

April 2015
in this issue

*A monthly report for
wealth management
professionals.*

*Obama Administration
Announces Revenue
Proposals1*

*Estate Denied Income
Tax Charitable
Deduction2*

*Nevada Trust Held Not
an "Asset Protection
Trust"2*

*Decanting Denied under
New York Law3*

*LLC Formalities Need to
be Followed 4*

Edited by **Henry J. Leibowitz**

Contributors: **Scott A. Bowman and Nathan R. Brown**

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.

Obama Administration Announces Revenue Proposals

The Obama Administration has recently announced its Fiscal Year 2016 Revenue Proposals in its annual "Greenbook." The Greenbook sets forth the Administration's proposals for changes in the tax law for the fiscal year. Although these proposals are not proposed legislation, they give us some insight into the Administration's legislative agenda for the coming year. Here is a summary of the relevant proposals:

Retirement Plans

- Require "required minimum distributions" from Roth IRAs
- Require non-spouse beneficiaries to take distributions over 5 years, rather than their life expectancy
- Limit accrual of retirement benefits in traditional IRAs (no more contributions after \$3.4 million in value)
- Prohibit after-tax amounts attributable to basis from being converted from a traditional IRA to a Roth IRA (in other words, the conversion would be permitted only to the extent taxable)

Estate, Gift and GST Taxes

- Return to 2009 exemption amount (\$3.5 million estate and GST tax exemption; \$1 million gift tax exemption)
- Maintain 40 percent tax rate and "portability"
- Impose gift tax on distribution from "intentionally defective grantor trusts" to the extent the distribution is from trust appreciation or income; termination of "grantor trust" status would be deemed a distribution
- Require same valuation for income tax purposes as used for estate, gift and GST tax purposes
- "Grantor retained annuity trusts" ("GRATs")

- Require minimum term of 10 years and maximum term of life expectancy plus 10 years
- Require that the remainder must be at least equal to greater of 25% of contribution or \$500,000
- Prohibit a decrease in the annuity over the GRAT term
- Prohibit income tax free exchanges between grantor and GRAT (no sales or “swaps”)

Other Provisions

- Increase capital gain / qualified dividend rate to 24.2% (28% when including 3.8% net investment income tax)
- Treat gifts and death as a deemed sale for income tax purposes, with certain exemptions
- Enact the “Fair Share Tax,” which would impose a 30% tax rate phased in between \$1 million and \$2 million (less whatever amount is paid in regular tax and alternative minimum tax)
- Tax “carried interest” as ordinary income and subject to self-employment tax

Estate Denied Income Tax Charitable Deduction

In *Belmont v. Commissioner*, 144 TC 6, the Tax Court denied an estate an income tax charitable deduction because funds were not “permanently” set aside for charity. The decedent had owned a condominium in which her brother had resided. After the decedent’s death, the brother asserted that he was entitled to a life estate in the condominium.

The estate engaged in extensive litigation with the decedent’s brother in an effort to evict him. To pay legal fees associated with the litigation, the estate used funds that it had received as a payout of the decedent’s pension fund. The payment of the pension fund constituted “income in respect of a decedent,” but the estate claimed an offsetting income tax deduction because the funds were to pass to charity as the residual beneficiary of the estate. However, because the funds were depleted in litigation, they were not actually available to pass to charity.

The Tax Court held that the litigation was a reasonably foreseeable expense of the estate, which negated the estate’s argument that the pension funds were “permanently” set aside for charity, as required to receive the charitable deduction. Accordingly, the deduction was denied.

Nevada Trust Held Not an “Asset Protection Trust”

In *Dahl v. Dahl*, 2015 UT 23, the Utah Supreme Court held that a trust created by a Utah resident under Nevada law was not an “asset protection trust.” The assets of the trust in question were subject to a divorce proceeding in which the wife argued that the assets should be available to her as marital assets.

The husband had created the trust in 2002 naming himself as settlor and his brother as investment trustee. A Nevada bank served as the “qualified person trustee” for purposes of creating a nexus to Nevada. The trust named the husband, wife, their descendants, and unnamed charities as beneficiaries. The trust was governed by Nevada law and was apparently intended to be a Nevada asset protection trust. The husband transferred 97% of an LLC, which owned the majority of the marital assets, to the trust. The wife co-signed a deed on the couple’s primary residence to the trust. Interestingly, the trust provided that it was “irrevocable,” but that the husband, as settlor, reserved “any power whatsoever to alter or amend any of the terms of provisions” of the trust.

In 2006, the couple filed for divorce. The wife argued that the trust assets were marital property, that the trust was revocable as a matter of law, that she was a “settlor” and that she was entitled to an accounting.

The Utah Supreme Court found in favor of the wife, holding that Utah governing law applied and asserting a strong public policy interest in the equitable division of marital assets. Although the revocation clause appeared to be a scrivener’s error, the court found that the trust was essentially revocable and that the wife had the right to revoke one-half of the trust.

Decanting Denied under New York Law

In *Petition of Johnson*, 2011-2809/B, NYLJ 1202718164118, the New York Surrogate’s Court held that a trust decanting was invalid because the terms of the recipient trust expanded the class of beneficiaries.

