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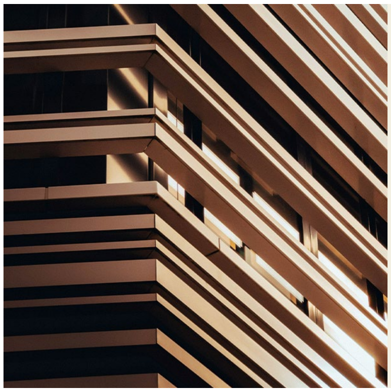

Wealth Management Update

September 2026

Table of Contents

A monthly report for wealth management professionals.

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.

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September AFRs and 7520 Rate

The September 2026 Section 7520 rate for use with estate planning techniques such as CRTs, CLTs, QPRTs and GRATs is 5.40%, up from 5.20% in August. The September applicable federal rate (“AFR”) for use with a sale to a 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 4.18%, up from 4.10% in August;
- 3 to 9 years (the mid-term rate, compounded annually) is 4.49%, up from 4.35% in August; and
- 9 years or more (the long-term rate, compounded annually) is 5.12%, up from 4.92% in August.

NYC “Pied-à-Terre” Tax – Final Rules & Other Updates

Background and Surcharge Framework

The New York City pied-à-terre surcharge took effect on July 1, 2026 and applies annually through June 30, 2031 to certain high-value residential properties that are not used as primary residences.

For fiscal years 2026–2027 and 2027–2028, the surcharge generally applies to one-, two-, and three-family homes ("Class 1 homes") valued by the New York City Department of Finance ("DOF") at $5 million or more and condominium and cooperative units valued at $1 million or more.[1] Rates range from 0.8% to 1.3% for Class 1 homes and from 4% to 6.5% for condominium and cooperative units.[2]

The surcharge does not apply if the property qualifies as a "primary residence" under the statute. Primary-residence status is tested annually as of January 5 immediately preceding the applicable fiscal year, and subsequent changes in ownership or occupancy generally do not affect that year's determination. Accordingly, looking forward, planning for the 2027–2028 fiscal year generally must be implemented by January 5, 2027.

Initial Implementation

On July 14, 2026, DOF's final rules implementing the surcharge became effective. Under the final rules, DOF first identifies properties that may be subject to the pied-à-terre tax and then determines whether each property qualifies for the primary-residence exemption. DOF released its initial list of potentially covered properties on July 24, 2026, which included more than 31,000 properties, and began notifying property owners of their potential liability.

DOF is required to send individualized notices to the owners of the properties included on the list. The notices include the projected surcharge amount, the deadline and instructions for submitting a primary-residence exemption request challenging DOF's determination. However, they do not explain the factual basis for DOF's determination that the property is not a primary residence. As a result, owners generally must prepare an appeal without knowing why DOF concluded that the property did not qualify as a primary residence.[3]

Qualifying for the Primary-Residence Exemption

Property owners can receive an exemption from paying the surcharge after establishing that their property is a qualifying primary residence. A property will qualify as such if it is the primary residence of a "covered owner," an immediate family member of a covered owner, or a qualifying lessee or sublessee. A "covered owner" is an individual who owns Class 1 property, a tenant-stockholder who owns the cooperative shares associated with a coop unit or an individual who owns a condominium unit. An "immediate family member" of a covered owner is strictly limited to the covered owner's spouse, child, sibling, parent, grandparent, or grandchild.

Individual-Owned and Entity-Owned Property

An individual may qualify as a "covered owner" even if that person owns only a fractional interest in the property, as long as he or she owns a direct interest in the property. However, where property is owned through an entity, the entity's owners may qualify as covered owners only if the entity itself owns the entire undivided interest in the property (or, for a cooperative, all of the shares attributable to the unit). The individuals residing in the property must, alone or collectively, hold a majority interest in the entity. The final rules permit multiple resident shareholders, members, or partners to aggregate their ownership interests to satisfy this requirement. Therefore, no single resident needs to own a majority interest in the entity, provided that the resident owners collectively own more than 50%.

However, an individual cannot establish covered-owner status through a multi-tier entity structure. For example, if an individual owns 100% of LLC 1, which in turn owns 100% of LLC 2, and LLC 2 owns the residence, the individual cannot qualify as a covered owner merely by virtue of the individual's ownership of LLC 1.

