Proskauer

newsletter

Edited by **Henry J. Leibowitz**
Contributor: **Catrina A. Crowe**

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.

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

The October Section 7520 rate for use with estate planning techniques such as CRTs, CLTs, QPRTs and GRATs is 1.6%, up 0.2% from September. The October 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 1.29%, up 0.7% from September.

The relatively low Section 7520 rate and AFR continue to present potentially rewarding opportunities to fund GRATs in October 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 0.66% for loans with a term of 3 years or less, 1.29% for loans with a term between 3 and 9 years, and 1.95% 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 1.29%, the child will be able to keep any returns over 1.29%. These same rates are used in connection with sales to defective grantor trusts.

IRS Announces “Self-Certification” Procedure for Taxpayers to Rollover IRAs, even after Deadline has Passed (Revenue Procedure 2016-47 (August 2016))

The IRS has developed a “self-certification” procedure by which a taxpayer can complete a rollover of an IRA even if they missed the original sixty-day deadline. Prior to issuance of Rev. Proc. 2016-47, a taxpayer who missed the sixty-day deadline under Sections 402(c)(3) or 408(d)(3) had to request a Private Letter Ruling to obtain waiver of the deadline, and such waiver was only available under certain circumstances discussed in Rev. Proc. 2003-16. Under Rev. Proc. 2016-47, the taxpayer can “self-certify” to plan administrators that they are eligible for the waiver if the following requirements are met: (1) Taxpayer has not previously been denied a waiver for this rollover; (2) Taxpayer was unable to complete the rollover within the sixty-day period for due to certain circumstances (including an error by the financial institution, death or illness of the Taxpayer’s family members or incarceration) and (3) the rollover must be completed “as soon as practicable” after the reason that prevented Taxpayer from complying with the deadline has been resolved.

The plan administrator may rely on the self-certification to determine whether the conditions for a waiver of the 60-day deadline have been met as long as they do not know that the information in the self-certification is false. The self-certification is not a waiver by the IRS. If your income tax returns are audited and the IRS later determines the rollover did not meet the requirements for the waiver, or that the self-certification was false, the taxpayer may be subject to interest and penalties on the income tax associated with the distribution if it had not been eligible for the rollover.

Reformation of an Irrevocable Trust to Correct Drafting Mistakes Did Not Result in Taxpayer Having (or Releasing) a General Power of Appointment (Private Letter Ruling 201634015 (August 19, 2016))

The IRS issued a ruling indicating that the judicial reformation of an irrevocable trust to correct drafting mistake would not result in the taxpayer having (or releasing) a general power of appointment. Settlors created an irrevocable trust for their son. The trust provided that distributions may be made to son for “support, maintenance, health, education or other needs” and that if the trustees deem the trust to be uneconomical, they can terminate it and distribute the proceeds to son or his descendants. The son has the power to remove and replace trustees at age 40 (which he has not yet attained). The trust contains a testamentary power of appointment exercisable by son in favor of his son and surviving issue. The trust goes on to say that “in the event or to the extent that the beneficiary fails to validly exercise the foregoing *general* testamentary power of appointment, the property shall pass to his surviving children…”

The Settlors petitioned the court to reform the trust based on scrivener’s errors, mainly that son does not have a general power of appointment as defined in Section 2041(b)(1) and that it is against their intent, which was to have the trust not be subject to transfer tax upon son’s death. The Court issued an order that only an independent trustee may make discretionary distributions to son or to terminate the trust. Further, the word “general” was deleted from the relevant provision in the trust. The taxpayers asked the IRS for the following rulings: (1) As a result of the judicial reformation, son never possessed and will not possess a GPOA which would cause the assets to be includible in his gross estate under Section 2041; and (2) as a result of the judicial reformation, son not treated as having released a general power of appointment for federal gift and estate tax purposes under Sections 2514(b) or 2041(a)(2). The IRS ruled that because it was a mistake in drafting (and the instrument does not contain the terms intended by the settlor) and the parties were entitled to ask the court for reformation, and the order modifying the trust was consistent with the applicable state law, as it would be applied by the state's highest court, the son never possessed a general power of appointment and, therefore, would not be treated as having released a general power of appointment.

