Proskauer

Wealth Management Update

July 2018

July Interest Rates for GRATs, Sales to Defective Grantor Trusts, Intra-family Loans and Split Interest Charitable Trusts (Rev. Rul. 2018-16)

The July § 7520 rate for use with estate planning techniques such as CRTs, CLTs, QPRTs and GRATs held steady at 3.4%, which is the same as the June 2018 § 7520 rate. 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 2.85%, up slightly from 2.84% in June.

The still 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 2.37% for loans with a term of 3 years or less, 2.85% for loans with a term between 3 and 9 years, and 3.04% 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 2.85%, the child will be able to keep any returns over 2.85%. These same rates are used in connection with sales to defective grantor trusts.

IRS Publishes Section 6621 Interest Rates for 3rd Quarter 2018 (Rev. Rul. 2018-18)

Interest rates for the quarter beginning July 1 will remain unchanged at 5 percent (5%) for overpayments by individuals, 4 percent (4%) for overpayments by corporations, 5 percent (5%) for underpayments by individuals, 7 percent (7%) for large corporate underpayments, and 2.5 percent (2.5%) for corporate overpayments exceeding $10,000.

IRS Announces Intention to Enact Regulations Disallowing State-level Workarounds for Eliminated SALT Deduction (Notice 2018-54)

The IRS formally announced that it intends to propose regulations that address the federal income tax treatment of certain payments made by taxpayers for which taxpayers receive a credit against their state and local taxes. The Notice states, in pertinent part:

"In response to this new limitation [the $10,000 SALT deduction cap], some state legislatures are considering or have adopted legislative proposals that would allow taxpayers to make transfers to funds controlled by state or local governments, or other transferees specified by the state, in exchange for credits against the state or local taxes that the taxpayer is required to pay. The aim of these proposals is to allow taxpayers to characterize such transfers as fully deductible charitable contributions for federal income tax purposes, while using the same transfers to satisfy state or local tax liabilities. . . .

The proposed regulations will make clear that the requirements of the Internal Revenue Code, informed by substance-over-form principles, govern the federal income tax treatment of such transfers. The proposed regulations will assist taxpayers in understanding the relationship between the federal charitable contribution deduction and the new statutory limitation on the deduction for state and local tax payments."

Tax Court Holds that Distributions from Invalidated IRA is Nontaxable (*Marks v. Commissioner*, T.C. Memo 2018-49)

The Tax Court held that deemed distributions of two promissory notes from an IRA were not income because the IRA was disqualified a decade prior to the distributions for impermissible loans. In 2005, Petitioner's IRA lent $40,000 to Petitioner's father in exchange for a promissory note. In 2012, Petitioner's IRA lent $60,000 to Petitioner's friend in exchange for a promissory note. In 2013, the Petitioner opened a new IRA account and attempted to roll over the assets of her old IRA to the new account. The Petitioner did not report that she had received a taxable distribution from her old IRA on her 2013 income tax return. The IRS argued that the two notes were not successfully rolled over to the new IRA and thus includable in the Petitioner's income for 2013. The Court held that the Petitioner's old IRA engaged in a prohibited transaction under IRC § 408(d)(3)(A) when it made the $40,000 loan to Petitioner's father in 2005 and thus ceased to be an IRA. Thus, the Petitioner's 2013 income could not include a taxable distribution from her old IRA account because that account was not an IRA in 2013.

9th Circuit Upholds Tax Court Decision that Marriage Settlement Agreement Payments are Alimony under I.R.C. § 71(b) (*Leslie v. Commissioner*, 9th Cir. Case No. 17-70450)

In an unpublished opinion, the 9th Circuit upheld a Tax Court decision that certain payments received by the petitioner pursuant to a marriage settlement agreement were alimony under IRC § 71(b). Petitioner argued that such payments should have been treated as a lump-sum payment under § 1041(a) (and thus not subject to federal income tax). The court analyzed the petitioner's argument under § 71(b) and held that (i) the petitioner's marriage settlement agreement was a "separate instrument" (§ 71(b)(1)(B)), (ii) the petitioner and her ex-spouse were "not members of the same household" at the time the payments were made (§ 71(b)(1)(C)), (iii) by operation of California law, the liability to make payments would have ended upon the petitioner's ex-spouse's death (§ 71(b)(1)(D)). Thus, the court held that under the statute's plain meaning, such payments were properly categorized as alimony.

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