Proskauer

newsletter

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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 2.2%, which is a 0.2% decrease from last month. The March 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 having a duration of 3-9 years (the mid-term rate, compounded annually) is 1.84%, which is a 0.13% decrease from the February rate.

The relatively low § 7520 rate and AFR continue to present potentially rewarding opportunities to fund GRATs in March with depressed assets that are expected 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 0.28% for loans with a term of 3 years or less, 1.84% for loans with a term between 3 and 9 years, and 3.36% 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 1.84%, the child will be able to keep any returns over 1.84%. These same rates are used in connection with sales to defective grantor trusts.

Revenue Procedure 2014-18 issued January 27, 2014 – Extension of Time for Portability Elections Where No Form 706 Was Filed

In Revenue Procedure 2014-18, the Internal Revenue Service ("IRS") provided a simplified method of obtaining relief under § 301.9100-3 of the Procedure and Administration Regulations to make a Portability election under § 2010(c)(5)(A) of the Code.

For decedents who died after December 31, 2010 but before January 1, 2014 and were survived by a spouse, and for whom no Form 706 was required to be filed under § 6018(a) of the Code due to the decedent's gross estate and adjusted taxable gifts being under the applicable threshold at the time of the decedent's death, this Revenue Procedure permits an executor to file Form 706 to make a Portability election before December 31, 2014 with no filing fee. The Executor must file the Form 706 before December 31, 2014 and state at the top of the return: "FILED PURSUANT TO REV. PROC. 2014-18 TO ELECT PORTABILITY UNDER § 2010(c)(5)(A)."

If the taxpayer complies with these rules, the filed Form 706 is deemed timely filed for purposes of electing Portability for the decedent's surviving spouse. If, however, the IRS determines that a Form 706 should have been filed because the decedent had a gross estate plus adjusted taxable gifts in excess of the filing requirement, then the extension is null and void and the Form 706 may be considered untimely filed if not filed within the time period for filing.

If a taxpayer has a pending private letter ruling request for an extension of time to make a portability election and that decedent's estate would qualify under this Revenue Procedure, then the taxpayer may withdraw that ruling request and obtain a refund of the applicable user fee if the IRS is notified of such withdrawal before the earlier of March 10, 2014 and the IRS issuing a favorable ruling to the taxpayer.

If a taxpayer does not qualify for relief under this Revenue Procedure for any reason, the taxpayer may still file for Section 9100 relief under the general rules for requesting such an extension of time.

New York State Department of Taxation and Finance Advisory Opinion (TSB-A-14(6)S) Concludes that Substitution of Property by the Settlor of an Irrevocable Grantor Trust is Subject to New York Sales Tax

The New York State Department of Taxation and Finance (the "Department") provided an advisory opinion on January 29, 2014 to a New York resident taxpayer who retained the right under an irrevocable trust created by the taxpayer to substitute assets of the trust for assets of equal value. The taxpayer proposed to exercise the power of substitution by transferring tangible personal property to the trust in exchange for intangible assets of the trust. The trust and the taxpayer were considered the same taxpayer for federal and New York income tax purposes.

The Department concluded that although the grantor and the trust may be considered the same taxpayers for income tax purposes, the transfer would nonetheless be considered a sale for state sales tax purposes if the assets transferred would be subject to sales tax for any unrelated taxpayers.

Section 1105(a) of the New York Tax Law imposes sales tax on the receipts from every sale of tangible personal property unless the sale is exempt. The term "sale" is any transfer of title or possession or both in exchange for consideration. The Department states that "[w]hen an individual transfers title or possession of property to a trust, a transfer has been made to a separate entity….This is true even in the case of a grantor trust or a revocable living trust. If there is consideration given in any form in connection with the transfer, a retail sale of tangible personal property occurs and sales tax is imposed….”

While there may be exceptions to the application of New York sales tax in situations where an irrevocable trust and its settlor exchange tangible personal property, it is imperative that an analysis of not only the income tax but also the state sales tax is made prior to such an exchange.

Berlinger v. Casselberry (Case no. 2D12-6470. Fla. 2d DCA Nov. 27, 2013) – Florida District Court of Appeal Upholds Order of Continuing Garnishment of Trust Distributions by an Ex-Spouse with a Support Order

In a case of bad facts for the beneficiary of purely discretionary irrevocable trusts, the Florida Second District Court of Appeal held that the trial court acted within its authority in granting continuing writs of garnishment against the trustees of such trusts for the benefit of a spouse who defaulted in his alimony obligations to his ex-spouse.

