Proskauer

newsletter

Wealth Management Update

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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.

June Interest Rates for GRATs, Sales to Defective Grantor Trusts, Intra-Family Loans and Split Interest Charitable Trusts

The June § 7520 rate for use with estate planning techniques such as CRTs, CLTs, QPRTs and GRATs is 1.8%, which has remained constant since March. The June 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 semiannually) is 1.41%, down from 1.43% in May.

The relatively low § 7520 rate and AFRs continue to present potentially rewarding opportunities to fund GRATs in June with depressed assets that are expected to perform better in the coming years.

The AFRs (based on semiannual compounding) used in connection with intra-family loans are 0.64% for loans with a term of 3 years or less, 1.41% for loans with a term between 3 and 9 years, and 2.23% 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 1.41%, the child will be able to keep any returns over 1.41%. These same rates are used in connection with sales to defective grantor trusts.

The Tax Court held that split-dollar insurance arrangements between the decedent and three dynasty trusts she had created for her sons were taxable under the economic benefit regime in *Estate of Clara M. Morrissette et al. v. Commissioner*, 146 T.C. No. 11; No. 4415-14 (April 13, 2016)

Clara Morrissette had three sons, each of whom was a shareholder in the family's corporation. The family entered a buy-sell agreement under which the parties agreed that upon the death of any of the sons, the other sons and their dynasty trusts would purchase the family stock held by or for the benefit of the deceased son.

To fund the buy-sell agreement, each son's dynasty trust purchased a universal life insurance policy on the life of each other son. Clara's revocable trust entered split-dollar insurance arrangements with the three dynasty trusts and contributed an aggregate of $29.9 million to them to enable the trusts to purchase such policies with a lump sum payment. Under the split-dollar arrangements, Clara's revocable trust was entitled to receive a portion of the death benefit from each policy equal to the greater of the cash surrender value of the policy or the aggregate premium payments on that policy, and each dynasty trust was entitled to the balance of the death benefit under a policy. Each split-dollar arrangements included a representation that the parties intended the agreement to be taxed under the economic benefit regime. The dynasty trusts executed collateral assignments of the policies to Clara's revocable trust to secure their obligations and none of the trusts had the right to borrow against the policies.

The IRS argued that the economic benefit doctrine should not apply to the arrangements because under the terms of the revocable trust, Clara's revocable trust's interest in the policies' cash values would pass to the dynasty trusts or to Clara's sons upon her death. The IRS asserted that such provisions give the dynasty trusts indirect access to the cash surrender value of each policy. The Court rejected this argument noting that (i) Clara could at any time during her lifetime change the terms of her revocable trust; (ii) the split-dollar arrangements did not require the revocable trust to distribute its interest to the dynasty trusts; and (iii) the governing treasury regulations look only to the current or future rights to cash value "under the arrangement" and the provisions of the revocable trust were not part of the split dollar arrangement.

The Court also rejected the IRS's argument that by paying the premiums in a single lump sum, Clara's revocable trust conferred on the dynasty trusts the benefit of current and future insurance protection. The Court noted that such argument would only hold water if the dynasty trusts were obligated under the split-dollar arrangements to pay the premiums.

Because the Court found that the dynasty trusts did not receive an economic benefit beyond that of current life insurance protection, it deemed Clara's revocable trust to be the owner of the policies and the economic benefit regime to apply to the split-dollar arrangements.

The Tax Court prevented taxpayer from using her deceased husband's AMT tax credit carryforward to offset her own individual income tax liability in *Vichich v. Commissioner*, 146 T.C. No. 12; No. 7509-12 (April 21, 2016)

Following the death of her husband, Nadine Vichich attempted to use an AMT credit carryforward that arose from her husband's exercise of incentive stock options before his death.

