

Personal Planning Strategies

Wealth Management Update

A monthly report for wealth management professionals.

November 2008

As part of our ongoing efforts to keep our clients and friends 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.

November AFR Down for GRATs, QPRTs and Split Interest Charitable Trusts

The November applicable federal rate for use with CRTs, CLTs, QPRTs and GRATs is 3.6%. This is a decline from October. Given the Federal Reserve Board's recent reduction in rates, it is possible that the applicable federal rate will go down in December. Remember that lower rates work best with GRATs and CLATs. And, because of a special rule in the Internal Revenue Code, a taxpayer can elect to use the most favorable rate for a three month period with respect to a CLAT. Thus, given the strong possibility that income tax rates will go up in 2009, it makes sense to fund a grantor type CLAT in January 2009 (to obtain an income tax deduction) in order to take advantage of the lower interest rate (using the election) and higher income tax rates.

Gifts of Limited Partnership Interests Not Indirect Gifts of Underlying Assets

In *Gross v. Comm'r*, T.C. Memo 2008-221 (Sept. 29, 2008), the Tax Court held that a taxpayer's gifts of limited partnership interests was not a gift of the underlying partnership assets. Taxpayer and her daughters formed a limited partnership. Over the next several months, taxpayer contributed securities to the partnership. Eleven days after the last contribution, taxpayer and her daughters signed the partnership agreement and, on the same day, taxpayer gifted limited partnership interests to her daughters, applying a 35% discount. The IRS claimed that the formation, funding and gifting occurred on the same day, i.e. the date that the partnership agreement was signed, and considered the gifts to be indirect gifts of the underlying marketable securities, with no valuation discounts. The Tax Court, concluding that a general partnership was formed when the certificate of formation was filed, rejected the IRS' step transaction argument, and found that the taxpayer bore a real economic risk of a change in the value of the partnership between the date of funding

and the date of the gifts. The Court cautioned, however, that the step transaction argument could be viable in certain instances if the investment is one which is not heavily traded because there would be less economic risk. To avoid the step transaction pitfall, there has to be a material risk of a change in value.

Inflation-Adjusted 2009 Figures for Estates and Trusts

In 2009, the following adjustments are made:

Annual exclusion increases to \$13,000 per donee, or \$26,000 if a husband and wife split gifts;

Annual exclusion for gifts to non-citizen spouses increases to \$133,000.

Tax rates for taxation of estates and trusts:

Taxable Income	Tax
Not over \$2,300	15% of the taxable income
Over \$2,300 but not over \$5,350	\$345 plus 25% of the excess over \$2,300
Over \$5,350 but not over \$8,200	\$1,107.50 plus 28% of the excess over \$5,350
Over \$8,200 but not over \$11,150	\$1,905.50 plus 33% of the excess over \$8,200
Over \$11,150	\$2,879 plus 35% of the excess over \$11,150

Marital Deduction Disallowed Where Spouse Presumed to Have Survived Decedent

In *Estate of Lee*, T.C. Memo 2007-371 (Dec. 20, 2007), the decedent's wife predeceased the decedent. The decedent's Will provided that the decedent's spouse should be presumed to have survived the decedent resulting in a funded credit shelter trust and residuary being distributed to the predeceased wife. The Executors of the decedent's estate claimed a marital deduction for the residuary passing to the predeceased wife relying on I.R.C. Section 2056(b)(3) which they asserted permitted an ordering of deaths. The Tax Court disallowed the marital deduction finding that Section 2056(b)(3) allows a marital deduction if the passing of an interest to a surviving spouse is conditioned upon the spouse's surviving the decedent by a period not exceeding six months. The key, however, is that the spouse has to actually survive the six month period.

Supreme Court Denies IRS's Request to Review Methodology to Determine Value of Assets with Built-In Capital Gain Tax

The Supreme Court denied certiorari in *Estate of Jelke III*, U.S., No. 07-1582, *cert. denied* (Oct. 6, 2008). The Eleventh Circuit had held that, for purposes of determining the value of an estate's interest in a closely held corporation with assets consisting primarily of marketable securities, the corporation's pre-tax net asset value should be reduced by the built-in capital gains tax liability as if all the securities were sold on the valuation date.

Certain Split-Dollar Arrangements Must Comply with Section 409A

In accordance with IRS Notice 2007-34, certain split-dollar insurance agreements must be amended prior to December 31, 2008 to avoid current income taxation of non-qualified deferred compensation and a 20% penalty. Section 409A applies to pre-final regulation equity collateral assignment arrangements terminated during the employee's lifetime where there is equity, to the extent the equity is not grandfathered, pre- and post-final regulation loan arrangements where the agreement provides that the loan is forgiven and pre- or post-final regulation equity endorsement arrangements.

To comply with Section 409A, the agreement must provide that the deferred compensation cannot be distributed earlier than:

1. The employee's separation from service;
2. The date the employee becomes disabled;
3. The employee's death;
4. A specified time specified under the plan at the date of the deferral of the compensation;
5. Change in ownership or effective control of the corporation or in the ownership of a substantial portion of the assets of the corporation; or
6. Occurrence of an unforeseeable emergency.

Agreements that allow the employee to terminate the split-dollar arrangement at any time must be amended to comply with these distribution requirements. A provision that allows the employee to withdraw from cash value at any time without a repayment obligation must be modified as this may be viewed as a right to terminate the arrangement.

Personal Planning Newsletter

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This publication is a service to our clients and friends. It is designed only to give general information on the developments actually covered. It is not intended to be a comprehensive summary of recent developments in the law, treat exhaustively the subjects covered, provide legal advice, or render a legal opinion.

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