Proskauer

newsletter

Wealth Management Update

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in this issue

A monthly report for wealth management professionals.

Edited by **Henry J. Leibowitz**
Contributor: **Daniel W. Hatten**

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.

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

The August § 7520 rate for use with estate planning techniques such as CRTs, CLTs, QPRTs and GRATs is 2.4%, up slightly from 2.2% in July. The August 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 1.94%, up slightly from 1.88% in July.

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 1.29% for loans with a term of 3 years or less, 1.94% for loans with a term between 3 and 9 years, and 2.56% 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 1.94%, the child will be able to keep any returns over 1.94%. These same rates are used in connection with sales to defective grantor trusts.

Tax Court finds that assets transferred during life in exchange for a limited partnership interest were includible in the decedent's estate after the decedent, through her attorney-in-fact, engaged in "aggressive death bed tax planning" in *Powell v. Commissioner*, 148 T.C. No. 18 (May 18, 2017)

Nancy Powell was terminally ill when her son, using a California power of attorney, undertook "aggressive deathbed tax planning" that began by creating a limited partnership. As Ms. Powell's attorney-in-fact, her son then contributed almost all of her assets ($10 million in liquid assets) to the limited partnership in exchange for a 99%

limited partnership interest. In his individual capacity, the son, along with his brother, contributed an unsecured promissory note to the limited partnership in exchange for a 1% general partnership interest. The partnership agreement gave the general partners absolute discretion regarding distributions and investment, but allowed for the partnership to be dissolved upon the consent of all the partners (including the limited partner). Lastly, as Ms. Powell's attorney-in-fact, her son contributed Ms. Powell's 99% limited partnership interest to a charitable lead annuity trust ("CLAT") that would pay the remainder to himself and his brother in their individual capacities. Ms. Powell died a week after her son undertook the steps in this transaction.

Ms. Powell's son was also her executor and filed the relevant gift tax return to report the transaction. On Ms. Powell's gift tax return, the transfer to the CLAT was reported but the value of the gift was reported with a 25% discount for lack of control and lack of marketability. Ms. Powell's estate tax return did not include the value of the limited partnership interest or the securities transferred to the limited partnership.

The IRS issued an assessment, arguing that the assets transferred were includable in the decedent's estate under IRC § 2036(a)(2) and IRC § 2035. Specifically, the IRS argued that the transfer from Ms. Powell to the limited partnership was includible under IRC § 2036(a)(2) because under the terms of the partnership agreement, which required unanimous consent of the partners to dissolve the partnership, Ms. Powell effectively retained the ability to designate who could possess or enjoy the property or its income. This, despite the partnership agreement providing explicitly that the general partners had sole discretion regarding distributions. The IRS also argued that Ms. Powell effectively retained control over the limited partnership via her son, who was the general partner individually and had a fiduciary duty as her power of attorney. Accordingly, the IRS stated that the son's powers over distributions should be attributed to Ms. Powell.

The tax court agreed with these arguments fully and found that the family nature of the fiduciary duties held by the son made Ms. Powell's interest in the limited partnership includible under IRC § 2036(a)(2). The tax court also agreed that any power to be involved in a distribution or dissolution decision, even if allowed by state law, would subject an interest in a limited partnership to inclusion under IRC § 2036(a)(2). Alternatively, the tax court found that the value of the assets transferred were includible under IRC § 2035 as a transfer within three years of death. Further, the tax court, without briefing from any parties, noted that if such a transfer were to occur in another case where there was appreciation on the transferred assets, the appreciation may be subject to double taxation in the decedent's estate under IRC § 2036(a)(2) and as an interest in a partnership or other entity under IRC § 2033.

New York Administrative Law Judge sides with taxpayer to find that he was not a New York domiciliary or resident upon moving" to France despite retaining a New York City apartment and spending more than 183 days in New York in *Matter of Patrick*, DTA 826838, N.Y. Div. Tax App. (June 15, 2017)

A New York Administrative Law Judge ruled in favor of a taxpayer on the issue of whether he was a New York domiciliary or otherwise a statutory resident of New York for income tax.

New York subjects New York domiciliaries and New York statutory residents to its state income taxes. Whether one is a New York domiciliary is largely based on intent, whereas a statutory resident is based on an objective test that subjects a taxpayer to New York income tax if he or she has a permanent place of abode in New York and spends more than 183 days in the state (subject to certain exceptions).

The taxpayer in Patrick rented or owned a New York apartment from 2008 through the end of 2012. He was concededly a New York domiciliary from 2008 through March of 2011. However, on March 2, 2011 he left his high-paying executive job and flew to Paris to be with his second wife, who was his high school sweetheart that he had reconnected with on Facebook upon becoming very sick in 2008.

The Administrative Law Judge held that even though the taxpayer owned an apartment in New York City for the relevant tax periods (2011 and 2012), had his bills addressed to that apartment and spent more than 183 days in New York, including staying at the apartment, the taxpayer was not a New York domiciliary or statutory resident. This holding was based on the day count being reduced due to some of the days being related to treatments for a serious illness and recovery, the taxpayer having no family, friends or "near and dear items" in New York and the circumstances of his move to Paris to be with his second wife. Additionally, the Administrative Law Judge, citing the fact that the taxpayer immediately applied to be a French resident and paid taxes as a French resident, concluded that the taxpayer was a French domiciliary as of March 2, 2011 and not otherwise subject to New York's income tax on statutory residents.

Florida's Governor vetoes The Florida Electronic Wills Act

The Florida Congress passed the Florida Electronic Wills Act on May 5, 2017, which would have made Florida only the second jurisdiction (after Nevada) to legalize the use of electronic Wills. The bill would have allowed individuals to sign, witness and otherwise fulfill the requirements for executing a Will while in different locations through the use of video conferencing and other technology.

On June 26, 2017, Governor Scott vetoed the Florida Electronic Wills Act citing (a) his "responsibility to ensure that notaries safeguard the most vulnerable Floridians against fraud and exploitation," (b) the potential increased burden on Florida courts through the bill's provisions that would have allowed any electronic will executed in accordance with the bill to be probated in a Florida court, whether or not the testator was a Florida domiciliary, and (c) the unfinished nature of the bill's provisions regarding remote witnessing, remote notarization and non-domiciliary venue rules.

Delaware enacts law to sunset state estate tax

On July 2, 2017, Governor Carney of Delaware signed a bill that would sunset Delaware's state estate tax as of December 31, 2017. Before the sunset provision of this bill takes effect, Delaware taxes estates at a rate of 16%, the second highest in the country. With the passage of this law, Delaware joins the growing list of states that have recently repealed their state estate taxes, including Tennessee in 2016 and New Jersey, effective January 1, 2018.

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

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

Stephanie E. Heilborn
+1.212.969.3679 — sheilborn@proskauer.com

Henry J. Leibowitz
+1.212.969.3602 — hleibowitz@proskauer.com

Vanessa L. Maczko
+1.212.969.3408 — vmaczko@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