Certain Trust Modifications did not result in Loss of Grandfathered GST Exempt Status and Trust Assets were not Includible in Taxpayer's Gross Estate (Private Letter Ruling 201634016 (August 19, 2016))

The Grantor created an irrevocable trust for taxpayer and taxpayer's issue prior to September 25, 1985, so the trust was grandfathered for generation-skipping transfer ("GST") purposes. The taxpayer petitioned the state court to modify the trust to provide that (1) each co-trustee has power to appoint successor or co-trustees (and revoke such appointment before it becomes effective), (2) taxpayer may remove trustee but only if they replace with an independent trustee, and (3) taxpayer can transfer the power to remove and replace to any of his or her issue; and also to modify the distribution standards so that a beneficiary, as sole trustee, can make distributions for his or her health, education, maintenance and support ("HEMS"), and only an independent trustee can make other discretionary distributions. The court approved the modification, contingent on the following rulings: (1) the modification will not shift the beneficial interest in the trust to a beneficiary occupying a lower generation than the person holding the interest under the original trust; and (2) the modification will not extend the time for vesting beyond the perpetuities period of the original trust. The IRS ruled that the modifications would not shift beneficial interest or extend the time for vesting because the modifications met the "trust modification safe harbor" of the regulations to Section 2601.

First Circuit Rules that Executors May be Personally Liable for Decedent's Unpaid Taxes Where Executor Distributes Property and Knows of the Tax Deficiency (*U.S. v. McNicol*, 118 AFTR 2d 2016-5150 (CA1 2016, decided July 15, 2016))

The First Circuit ruled that an executor was liable for unpaid federal income tax when she distributed property from an insolvent estate and had prior knowledge of the tax deficiencies. The decedent owed $340,000 in unpaid federal income tax, which would have left his estate insolvent. Decedent's assets consisted of a 100% interest in one corporation and a 50% interest in another. His wife was the executor. Right after he died and before she was appointed executor, she transferred the 100% interest to herself. About six months later, she was appointed executor and then transferred the other 50% interest to herself.

Section 3713(a)(1)(B) provides that a claim of the U.S. government shall be paid first when an estate is insolvent (it has priority over any other claims). If the executors fail to honor that priority, they become personally liable for the deficiency under Section 3713(b) if three requirements are met: (1) they transfer assets before paying the government's claim; (2) the estate is insolvent; and (3) they had knowledge of the liability.

Here, the wife tried to argue that it should not apply to the stock transferred before she was appointed executor since a strict reading of the statute found it applied to "a representative of the person or an estate…" The court said that whether she had actually been appointed executor at the time was irrelevant because the assets were under her control at the time they were transferred.

New York Amends its Civil Practice Laws and Rules to Protect Attorney-Client Privilege in Preparation of Revocable Trusts (NYCPLR Section 4503(b)) (effective as of August 19, 2016)

Section 4503 of the NY civil practice law and rules protects the attorney-client privilege as it relates to communications over the preparation of wills. Specifically, Section 4503(b) provides that in any action involving the probate, validity or construction of a will, an attorney or his employee shall be required to disclose information as to the preparation, execution or revocation of any will or relevant instrument, but he shall not be allowed to disclose any communication privileged under subdivision (a) which would tend to disgrace the memory of the decedent.

While Section 4503(b) unquestionably applies in probate contests, there is no similar statutory exception for contests concerning revocable trusts. The question of whether a revocable trust is a "relevant instrument" (and therefor the exception should apply) has come up in several cases.

This amendment provides that the same attorney-client privilege guaranteed for the probate or construction of a will also extends to revocable trusts.

IRS Issues Final Regulations to Define Terms Related to Marital Status as a Result of Recent Supreme Court Decisions (T.D. 9785)

The IRS has issued final regulations that reflect the holdings of *Obergefell v. Hodges*, 135 S. Ct. 2584 (2015), *Windsor v. U.S.*, 133 S. Ct. 2675 (2013) and Rev. Rul. 2013-17, to define terms in the Internal Revenue Code describing the marital status of taxpayers for federal tax purposes.

Treas. Reg. Section 301.7701-18 has been amended to provide that for federal tax purposes, the terms spouse, husband and wife mean an individual lawfully married to another individual. A marriage of two individuals is recognized for federal tax purposes if the marriage is recognized by the state, possession or territory of the United States in which the marriage is entered into, regardless of domicile.

To discuss any aspects of these cases or associated tax implications, please contact one of the attorneys in the Private Client Services Department at Proskauer.

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.

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

WASHINGTON, D.C.

Scott A. Bowman
+1.202.416.5860 — sbowman@proskauer.com

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

www.proskauer.com