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[1] For fiscal years 2026-2027 and 2027-2028, DOF uses NYC's existing property-tax valuation system to determine which properties are subject to the surcharge. The value of Class 1 homes is determined using a comparable sales valuation methodology. The value of coops and condos is generally derived from the hypothetical income the property would generate if it were operated as a rental property.

[2] Beginning July 1, 2028, condominium and cooperative units move to the same $5 million threshold and 0.8%–1.3% rate schedule applicable to Class 1 homes, while their market value will be determined under the Phase Two valuation methodology, which uses comparable sales.

[3] The final rules state that for FY 2026-2027, DOF will use income tax data to make initial determinations of primary residency.

Trust-Owned Property

Special rules apply to trust-owned residences. An individual residing in property owned by a trust can qualify as a covered owner only if the resident beneficiary or beneficiaries are the "sole beneficiaries" of the trust. In making that determination, contingent and future beneficial interests are disregarded, so the existence of remainder beneficiaries or other persons holding only future or contingent interests does not necessarily prevent the current beneficiaries from qualifying. Multiple current beneficiaries can qualify collectively, provided they are the sole beneficiaries for this purpose.

For example, if Husband and Wife reside in a trust-owned apartment and are current beneficiaries, but their Child is also a current beneficiary, Husband and Wife would not qualify because they are not the trust's sole beneficiaries.

The trust rules are stricter than those applicable to individual or entity ownership because an immediate family member of a trust beneficiary cannot establish primary residence on the beneficiary's behalf. In other words, for trust-owned property, the primary-residence requirement cannot be satisfied just because an immediate family member of a qualifying trust beneficiary resides at the property. Instead, the resident family member must independently qualify under the trust rules. For example, if a trust owns an apartment for the benefit of Parent but Child resides there, Child's occupancy cannot be attributed to Parent for purposes of the exemption.

Leased Property

A property leased or subleased to an individual can qualify if that person uses it as a primary residence and the lease or sublease is an "arm's length transaction." An entity such as an LLC cannot establish primary residency as a tenant. The arm's-length requirement also prevents an owner from creating a pretextual or nominal rental arrangement principally to escape the surcharge. Facts and circumstances indicating a reasonable possibility that the lease was entered into primarily to avoid the surcharge prevent it from qualifying as an arm's length transaction.

Death and Temporary Absences

The final rules provide temporary protection when a person who otherwise satisfies the primary-residence requirements dies, is hospitalized, or temporarily resides in a rehabilitation facility or nursing home. In those circumstances, the individual's primary-residence status is deemed to continue for one year immediately following the relevant event, rather than being lost immediately because the person is no longer physically occupying the property.

Exemption Requests

The rules provide that an owner who receives notice of DOF's initial surcharge determination but believes that DOF has incorrectly characterized his or her property as a non-primary residence, must submit an exemption request directly to DOF. The deadline to submit an exemption request has been extended to October 6, 2026 for all property types. The exemption request is submitted as a written appeal through DOF's electronic portal.

The appeal must include a certification that the property qualifies as a primary residence and supporting documentation demonstrating that it is the primary residence of either (a) a covered owner, (b) an immediate family member of a covered owner, or (c) a qualifying lessee or sublessee.

The rules specify the documentation required to establish eligibility for the exemption. Primary residence generally may be proven by either the individual's most recently filed federal or state income tax return listing the property as the person's permanent home address, or at least two of the three following documents if tax returns are not available:

1. A driver's license;
2. A voter identification card; or
3. "Other proof" of occupancy.

Additional documentation is required depending on the ownership structure. For example, trust-owned property requires the trust agreement and a trustee affidavit confirming that the resident beneficiary, either alone or together with any other resident beneficiaries, constitutes the sole current beneficiary or beneficiaries of the trust. Property owned by an entity requires organizational documents and an affidavit establishing the resident's majority ownership interest in the entity.

The Commissioner of DOF will review appeals and issue a determination electronically. If the exemption is granted, the property is excluded from the surcharge for that fiscal year. An owner who does not timely file an appeal or fails to submit the required proof generally loses the opportunity to challenge DOF's initial determination administratively.

