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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.

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

The July § 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 July 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 1.42%, up slightly from 1.41% in June.

The relatively low § 7520 rate and AFRs continue to present potentially rewarding opportunities to fund GRATs in July 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 0.71% for loans with a term of 3 years or less, 1.42% for loans with a term between 3 and 9 years, and 2.17% 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 1.42%, the child will be able to keep any returns over 1.42%. These same rates are used in connection with sales to defective grantor trusts.

Bankruptcy Court finds that Taxpayer's funds used in complex system of domestic and offshore trusts and other entities used to buy real estate and other assets for his children's use were not taxable gifts in *In re: Wyly*, 115 AFTR 2d 2016-682 (Bankruptcy Ct. Tex. 2016)

Sam Wyly ("Sam") and his brother, Charles, created a complex series of offshore trusts, LLCs along with related domestic trusts and LLCs with an explicit goal of avoiding tax liability. These entities were used to hold substantially all of their assets, including various securities. The brothers were convicted of securities fraud in connection with certain

transactions involving the securities undertaken by the various offshore entities. Judgment was entered against the brothers for over \$180,000,000. Subsequently, the brothers declared bankruptcy and the IRS sought to collect as a creditor for back taxes owed. In dispute in the bankruptcy proceeding were certain interest and penalty issues relating to back income taxes owed by the brothers, as well as certain gift tax issues.

In regards to the gift tax issues, the IRS sought to characterize transactions as gifts where the transactions involved funds in an offshore trust created by Sam being transferred through layers of LLCs and trusts to be held eventually in domestic LLCs controlled by Sam's children. These assets were then used to purchase real estate and other assets for the benefit and use of Sam's children. In order to find that there was a gift made, the court correctly stated that it had to find, among other factors, that Sam had a donative intent in making the transfers and that he gave up all dominion and control over the funds.

The IRS argued that the economic substance doctrine, the substance over form doctrine and the step transaction doctrine should be used to look through the formalities of the transaction and treat the transactions as simply taxable gifts from Sam to his children. Sam's children controlled certain entities and the assets therein and had unfettered use of the assets ultimately purchased, including real estate used as each child's primary residence and vacation home. Therefore, according to the IRS, Sam's children were the donees of taxable gifts from Sam.

According to Sam, however, there was no donative intent in funding the original trust or in transferring funds to the domestic entities that were eventually used to purchase the real estate. Moreover, Sam argued that he never gave up dominion and control over the funds used to purchase the real estate because the real estate was at all times owned by one of the entities he created and retained control over. Sam contended that he controlled the entities by actually directing their actions and legally by retaining the right to hire and fire managers, trustees, board members and other officers.

The court ultimately agreed with Sam and found that there was no taxable gift made through this series of transactions. According to the bankruptcy court, Sam did not have a donative intent in making the transfers. Additionally, the court looked through the various entities and found that Sam was able to remove and replace the trustees, managers and controlling parties of each entity and directed each entity so that he remained in control of the funds and assets involved, including the real estate used by his children.

New Jersey Tax Court denies marital deduction to decedent who died six days before he was scheduled to wed his same-sex partner of thirty-one years in *Rucksapol v. Dir., Div. of Taxation*, N.J. Tax Ct., No. 009356-2015 (May 11, 2016)

The decedent and his partner were in a committed relationship for thirty-one years prior to the decedent's death six days before their scheduled wedding.

The couple had registered as a domestic partnership, a statutory status offered by New Jersey that gave same-sex couples certain benefits and rights. However, this status did not allow the surviving partner to be treated as a surviving spouse for state estate tax purposes. New Jersey later permitted civil unions between same-sex couples, which did treat the surviving partner as a surviving spouse for state estate tax purposes. The

couple did not enter into a civil union. Instead, they decided to make a political statement and wait until same-sex couples had the right to marry under New Jersey law.

Once same-sex couples had the right to marry under New Jersey law, the couple began planning their wedding but did not immediately wed. Same-sex couples only had the right to marry in New Jersey for seven months when the decedent passed. Accordingly, when the decedent died, New Jersey only recognized the couple as a registered domestic partnership.

After a straightforward application of the relevant laws, the New Jersey tax court denied the decedent's estate a marital deduction for any amounts passing to his surviving partner. According to the court, the legal status of the couple did not give the surviving partner the right to be treated as a surviving spouse for state estate tax purposes, especially in light of the couple's choice not to enter into a civil union and not to marry immediately once same-sex couples had the right to do so under New Jersey law.

Attorney who was the court-appointed receiver of a private foundation was removed for making improper distributions in *Matter of Kermit Gitenstein Foundation*, 357003A, NYLJ 1202758893277 (N.Y. Surr. Ct. Nassau Co., decided May 26, 2016)

A private foundation was established in 1967 and eventually operated by the founder's niece until the niece's death in 2007. There were no other directors or officers of the foundation at the time of the niece's death and, therefore, the Surrogate's Court had to supervise the foundation and appointed an attorney to operate the foundation as a receiver.

The receiver appeared to have taken all necessary and appropriate steps in managing the foundation – he marshaled the assets, petitioned the court for approval before making any distributions, and indicated how all of the distributed funds were being used. Following this pattern, the receiver made about \$3,000,000 of distributions over three years.

Eventually, however, the court ordered the receiver to account for his actions as receiver. In the accounting it became clear that the receiver made additional distributions from the Foundation of over \$7,000,000. The court and the attorney general were unaware of these additional distributions. Additionally, the court found that the receiver gave control over the decision to make some of the distributions to clients and that certain distributions were made to organizations that he, his law firm, his family and his clients may have been interested in. Noting also that some of the distributions did not align with the foundation's corporate purposes or its history of distributions, the court removed the receiver in a harsh rebuke of his actions.

FinCEN issues final Customer Due Diligence Regulations requiring financial institutions to gather additional information about certain entities

Financial Crimes Enforcement Network (FinCEN) issued final regulations requiring financial institutions to gather information on the identity of the beneficial owners of, and an individual who controls certain types of, legal entities when opening entity bank accounts. These regulations were passed in light of the concerns raised by the Panama Papers and to fight terrorist financing. Notably, trusts are not included as such entities

from which information has to be gathered. Other entities, such as LLCs and FLPs will be looked through to their beneficial owners and financial institutions will be required to gather information on all beneficial owners of these entities.

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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