As background, after 30 years of marriage, Bruce Berlinger (“Berlinger”) and Roberta Sue Casselberry (“Casselberry”) divorced in 2007. Pursuant to the parties’ divorce agreement, Berlinger agreed to pay Casselberry $16,000 per month in permanent alimony. Shortly thereafter, Berlinger remarried and he and his new spouse supported their lifestyle with discretionary distributions from Irrevocable Trusts for his benefit (the “Berlinger Discretionary Trusts”). The Berlinger Discretionary Trusts provided for distributions to Berlinger in the absolute discretion of the trustees, and contained a spendthrift clause prohibiting attachment of Berlinger’s interest in the Trusts by his creditors.

In May, 2011, Berlinger stopped making alimony payments to Casselberry. In July 2011, Berlinger transferred his two-thirds interest in real property (including his home) to an irrevocable trust, but denied doing so in a subsequent deposition.

In September 2011, in lieu of making distributions directly to Berlinger, he instead received a credit card from the corporate co-trustee of the Berlinger Discretionary Trusts, to be used for payment of expenses including travel, entertainment, clothing, medical expenses, grooming, gifts and his current wife’s credit card bills. The credit card bills were paid directly from the Berlinger Discretionary Trusts.

Casselberry filed a motion for writ of garnishment against the trustees of the Berlinger Discretionary Trusts, which was granted by the trial court. The order provided that all distributions made directly or indirectly to, on behalf of, or for the benefit of Berlinger by the trustees of the Berlinger Discretionary Trusts would be made payable to Casselberry unless, at the time of any future distributions, there was no alimony or alimony arrears owed. In addition, if the trustee of a Berlinger Discretionary Trust, after satisfying outstanding alimony amounts, wanted to make a distribution to Berlinger, it would require court approval to ensure there remained sufficient assets in the Berlinger Discretionary Trusts to secure continued payment of alimony. Berlinger appealed the trial court’s order to the Second District Court of Appeal.

In his appeal, Berlinger argued that Section 736.0504 of the Florida Trust Code specifically prohibited Casselberry from attaching distributions made to or for the benefit of Berlinger from the Berlinger Discretionary Trusts. The District Court of Appeal disagreed, holding that the Florida Supreme Court's decision in *Bacardi v. White*, 463 So. 2d 218 (Fla. 1985), was controlling and that the Florida Trust Code enacted in 2006 was a codification of the *Bacardi* holding.

In *Bacardi*, the Florida Supreme Court held that with respect to spendthrift trusts that were not purely discretionary (*i.e.*, trusts which mandate distributions to the beneficiary), a spouse or former spouse with a judgment in the form of support could seek a court order to obtain distributions otherwise payable to the intended beneficiary. For discretionary Trusts, where no present distributions were required, the *Bacardi* Court held that a court could not direct distributions to be made, however, if trustee of a discretionary trust decided to make a distribution to the intended beneficiary then such beneficiary's former spouse with a judgment for support could petition the court to obtain a continuing garnishment. Therefore, if the Trustee wants to make a distribution to or for the benefit of the beneficiary, the former spouse holding a judgment could intercept the proposed distributions before they reach the intended beneficiary.

Berlinger argued that the Florida Trust Code, enacted in 2006, provided greater protection to beneficiaries of spendthrift trusts with a discretionary distribution standard than under the *Bacardi* ruling. Specifically, Section 736.0503 of the Florida Trust Code provides, in relevant part, as follows:

> "(2) To the extent provided in subsection (3), a spendthrift provision is unenforceable against:
>
> (a) A beneficiary's child, spouse, or former spouse who has a judgment or court order against the beneficiary for support or maintenance…."

Section 736.0504 of the Florida Trust Code provides, in relevant part, as follows:

> "(1) As used in this section, the term "discretionary distribution" means a distribution that is subject to the trustee's discretion whether or not the discretion is expressed in the form of a standard of distribution and whether or not the trustee has abused the discretion.
>
> (2) Whether or not a trust contains a spendthrift provision, if a trustee may make discretionary distributions to or for the benefit of a beneficiary, a creditor of the beneficiary, *including a creditor as described in s. 736.0503(2)*, may not:
>
> (a) Compel a distribution that is subject to the trustee's discretion; or
>
> (b) *Attach or otherwise reach the interest, if any, which the beneficiary might have as a result of the trustee's authority to make discretionary distributions to or for the benefit of the beneficiary*…." (emphasis added.)