If DOF denies the appeal, the denial constitutes a final agency determination. The owner may then seek further review before the New York City Tax Commission pursuant to Administrative Code § 11-3206, rather than pursuing another appeal within DOF. Alternatively, where the owner is also challenging the property's market value, the owner may elect to challenge DOF's initial primary-residence determination before the Tax Commission in the first instance. The rules prohibit an owner from pursuing parallel primary-residence challenges before both DOF and the Tax Commission.

Penalties

DOF may audit a property's surcharge liability, including whether the property properly qualified as a primary residence and whether the supporting certifications and documentation were accurate, within six years after those materials were submitted. In conducting an audit, DOF may request information and documentation necessary for its review and may "subpoena and require the attendance of witnesses and the production of books, papers and documents."

An audit may result in penalties if DOF determines that "inaccurate or misleading information" material to the surcharge determination was submitted "negligently or in bad faith."

Where the inaccurate or misleading information, if accepted by DOF, would cause the surcharge not to be imposed at all, the penalty is "50% of the surcharge applicable to such property for such fiscal year." Where inaccurate or misleading information results in a lower valuation and reduced surcharge, the penalty is 300% of the amount by which the surcharge was understated, capped at 50% of the surcharge otherwise applicable to the property. In either instance, DOF will still impose the underlying surcharge.

If a penalty is challenged, DOF bears the burden of establishing the relevant facts by a preponderance of the evidence. The owner may seek administrative review of the penalty, and the Commissioner's ultimate determination constitutes a final agency determination.

Due to these penalties, the exemption process should not be viewed as a risk-free opportunity to apply and see what happens. An owner who knows the property does not qualify should be cautious about certifying otherwise, because a knowingly inaccurate certification could support a finding of bad faith and trigger the penalty provisions.

Planning Opportunities and Takeaways

Practitioners should review the ownership and occupancy of potentially covered residences well before the January 5, 2027 testing date for the 2027–2028 fiscal year. Potential planning opportunities include modifying or severing a trust so that the residents of a trust-owned property are its only current beneficiaries, simplifying multi-tier or multi-owner entity structures so that resident owners can qualify as covered owners, or entering into a bona fide, arm's-length lease with a tenant who will use the property as a primary residence.

The surcharge should also be considered in domicile planning for clients who have left or are considering leaving New York City but intend to retain a residence there, as the cost of the surcharge may affect the overall tax benefits of changing domicile.

Proposed Limits on "Mega" Retirement Accounts (S. 5040 and H.R. 9813)

On July 22, 2026, Senator Ron Wyden (D-Ore.) and Representative Richard Neal (D-Mass.) introduced companion legislation in the House and Senate that would impose new restrictions on retirement accounts with aggregate balances exceeding $10 million.

Under the proposal, taxpayers with aggregate retirement account balances exceeding $10 million generally would be prohibited from making additional IRA contributions if their modified adjusted gross income exceeds $400,000 ($450,000 for married taxpayers filing jointly). In addition, beginning in 2034, affected taxpayers generally would be required to take annual distributions equal to 50% of the amount by which their aggregate retirement account balances exceed $10 million. Taxpayers with aggregate retirement account balances exceeding $20 million would first be required to take distributions equal to the lesser of (a) the amount by which their retirement account balances exceed $20 million or (b) the value of their Roth retirement accounts, before applying the general distribution requirement for balances that exceed $10 million

Lewis v. Commissioner, T.C. Memo. 2026-58 (July 20, 2026)

Background

Clotilde McDougall died in 2011. Her will directed the residue of her estate to a testamentary QTIP trust for the benefit of her surviving spouse, Bruce McDougall (the "Residuary Trust"). Bruce was entitled to the trust income during his lifetime and could receive distributions of principal for his health, maintenance and support. He also held a testamentary limited power of appointment over the trust property in favor of Clotilde's descendants. Any property remaining at Bruce's death that was not appointed by him would be distributed to the couple's two children, Linda Lewis and Peter McDougall. Clotilde's will provided that, upon termination of the trust, the beneficiaries were to receive assets equal in value to their respective interests in the trust at the time of the termination.

