Court for the Central District of Illinois held that a debtor's explanation of estate planning as a rationale for asset transfers made prior to bankruptcy is sufficient to survive the Bankruptcy Trustee's motion for summary judgment. However, the Court noted that a deeper factual analysis would be required and expressed skepticism for the debtor's estate planning rationale.

The debtor transferred his interest in two limited liability companies to his wife prior to filing for bankruptcy. The Bankruptcy Trustee argued that the transfers were fraudulent transfers under the Illinois Fraudulent Transfer Act, alleging that the debtor made the transfers "with actual intent to hinder, delay and defraud any creditor," and moved for summary judgment on the issue. The debtor argued that the transfers were made for estate planning purposes and, as corroborating evidence, submitted a letter from his attorney from the time of the transfers that referenced an estate planning purpose.

The Court denied the Bankruptcy Trustee's motion, holding that questions of intent are necessarily factual and cannot be decided on summary judgment. The Court noted that the analysis at trial should consider, among other things, the debtor's equity in the interests transferred versus those retained, the relationship of the recipients of the property to the transferor, the transferor's continued enjoyment of the property, the chronology of events and the financial status of the transferor at the time of the transfer. The Court also noted that an estate planning rationale will not automatically exonerate a transferor from a fraudulent transfer charge and proof that estate planning was the true motivation for the transfers will require opinion testimony from experts other than counsel for the parties.

Gaughen v. U.S. (M. D. Pennsylvania, January 31, 2012)

In a tax refund action, a U.S. District Court in Pennsylvania denied a taxpayer's motion for summary judgment. The Court held that the taxpayer was not entitled to summary judgment regarding the assessment of a fraud penalty because there may be sufficient evidence for a jury to conclude that the taxpayer had intentionally undervalued properties.

The taxpayer timely filed a gift tax return for gifts of his ownership interests in seven parcels of property. The IRS disputed the value of three of the parcels and assessed both additional gift tax and a fraud penalty on the transfers. In this action, the taxpayer motioned for summary judgment on the issue of fraud, requesting a refund of the fraud penalty that he paid.

The Court denied the motion, noting that issues such as intent are rarely suitable for summary judgment. In its opinion, the Court pointed to a number of facts that should be considered at trial and which could lead a jury to find that the taxpayer had intentionally undervalued the properties, including the large difference in value between the values claimed on the return and the IRS's expert valuations at trial, the difference between the county tax assessments and taxpayer's reported values, the existence of prior contracts to sell two of the properties for amounts greater than the taxpayer's reported values, the failure of the taxpayer to inform the appraiser of the prior sales contracts and a final appraisal that reflected values suggested by the taxpayer to the appraiser.

Private Letter Ruling 201203033 (January 20, 2012)

In PLR 201203033, the IRS ruled that a trust qualified as a designated beneficiary after a trust beneficiary released certain portions of a power of appointment.

The decedent died designating the marital trust created under his revocable trust as the beneficiary of his IRA. On the wife's death, the assets in the marital trust are to be distributed to GST exempt and GST non-exempt trusts for his two children also created under the revocable trust. The regulations provide that in order for a trust to qualify as a designated beneficiary, all of the trust beneficiaries must be (i) identifiable from the trust instrument (so that the beneficiary with the shortest life expectancy can be determined) and (ii) individuals with ascertainable life expectancies. Consequently, all of the potential beneficiaries of the marital trust on the wife's death needed to be analyzed to determine whether the marital trust would qualify as a designated beneficiary.

In the present case, the GST non-exempt trust for the benefit of the decedent's son presented a potential problem because the son had a testamentary power of appointment over one-half of the principal which power could be exercised in favor of anyone (including an organization) other than himself, his estate or creditors of his estate. The son cured the defect by releasing his right to appoint the principal of his GST non-exempt trust to any person who is not a natural person or who has a shorter life expectancy than the decedent's wife and thus the marital trust was able to qualify as a designated beneficiary of the decedent's IRA.

Private Letter Ruling 201151003 (December 23, 2011)

The IRS granted a decedent's estate an extension to make the alternate valuation election where the executor of the estate relied on advice of the CPA that he hired to prepare and file the decedent's estate tax return.

The executor of the decedent's estate hired a CPA to prepare and file the decedent's estate tax return. The CPA prepared and timely filed the return without making the alternate valuation election. Thereafter, the executor learned that the estate should have made the election. He then hired a second CPA who prepared a supplemental return for the estate electing alternate valuation.

The IRS granted an extension of time to file the supplemental return because the granting of relief will not prejudice the interests of the government and the executor was deemed to have acted reasonably and in good faith where he reasonably relied on a qualified tax professional as to the alternate valuation election.