Because the applicable statue and regulations did not provide a clear answer regarding whether such credits could be transferred to a surviving spouse, and there was no judicial guidance on the issue, the Court looked to general tax principles that apply to deductions to make its decision, noting that (a) the ability to offset one spouse's income with another's losses is only available to spouses who file joint income tax returns; (b) spouses generally cannot inherit or otherwise retain, after a marriage ends, a tax benefit that was originally conferred on the other spouse; and (c) deductions generally are not transferrable on the death of the taxpayer who incurred them.

As a result, the Court held that Nadine was not entitled to use her husband's AMT tax credits to offset her own income tax liability after his death.

The U.S. District Court allowed the government to attach a federal tax lien to a delinquent taxpayer's right to funds in a trust established for him under his deceased mother's Will in *Duckett v. Enomoto et al.*, No. 2:14-cv-01771 (April 18, 2016)

Dennis Enomoto, who is delinquent in paying his federal income taxes, is the beneficiary of a testamentary trust that provides that the Trustees shall pay to Dennis so much or all of the net income and principal of the trust as in the sole discretion of the Trustees may be required for support in Dennis's accustomed manner of living. The IRS sought to attach a tax lien to the trust and to seize all of its assets.

Generally, the government may only impose a tax lien on any "property" or "rights to property" belonging to the taxpayer. The Court looked at the specific language in the trust and the Arizona uniform trust code and concluded that Dennis had a right to the property in his trust because, even though the Trustees had the discretion to determine how much to pay him, the language "shall pay" created an enforceable right to payments, the withholding of which would constitute an abuse of discretion in applying an ascertainable standard.

The Court distinguished the facts of this case from a case where a trust provided that the Trustees may distribute income or principal to a beneficiary and directed that any income not so distributed be accumulated. The Court noted that in such case, it was clear that the Trustee was not obligated to distribute anything to the beneficiary and, therefore, the beneficiary did not have a property right in the trust.

Although the Court held that the IRS could attach a tax lien to the trust, it denied the government's motion for summary judgment for permission to seize all of the trust's assets. The Court noted that Dennis's enforcement right does not by itself justify enforcement of the lien to any specific amount of the trust.

IRS Issues Final Regulations Regarding Program-Related Investments under IRC § 4944

On April 25, 2016, the IRS published final regulations that provide guidance and examples to private foundations engaging in program-related investments. The final regulations add nine new examples to the existing examples illustrating investments that qualify as program-related investments.

Whereas the prior examples were primarily concerned with domestic investments in programs involving economically disadvantaged individuals and deteriorated urban areas, the new examples demonstrate that program-related investments may fund activities in foreign countries as well as investments in organizations undertaking environmental, scientific, or micro-loan programs.

The final regulations made changes to proposed Examples 11, 13 and 15. Notably, in Example 13, which describes a situation in which the business enterprise offers a private foundation common stock as an inducement for the foundation to make a below-market rate loan, the final regulations remove the sentence that stated that the foundation plans to liquidate its stock in the business as soon as the business is profitable or it is established that the business will never become profitable. Despite removing such sentence, the commentary to the final regulations indicates that the IRS believes that establishing an exit strategy at the outset of an investment is an important indication that a foundation's primary purpose in making a program-related investment (and, therefore, a qualifying investment) is furtherance of its charitable purpose.

Florida has adopted the Florida Fiduciary Access to Digital Assets Act

Florida has adopted the Florida Fiduciary Access to Digital Assets Act. The statute provides owners of digital assets the ability to plan for the management and disposition of those assets by specifying whether they will be preserved, distributed to heirs, or destroyed. In addition, the law gives fiduciaries legal authority to manage digital assets and custodians that comply with a fiduciary's apparent authority immunity from liability under the statutes that prohibit unauthorized access to such assets. The law applies to four types of fiduciaries, including: (i) personal representatives of decedents' estates, (ii) guardians of the property of minors or incapacitated persons, (iii) agents who are acting under a power of attorney and (iv) trustees.

The act will be located in the new chapter 740 in the Florida Statutes and will become effective on July 1, 2016.

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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