In June 2016, Bruce executed a will exercising his limited power of appointment by directing the remaining Residuary Trust assets at his death to his revocable trust, which provided for distributions among his descendants. Then, in October 2016, Bruce and his children agreed to terminate the Residuary Trust and distribute all of its approximately $117.6 million in assets outright to Bruce. In an earlier opinion, the Tax Court concluded that the transaction resulted in taxable gifts when the children surrendered their remainder interests. The remaining issue before the Court was how those gifts should be valued.

Valuation Issues

The parties took fundamentally different approaches to valuing the children's gifts. The IRS valued each gift at approximately $53.4 million using the actuarial tables under § 7520. Starting with the trust's stipulated value of approximately $117.6 million, the IRS used the actuarial factors under the statute to determine the value of Bruce's lifetime interest and treated the remaining value as attributable to the remainder interests, divided equally between Linda and Peter.

On the other hand, the children's expert used a discounted cashflow analysis. Rather than relying on the § 7520 actuarial factors, he estimated the distributions each beneficiary would have been expected to receive if the trust had continued and discounted those future distributions to their present value. His analysis therefore depended on assumptions concerning when the beneficiaries would receive distributions and the extent to which Bruce's rights under the trust, including his right to receive principal distributions and his limited power of appointment, could affect the amounts ultimately received by Linda and Peter.

The parties' competing valuations turned on four main issues:

- **Limited Power of Appointment:** The children argued that Bruce's testamentary limited power of appointment substantially reduced the value of their remainder interests because he could exercise the power in a manner that could prevent them from receiving trust assets. The IRS argued that the power should have no effect on the value of the gifts because it was extinguished when the trust terminated.
- **Section 2207A Reimbursement:** The parties disputed whether the children's gifts should be reduced by the gift-tax reimbursement obligations they would have owed Bruce under § 2207A if the trust had terminated and the assets had been distributed according to their respective trust interests.
- **Section 7520:** The IRS argued that the § 7520 actuarial tables controlled the valuation of the children's remainder interests. The children argued that the tables were inapplicable because their interests were subject to contingencies and restrictions, including Bruce's limited power of appointment.
- **Life Expectancy:** The children's expert valued Bruce's lifetime interest by treating the 85-year-old Bruce as having the life expectancy of an 80-year-old based on his financial circumstances and perceived good health. The IRS argued that Bruce's actual age should be used.

Court's Analysis

Limited Power of Appointment

The Court acknowledged that Bruce's power theoretically could have affected future distributions. However, the Court concluded that it would be inconsistent with Clotilde's estate plan to value the children's interests based on the assumption that Bruce would exercise the power so as to leave them with virtually nothing. The Court pointed out that Clotilde could have left the property outright to Bruce while still obtaining the marital deduction, but instead she chose to put the assets in a trust, gave Bruce only specified rights during his lifetime, and limited his power of appointment to Clotilde's descendants. The Court applied state law and focusing on that overall plan, it determined that a trustee allocating the assets upon termination would have assumed that, absent termination, the remainder ultimately would pass equally to Linda and Peter. The Court therefore rejected the $156,000 valuation advanced by the children.

Section 2207A Reimbursement

The Court next considered whether the value of the children's gifts should reflect the reimbursement rights created by § 2207A. If the trust had terminated and Linda and Peter had received property corresponding to their remainder interests, Bruce's disposition of his qualifying income interest would have triggered § 2519, which treats a surviving spouse who disposes of a qualifying income interest in QTIP property as having transferred all other interests in that property. Consequently, Bruce would have been treated as making a taxable gift of the QTIP remainder interests, even though those interests were actually held by Linda and Peter. Section 2207A, which generally permits a surviving spouse to recover from the recipients of QTIP property the gift tax attributable to a deemed transfer under § 2519, would then have allowed Bruce to recover that gift tax from Linda and Peter.

The Court concluded that this hypothetical reimbursement obligation had to be considered in measuring the children's gifts. The relevant economic value was therefore the amount Linda and Peter otherwise would have received upon termination, reduced by the amount they would have been required to reimburse Bruce for his resulting gift tax.

