Proskauer

Wealth Management Update

August 2015

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 2.2%, the same as 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 annually) is 1.82%, up .05% from July.

Lower rates work best with GRATs, CLTs, sales to defective grantor trusts, private annuities, SCINs and intra-family loans. Based on recent statements by Janet Yellen, it appears likely that the Federal Reserve will reduce its bond purchasing policy and take other measures to increase interest rates toward the end of 2015. The current AFR, which is well below its historical average, presents a potentially rewarding opportunity to fund GRATs and sell assets to grantor trusts. In addition, current legislative proposals would significantly curtail short-term and zeroed-out GRATs. To lock in current interest rates and potentially avoid the impact of any new GRAT legislation, GRATs should be funded, and sales to grantor trusts should be consummated, as soon as possible.

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 0.48% for loans with a term of 3 years or less, 1.82% for loans with a term between 3 and 9 years, and 2.82% 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 1.82%, the child will be able to keep any returns over 1.82%. These same rates are used in connection with sales to defective grantor trusts.

Florida 5th District Court of Appeals determines Trustee's payment of trust corpus to a pooled trust fund was impermissible. *Harrell v. Badger*, Case Nos. 5D14-1145, 5D14-3469 (Fla. 5th DCA 2015).

The Florida 5th District Court of Appeals reversed a state trial court and found a decanting done by the Trustee impermissible because the qualified beneficiaries (in this case, the presumptive remaindermen) were not given 60 days' notice of the decanting pursuant to Fla. Stat. Sec. 736.04117(4) and the decanting had the effect of adding remainder beneficiaries to the original class in violation of Fla. Stat. Sec. 736.04117(1)(a)1. The court also found that an attorney's purported failure to alert the Trustee to his duty to notify beneficiaries did not absolve the Trustee from liability because the Trustee's misconduct resulted from his failure to comply with clear and unambiguous statutory requirements. Lastly, the court found that the trial court had abused its discretion in awarding $85,000 in legal fees to the Trustee.

Delaware Chancery Court denies a petition to modify a testamentary trust to include directed trustee provisions because the modification would circumvent testamentary intent. *In re Trust u/w/o Wallace B. Flint f/b/o Katherine F. Shadek* (DE Chancery June 17, 2015).

The Delaware Chancery Court denied the petition of the beneficiaries of a testamentary trust to modify the terms of the trust to include: (1) provisions appointing an investment advisor to direct the Trustees as to the investment of trust assets and (2) a choice of law provision that would cause the trust to adopt New York law in certain instances and Delaware law in other instances. The court determined that the terms of the trust under the original Will made clear that the intent of the Testator was to ensure that the beneficiaries would be unable to control the assets held in the trust corpus. Under the restated trust terms, the beneficiaries would have had excessive control because a remainder beneficiary was appointed as an investment advisor and the beneficiaries were granted the power to remove and replace the investment advisor. In addition, the court found that the broadened fiduciary indemnification provisions included in the restated trust terms would be contrary to testamentary intent. The court criticized the restated trust terms as "a new will and testament, written for [the Testator] by [a beneficiary's] current lawyers, eighty-one years after his death." Lastly, the choice of law provision was too vague and uncertain to be implemented.

Tax Court rules that private placement insurance policies should be disregarded and that all income and gains earned within the policies are currently taxable to the owner of the policies. *Webber v. Comm'r*, 144 T.C. 17 (T.C. July 2015).

The Tax Court sided with the Internal Revenue Service in determining that the taxpayer had exercised excessive control over private placement insurance policies held by a grantor trust as to him and that income earned within investment accounts associated with the policies was taxable to him. The taxpayer had provided extensive (though non-binding) investment advice, through his accountant and lawyer, to the investment manager of separate investment accounts associated with the policies. The investment manager invested almost entirely in start-up companies in which the taxpayer had invested capital of his own, and these deals would have been inaccessible without the involvement of the taxpayer. Many deals were negotiated directly between the taxpayer and the start-ups and then handed over to the investment manager (through the taxpayer's accountant or lawyer). The investment manager always followed the taxpayer's advice and produced no records of independent diligence or investment analysis. Accordingly, the court held that the investor control doctrine applied to treat the insurance policies as if they were owned, for income tax purposes, by the taxpayer.

Updated Portability Regulations Applicable to Estates after June 12, 2015. T.D. 9725

"Portability," which came into effect under the American Taxpayer Relief Act of 2012, allows the estate of a surviving spouse to utilize a predeceased spouse's unused applicable exclusion amount (the "Deceased Spousal Unused Exemption Amount" or "DSUEA"), if certain conditions are met. On June 12, 2015, the IRS passed final portability regulations. Major changes from the previously existing temporary regulations on the subject include clarifications that: (1) IRC Section 9100 relief is available to make a late portability election for estates of predeceased spouses falling below the filing threshold but not for those falling above the threshold; (2) if an executor files a complete and properly prepared estate tax return and the DSUEA changes due to a later-allowed deduction, the augmented DSUEA may be applied to the surviving spouse's estate; (3) the simplified "good faith estimate of value" filing is still permitted for estates below the filing threshold and the estimate will not be used as a basis for income tax valuation under IRC Section 1014; and (4) DSUEA is to be computed without regard to the credits for gift tax on pre-1977 gifts, the prior transfer credit and the foreign tax credit (in effect these credits are wasted if a Credit Shelter Trust is not employed).

The final regulations offered no new guidance on: (1) the definition of "executor" for the purposes of making the election at the death of the first spouse to die; (2) the materiality of omissions or misstatements for the purpose of determining whether a return is "complete and properly prepared"; (3) the creation of an abbreviated short portability election form; and (4) the integration of the rules pertaining to when a QTIP election will be disregarded under Rev. Proc. 2001-38 when a DSUEA election is made.

IRS To No Longer Automatically Issue Estate Tax Closing Letters

It previously had been the practice of the IRS to issue a closing letter notifying the Executor of an estate that the Federal estate tax return ("706") had been accepted as filed (i.e., it was not being audited). The IRS has updated Frequently Asked Questions on its website and announced that, for estates with 706s filed after June 1, 2015, it will not automatically issue closing letters. For estates with 706s filed between January 1, 2015 and June 1, 2015, the IRS generally will issue closing letters automatically for properly filed returns without errors. For estates with 706s filed during this period having less than the exemption amount and for which a portability election is rejected by the IRS, a closing letter will not be sent. Going forward, the IRS advises that letters requesting closing letters should be sent more than 4 months after the filing of the 706.

To discuss any aspect of these developments or associated tax implications, please contact one of the lawyers in the Personal Planning Department at Proskauer.

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