Berlinger argued that Section 736.0504(2) provided greater protection to the Trustee than the *Bacardi* Court, as a former spouse creditor under Section 736.0503(2) is specifically precluded under Section 736.0504(2)(b) from attaching or otherwise reaching the interest of the beneficiary.

The *Berlinger* Court disagreed, stating that Florida Trust Code Sections 736.0503 and 736.0504 "codify the Florida Supreme Court's holding in *Bacardi*. Neither section protects a discretionary trust from garnishment by a former spouse with a valid order of support….”

In summary, it is important to exercise caution when explaining to clients the protection provided to beneficiaries of Florida spendthrift discretionary trusts with respect to support obligations to former spouses.

New York State Budget Proposal Would Change New York State’s Estate Tax

New York Governor Andrew Cuomo has submitted a budget proposal which, if adopted, would significantly change the rules pertaining to the calculation of New York State’s estate tax. The proposed legislation would increase the amount of property that can pass free of New York state estate tax (the “exemption amount”) from its current $1 million level to the exemption amount allowed under federal law (currently $5.34 million, subject to annual inflation indexing). Notably, however, estates exceeding 105% of the exemption amount would receive no exemption. Under the new law, the top rate of tax applicable to estates in New York would be decreased from its current 16% to 10% for decedents dying in 2017 or later. Finally, the new law would cause all lifetime gifts to be added back into the estate of the donor for state estate tax purposes. For example, if a New York resident made $5 million of lifetime gifts and died with $10 million of assets on hand, the figure used for the purpose of calculating the New York estate tax would be $15 million.

Under the current law, gifts made by New York donors are not subject to state gift tax at the time of the gift. As a result, a donor may decrease the size of her New York taxable estate by making lifetime gifts. For example, under the current law, a donor with $15 million on hand could make a gift of $5 million worth of assets to her children during her life free of any New York gift tax, and the figure used for the purpose of calculating the New York estate tax at her death would be $10 million. The result would be a combined Federal and New York estate tax bill of approximately $4.5 million. If the same donor were to make no gift, her $15 million estate would incur a combined tax of nearly $5 million. Making a lifetime gift under the current law in this circumstance would result in a net savings of nearly $500,000. Aside from minimizing the donor’s New York taxable estate, lifetime gifts may produce the added benefit of excluding all income and appreciation generated by the gifted asset entirely from the donor’s estate. Under the proposed legislative change, lifetime gifts will be added to the estate of the donor, which would negate much of the tax benefit available under current law.

If approved, the proposed legislation would be effective for gifts made on or after April 1, 2014. New York residents should consider making gifts before April 1, 2014 to ensure gifted assets are removed from their New York estate. If a donor is able to gift assets such that her estate would not exceed 105% of the exemption amount in the year of her death, she may enable her estate to take advantage of the New York exemption that would otherwise be unavailable. For example, if a donor has $10 million worth of assets now, completes a gift of $5 million before April 1, 2014 and dies after 2017 with total assets of $5 million in her estate, no New York estate tax would be payable because her gross estate would be less than the exemption amount. In contrast, if that same donor did not make a gift (or made a similar gift after the deadline), her estate would lose the available exemption entirely because her gross estate would exceed 105% of the exemption amount. The result would be a state estate tax bill of approximately $900,000.

Additional measures included in the budget proposal would eliminate an existing loophole in the law that allows New York residents to create income tax favored non-resident trusts in other states and would eliminate the New York State generation-skipping transfer tax.

The proposed changes are generally intended to create a more favorable tax environment for New Yorkers whose estates will not exceed approximately $5 million, to stem the flow of New Yorkers to tax-favorable jurisdictions and to bring New York's estate tax laws into relative parity with federal estate tax laws. However, the tax savings are not as significant for larger estates. For instance, the New York State estate tax due with respect to a decedent's estate equal to $15 million would be approximately $1.9 million under current law. The New York State estate taxes due under the new law would be approximately $1.5 million. However, the same $15 million estate in Florida, California and other states that do not have a state estate tax would be zero. Thus, it is unlikely that the new law will stem the tide of wealthy New Yorkers moving to tax favorable jurisdictions.

To discuss gifting opportunities prior to April 1, 2014 and any associated tax implications, please contact one of the attorneys in the Personal Planning Department at Proskauer Rose LLP.

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.

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