Section 7520 Actuarial Tables

The Tax Court held that the § 7520 tables did not control. Because the children's gifts were measured by the distributions they would have received if the trust had terminated without directing all of the assets to Bruce, the threshold question was what each beneficiary would have been entitled to receive under Clotilde's will. That question concerned the beneficiaries' property rights and was governed by Washington law. A trustee could consider the § 7520 tables as a valuation tool in determining the value of each beneficiary's interest, but the tables did not conclusively establish the amounts to which the beneficiaries were entitled under the governing instrument.

Bruce's Life Expectancy

Because the children's expert used a discounted cashflow method, his valuation required an estimate of how long Bruce would continue receiving distributions before the remainder became distributable to Linda and Peter. Although Bruce was 85 when the trust terminated, the expert applied the life expectancy of an 80-year-old based on his financial circumstances and assessment that Bruce was healthier than the typical person his age. The Court concluded that the expert lacked a sufficiently comprehensive basis for concluding that Bruce should be treated as younger than his actual age.

Holding

The Court ultimately valued each child's taxable gift at $35,141,321. The IRS had conceded that each gift would not exceed $35,141,321 if the Court held that the § 2207A reimbursement obligation reduced the gifts and that the § 7520 tables did not control the valuation. Because the court ruled against the IRS on both issues, it adopted the IRS's conceded maximum and held that Linda and Peter each made a taxable gift of $35,141,321 to Bruce.

Takeaways

The decision shows that valuing a beneficiary's gift arising from the decision to terminate a QTIP trust may require more than simply applying federal actuarial tables to the beneficiary's trust interest. Where the amount transferred depends on what the beneficiary would otherwise have received upon termination, the governing instrument and applicable state law first determine the beneficiary's underlying property rights. The case also serves as a reminder of the potentially significant gift-tax consequences of terminating a QTIP trust by agreement and reallocating the trust property among family members.

South Dakota Senate Bill 100

South Dakota Senate Bill 100 went into effect on July 1, 2026. The legislation expands South Dakota's decanting statute by permitting trustees to implement decanting through a modification of the existing trust rather than requiring a transfer to a separate trust. The legislation also authorizes an independent trustee, trust advisor, or trust protector to reimburse a grantor for income taxes attributable to grantor trust status, unless the governing instrument provides otherwise; establishes a default rule that lifetime distributions generally are not treated as advancements absent contrary language; and clarifies that, unless otherwise agreed, an attorney representing a fiduciary owes duties solely to the fiduciary and not to trust or estate beneficiaries.

PLR 202632007 (August 7, 2026)

In this Private Letter Ruling, the IRS considered the tax consequences of dividing and modifying a grandfathered GST-exempt trust. The trust at issue (the "Family Trust") held assets originally contributed to an irrevocable trust created before September 25, 1985 (the "Original Trust"). The Original Trust granted the settlor's son a testamentary limited power of appointment, which Son exercised at his death to direct the Original Trust assets to the Family Trust for the benefit of his descendants. The Family Trust permitted discretionary distributions among Son's descendants, including his four children and their descendants, and both the governing instrument and applicable state law authorized the trustee to divide the trust into separate trusts, including on a non-pro rata basis.

The trustee proposed dividing the Family Trust into four separate trusts, one for each child and his or her descendants, so that investment and distribution decisions could be made separately for each family branch. The proposed restructuring also included several administrative changes, including provisions permitting the appointment of an investment advisor and trust protector. A state court approved the proposed restructuring and modifications, conditioned on receipt of a favorable IRS ruling.

The IRS ruled that the division and modifications would not cause the trust or the resulting trusts to lose their grandfathered GST-exempt status because the changes did not shift beneficial interests to lower generations or extend the time for vesting beyond that permitted under the original trust. The IRS also concluded that the restructuring would not result in taxable gifts by the beneficiaries.

For income tax purposes, the IRS ruled that allocating the trust's assets among the four resulting trusts, whether pro rata or non-pro rata, would not result in the recognition of gain or loss under § 1001. The assets would also retain their existing adjusted bases under § 1015 and holding periods under § 1223(2).

The ruling shows how a grandfathered GST-exempt trust may potentially be divided among separate family branches and updated with modern administrative and directed-trust provisions without jeopardizing its grandfathered status or triggering other adverse tax consequences.

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.

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