The case involved two trusts decanted into a single recipient trust. The recipient trust contained some terms that were materially different from the original trusts. Specifically, (i) the recipient trust did not provide for outright distributions at age 35, whereas the original trusts had; (ii) the recipient trust granted a limited power of appointment in favor of the settlor’s descendants, whereas the original trusts had granted a limited power of appointment in favor of the descendants of the settlor and his then wife; (iii) the “remote contingency” beneficiary in the recipient trust was the settlor’s intestate heirs at law, whereas the original trusts had named other remote contingency beneficiaries.

In determining whether these decantings were proper, the Surrogate’s Court looked to the legislative history of the New York decanting statute. The court reasoned that a later amendment to the decanting statute confirmed an interpretation of the statute that the beneficiaries of the recipient trust must be limited to those beneficiaries of the original trusts. In other words, the class of permissible beneficiaries cannot be broader. Because the appointees under the limited power of appointment and the remote contingency beneficiaries included possible beneficiaries who were not beneficiaries of the original trust, the court invalidated the decantings.

LLC Formalities Need to be Followed

In *GreenHunter Energy, Inc. v Western Ecosystems Tech, Inc.*, 2014 WY 144, 2014 GreenHunter Wind Energy, LLC (“GreenHunter LLC”) entered into a consulting services contract with Western Ecosystems Technology, Inc. (“Western”). Western performed the services pursuant to the contract; however, GreenHunter LLC failed to pay Western for its services. Realizing that GreenHunter LLC had no assets of its own, Western brought an action seeking to pierce GreenHunter LLC’s limited liability veil and hold GreenHunter Energy, Inc. (“GreenHunter Inc.”), the sole member of GreenHunter LLC, liable for the amount due.

The Wyoming Supreme Court held in favor of Western and pierced GreenHunter LLC’s limited liability veil. In reaching its holding, the court found that the determination of whether the veil of an LLC may be pierced focuses on whether the LLC has been operated as a separate entity, or, whether the LLC’s member has instead misused the entity in an inequitable manner to the detriment of its creditors. The court focused primarily on three factors: inadequate capitalization; intermingling of business and finances; and fraud.

With respect to the inadequate capitalization factor, the court noted that GreenHunter LLC owned no assets of its own and often carried a \$0 balance in its operating account. In fact, whenever GreenHunter LLC incurred an expense, GreenHunter Inc. would transfer to GreenHunter LLC only that amount necessary to satisfy such expense. Thus, it is important that an entity maintain sufficient assets to satisfy its ordinary debts as they come due.

With respect to the intermingling of business and finances factor, the court found that the business and finances of GreenHunter LLC and GreenHunter Inc. were intermingled because the same accountants managed the finances of both GreenHunter LLC and GreenHunter Inc.; the two entities had the same business address, and creditors of GreenHunter LLC mailed their invoices to GreenHunter Inc. for processing; GreenHunter LLC did not have any employees independent of GreenHunter Inc.; GreenHunter LLC had no revenue separate from GreenHunter Inc. and all funds were commingled in the sense that GreenHunter Inc. paid all bills of GreenHunter LLC that it decided were to be paid; and GreenHunter LLC’s tax returns were consolidated with the tax returns of GreenHunter Inc. Although this sort of tax consolidation is allowed under federal tax law for a single-member LLC, the court held it was still proper to use it as one of many factors in the analysis. Essentially, the court focused on the idea that GreenHunter Inc. manipulated assets and liabilities in such a way as to reap all the benefits of GreenHunter LLC’s activities while saddling GreenHunter LLC with all of the GreenHunter LLC’s losses and liabilities.

With respect to the fraud factor, the court admitted that the technical elements of fraud could not be shown in that there was no evidence that GreenHunter Inc. or GreenHunter LLC made false statements or made statements that were partially true though misleading. Still, the court asserted that contracting for valuable services knowing that it could not or would not pay for the services constitutes a fraud that should not enjoy protection.

Based on the foregoing, the court found that GreenHunter Inc. had ceased to be a separate entity due to GreenHunter Inc.’s misuse of GreenHunter LLC, and adherence to

the fiction of GreenHunter LLC's separate existence would lead to injustice. Accordingly, the court held that GreenHunter LLC's veil should be pierced to impose liability on GreenHunter Inc. for its debt to Western.

As noted above, *GreenHunter* was decided based upon Wyoming law. Whether a court would apply a similar analysis in determining whether to pierce the limited liability veil of an entity formed in another jurisdiction is unclear. However, *GreenHunter* reaffirms the importance of adhering to LLC formalities.

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:

BOCA RATON

Albert W. Gortz

+1.561.995.4700 — agortz@proskauer.com

George D. Karibjanian

+1.561.995.4780 — gkaribjanian@proskauer.com

David Pratt

+1.561.995.4777 — dpratt@proskauer.com

LOS ANGELES

Mitchell M. Gaswirth

+1.310.284.5693 — mgaswirth@proskauer.com

Andrew M. Katzenstein

+1.310.284.4553 — akatzenstein@proskauer.com

NEW YORK

Henry J. Leibowitz

+1.212.969.3602 — hleibowitz@proskauer.com

Lisa M. Stern

+1.212.969.3968 — lstern@proskauer.com

Philip M. Susswein

+1.212.969.3625 — psusswein@proskauer.com

Jay D. Waxenberg

+1.212.969.3606 — jwaxenberg@proskauer.com

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.

Beijing | Boca Raton | Boston | Chicago | Hong Kong | London | Los Angeles | New Orleans | New York | Newark | Paris
São Paulo | Washington, D.C.

www.proskauer.com

© 2015 PROSKAUER ROSE LLP. All Rights Reserved. Attorney Advertising.