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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%, which is a slight increase from February's rate of 1.2%. 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 9-year duration (the midterm rate, compounded annually) is 1.09%, which is up slightly from the January rate of 1.01% but still relatively low. 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 financial and real estate markets which remain undervalued presents a potentially rewarding opportunity to fund GRATs in February with depressed assets you expect to perform better in the relatively near future.

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 0.22% for loans with a term of 3 years or less, 1.09% for loans with a term of 9 years or less, and 2.66% 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 1.09%, the child will be able to keep any returns over 1.09%. These same rates are used in connection with sales to defective grantor trusts.

Estate of Giovacchini v. Commissioner, T.C. Memo 2013-27

The Tax Court redetermined values for estate and gift tax purposes of a large parcel of more than 2,500 acres of land near Lake Tahoe, California, transferred to an LLC controlled by the transferor's children. The court rejected the appraisals provided by both the taxpayer and the IRS basing the valuation on parts of both appraisals, taking into account a sale that occurred after both the gift and estate tax valuation dates. The court instead chose a value that was higher than the taxpayers reported, but lower than the value determined by the IRS. Although subsequent events normally are not admissible to determine a property's fair market value, the subsequent sale here was close enough in

time to be a reasonable indication of value. Key to the court's holding was that the property was limited by numerous environment restrictions on its use and development, which made the value less than the IRS argued. However, accuracy-related penalties were overturned because the taxpayer reasonably relied on competent appraisers, and relied in good faith on their advice.

Estate of Kite v. Commissioner, T.C. Memo 2013-43

The Tax Court held that a surviving spouse's sale of substantial entity interests to trusts for her children in exchange for a 10-year deferred private annuity was a valid transfer for full and adequate consideration because the value of the annuity had been properly valued using the actuarial tables under Internal Revenue Code Sec. 7520.

Mrs. Kite was the beneficiary of three trusts (two QTIP trusts, one marital deduction trust), which were liquidated and the entity interests they held transferred to her revocable trust. She then transferred the entity interests to her children in exchange for the annuity. Although the IRS argued that the transaction was a disguised gift because Mrs. Kite couldn't reasonably be expected to outlive the term and therefore had no expectation of actually receiving payment for the transferred interests, the Tax Court held that Mrs. Kite properly relied on the IRS actuarial tables to value the annuities, and noted that she even had a doctor certify that she was not suffering from an incurable illness at the time. The arrangement also did not result in Mrs. Kite retaining an interest in the transferred assets by way of the annuity, and so did not cause the assets to be pulled into her estate under Internal Revenue Code Section 2036.

However, the Tax Court did side with the IRS in finding that the termination of the marital trusts and the transfer of interests in exchange for the annuity was an integrated transaction. Accordingly, the transaction was a taxable termination of the QTIP trusts, resulting in a gift tax liability to Mrs. Kite calculated on the value of the trusts assets, less the value of her qualifying income interest therein.

PLR 201303003

The IRS privately ruled that a marital trust that qualified as a QTIP trust under Internal Revenue Code Section 2056(b)(7) would still qualify as such following a proposed division into two separate trusts.

The original trust provided that the spouse was entitled to receive all of the income of the trust annually, plus distributions of principal for her health and medical expenses. Upon the spouse's death the QTIP was to divide into separate shares for her three sons. After disagreement developed between the spouse and the sons over the trust's management, they proposed to divide the trust into two shares, one of which would continue for the benefit of the spouse as provided in the original trust. The other share would contain the same provisions following division, but the spouse agreed to thereafter renounce her interest in such trust, thereby causing it to be immediately distributable to the three sons.

The IRS ruled that because the spouse would continue to be entitled to all the trusts' income following division, and no person other than the spouse would have the power to receive income or principal, nor appoint any part of the property of the trusts to any person other than the spouse, the trusts would still qualify as QTIP trusts under the Code. However, the spouse's renunciation of her interest in the second trust would be a taxable

termination, resulting in a taxable gift of the spouse's income interest under Internal Revenue Code Section 2511, and a gift of the entire fair market value of the assets in the trust, as determined on the date of the disposition, less the value of the qualifying income interest in the trust under Internal Revenue Code Section 2519.

New Form 1041, U.S. Income Tax Return for Estates and Trusts for 2012, and Instructions Released

The IRS has released a final version of the Form 1041, U.S. Income Tax Return for Estates and Trusts for 2012, and the corresponding instructions. The Form is available here: <http://www.irs.gov/pub/irs-pdf/f1041.pdf>, and the instructions are available here: <http://www.irs.gov/pub/irs-pdf/i1041.pdf>. The new form includes tax deductions and credits that were extended for tax year 2012 by the American Taxpayer Relief Act of 2012.

IRS Considering Change in Method Used To Determine AFRs

The IRS has announced that it is considering changes to the methodology used to determine the adjusted applicable federal rates (AFRs) and the adjusted federal long-term rate, for the following reasons. When the adjustment factor was originally created, it used prime, general obligation tax-exempt bonds, which no longer are perceived to have the same credit quality with U.S. Treasury obligations. As a result, market yields of prime, general obligation tax-exempt bonds often have exceeded the corresponding AFRs. Accordingly, the adjustment factor no longer serves its intended purpose of making adjustments to reflect tax exemption but not credit quality, and are also in conflict with Congress's express intent that the adjusted federal long-term rate and long-term tax-exempt rate be lower than the federal long-term rate.

IRS Seeks Comment on Rules for Estate Tax Return Filing Extensions

The Internal Revenue Service is seeking public comment on final regulations governing the extension of time to file estate tax returns, which allow an automatic six-month extension beyond the initial deadline – nine months from the decedent's date of death, upon proper application. Comments (due by March 25, 2013) should be sent to Yvette Lawrence, IRS, Room 6129, 1111 Constitution Ave. N.W., Washington, D.C. 20224, addressing the following:

- > whether the collection of information has practical utility;
- > the accuracy of the agency's estimates of the paperwork burden on taxpayers;
- > ways to enhance the quality, utility, and clarity of the information to be collected;
- > ways to minimize the burden of the collection of information on respondents, including through the use of automated collection techniques or other forms of information technology; and
- > estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

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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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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