Freeman v. U.S. (E. D. Pennsylvania, January 30, 2012)

A U.S. District Court in Pennsylvania held that an estate was liable for penalties and interest for the late filing of an estate tax return because the executor did not have reasonable cause for filing after the deadline.

The decedent died in April 2003 and the executor of his estate retained an attorney to represent the estate. The attorney handled all estate administration matters, including correspondence with the IRS, and assumed responsibility for ensuring that the tax returns were filed and payments made. After speaking to the attorney several times about filing the return, the executor relied on the attorney's assurances that he would handle the estate's tax obligations.

Unknown to the executor, the attorney was suffering from physical and mental ailments and never filed the estate tax return or paid the tax. The attorney was eventually discovered to have embezzled money from the estate. The executor learned of the attorney's failure to file the return and pay the estate tax in 2007 when he received a bill from the IRS for the outstanding estate tax and related penalties. The IRS assessed two penalties, one for late filing of the return (including interest on the penalty for late filing) and the second for late payment of the estate tax.

The executor argued that the attorney's physical and mental ailments constituted reasonable cause to excuse the late filing. The Court disagreed, distinguishing between a taxpayer's reliance on legal advice, the substance of which may be beyond the competence of a layperson, and his reliance on advice concerning ordinary matters such as when a return is due. Ultimately, the Court held that the duty to file a tax return is nondelegable and that the executor's reliance on an agent did not excuse the untimely filing.

Estate of Fujishima (Tax Court Memorandum, January 9, 2012)

The Tax Court held that a decedent, not his mother, was the owner of two life insurance policies on his life. In its decision, the Court relied on the record ownership of the policies. In addition, the Tax Court noted that the initial inclusion on the estate tax return of one of the policies was an admission by the administrator that the policy was an estate asset.

At the time of his death, the decedent was the record owner of three life insurance policies. The decedent's estate tax return was timely filed and included two of the three insurance policies as assets of his estate and listed the third as "(disputed ownership)." The estate later claimed that two of the insurance policies were owned by the decedent's mother and should not be included in the decedent's taxable estate. The decedent's mother paid the insurance premiums on these policies and produced cancelled checks as evidence of her payment of the premiums. She argued that the insurance company records showing the decedent as policy owner were wrong but did not produce any corroborative testimony from the agent or the insurance company.

Relying on the record ownership of the policies as the most persuasive evidence, the Court held that the decedent was the owner of the policies and the payment of premiums by his mother was gratuitous. In addition, the Court noted that the initial inclusion on the estate tax return of the policies was an admission by the administrator of the estate that the policy was an estate asset.

Rosenkrantz v. Feit (Fla. Dist. Ct. App., December 14, 2011)

A Florida intermediate appellate court held that co-agents under a power of attorney are subject to the same fiduciary principles that apply to co-trustees and that a co-agent under a power of attorney had both the right and duty to seek an accounting from the co-agent.

In *Rosenkrantz*, a mother appointed her daughter and her son as co-agents under a Florida durable power of attorney. The mother and son lived in Florida, while the daughter lived in New York. The daughter alleged that her brother refused to account for their mother's assets and objected to her efforts to obtain information directly from financial institutions. She attempted to issue subpoenas on her mother's bank to obtain account information but could not issue the subpoenas or obtain this information without her brother's concurrence as co-agent. The daughter then brought a declaratory judgment action in a Florida court asking for a declaration of her rights as co-agent and an order for an accounting from her brother. The trial court dismissed her complaint with prejudice.

The appellate court, however, reversed the trial court's decision, noting that under the applicable Florida statute, co-fiduciaries under a durable power of attorney are liable "for failure either to participate in the administration of assets subject to the power or for failure to attempt to prevent a breach of fiduciary obligations thereunder." The court held that co-fiduciaries must be guided by the same fiduciary principles as trustees and, therefore, the daughter had both a right and a duty to seek an accounting from her co-agent.

2011-2012 Priority Guidance Plan

The IRS has updated its 2011-2012 Priority Guidance Plan for the plan year ending June 2012. There are a number of subjects relating to estate, gift and generation-skipping transfer taxes where guidance is to be released according to the revised Plan, including guidance on decanting of trusts, final regulations as to extensions of time to allocate GST tax exemption, restrictions on liquidation of interests in corporations and partnerships, guidance on private trust companies, guidance concerning tax on covered gifts and bequests from expatriates, and guidance on personal guarantees and the application of present value concepts in determining the deductible amount of administrative claims and expenses against the estate.

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:

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