Wealth Management Update

April 2019

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

The April § 7520 rate for use with estate planning techniques such as CRTs, CLTs, QPRTs and GRATs is 3.0%, which is a decrease from the March rate of 3.2%. The April 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 to 9 years (the mid-term rate, compounded semiannually) is 2.53%, down slightly from 2.57% in March.

The still relatively low § 7520 rate and AFRs continue to present potentially rewarding opportunities to fund GRATs in April 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 2.50% for loans with a term of 3 years or less, 2.53% for loans with a term between 3 and 9 years, and 2.87% 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 2.53%, the child will be able to keep any returns over 2.53%. These same rates are used in connection with sales to defective grantor trusts.

Florida Appellate Court Holds that "Strict Compliance with Signature Requirements" is Necessary for Execution of Will. *Bitetzakis v. Bitetzakis*, No. 2D17-4822, 2019 WL 405568 at *1 (Fla. Dist. Ct. App. Feb. 1, 2019).

A Florida individual sought to "execute" a Will at his home, by signing in the presence of two witnesses. The two witnesses signed the document and the testator began to sign but was stopped mid-signature by his wife who erroneously believed that a notary public had to be present at the execution. The next day, the testator brought a self-proving affidavit to a notary, who notarized the affidavit, and at all times, the testator believed that he executed his Will. Upon his death, the Will was probated and the testator's daughter challenged the grant of probate claiming that the Will was improperly executed.

In its decision, the Appellate Court noted that there was no dispute regarding the testator's intent to execute his Will. However, the court ultimately found that execution of a Florida Will required "strict compliance with the signature requirements" under Florida law, including that the Will had to be signed at the end of the document in the presence of two witnesses. Here, the self-proving affidavit was improperly executed and irrelevant except to show intent. Nonetheless, the testator's signature of his first name on the Will was less than his "full customary signature" and therefore was an invalid signature for purposes of executing a Will under the Florida statute.

U.S. District Court Holds that No Discount is Allowed for Restriction on Transfer of Stock Where Taxpayer Provided No Evidence that Restriction Would be in Arms' Length Transaction. *Kress v. United States*, 123 AFTR 2d 2019-XXXX (E.D. Wis.) (March 26, 2019).

Taxpayers owned interests in a closely-held operating company and gifted interests to trusts for their children. The company's bylaws included a provision that effectively restricted the transfer of stock to only descendants of the company's founders or spouses of such descendants. In making the gifts to their children, the taxpayers' took a valuation discount. The taxpayers' discount was largely upheld by the court, except with respect to the portion of the valuation that discounted the transferred stock based on the restrictions in the bylaws.

The court discussed Section 2703(a) of the Code, which provides that restrictions on the sale of stock shall generally be disregarded for purposes of valuing such stock for transfer tax purposes. The court also discussed the exception to this general rule under Section 2703(b). Under the exception, a discount may be applied if it is (1) a bona fide business arrangement, (2) not a device to transfer property to members of the decedent's family for less than full and adequate consideration and (3) the terms are comparable to similar arrangements entered into by persons in an arms' length transaction.

In determining whether the exception applied, the court found that the first two prongs were satisfied or otherwise inapplicable by the nature of the transfer, but that the third prong was not met because the taxpayers' valuation failed to provide evidence that the restriction might be found in arms' length transactions. Without this evidence, the court determined that the exception did not apply. Instead the discount relating to the restriction on the transfer of stock was to be disregarded under the general rule of 2703(a) of the Code.

IRS Rules that the Creation and Funding of an "ING" Trust Effectively Was a Non-Grantor Trust for Income Tax Purposes and an Incomplete Gift for Gift Tax Purposes. PLR 201908006

The Grantor created a trust of which the Grantor, his son and four unrelated individuals were lifetime beneficiaries in an effort to create an incomplete-gift non-grantor trust. The IRS confirmed that the Grantor's intent was carried out and ruled that the trust was a non-grantor trust for income tax purposes even when the Grantor was a permissible beneficiary of the trust. Moreover, the IRS ruled that contributions to the trust were incomplete gifts because the Grantor retained dominion and control over the assets.

The trust's terms prohibited the Trustee from making distributions except based on a power of appointment executed by the Grantor or by a "Power of Appointment Committee" made up of all the current beneficiaries. The Grantor's power of appointment during his lifetime allowed him to appoint the assets to one or more beneficiaries (other than himself, his estate, his creditors or his estate's creditors) pursuant to an ascertainable standard. The Power of Appointment Committee had two options with respect to appointing property. First, the Committee, by majority, could appoint property for any reason to any beneficiary with the Grantor's consent. Second, the Committee, unanimously, could appoint property for any reason to any beneficiary without the Grantor's consent. The trust also granted the Grantor a testamentary limited power of appointment.

The IRS concluded that the Grantor's retained powers did not make the trust a grantor trust under Subchapter J of the Code because his control over the trust property was subject to an ascertainable standard in accordance with Section 674(b)(5) of the Code and he could not vest any trust property in himself without the approval of parties with substantial adverse interests.

Moreover, the IRS ruled that the funding of the trust was an incomplete gift because the Grantor retained dominion and control over the trust property for gift tax purposes by virtue of (a) his lifetime power of appointment subject to an ascertainable standard, (b) his consent power of the Committee's appointment of trust property and (c) his testamentary power of appointment over the remainder interests.

IRS Finds that a Sale Between Former Spouses More than Six Years After a Divorce is a Transfer Incident to Divorce for Income Tax Purposes and a Transfer for Full and Adequate Consideration for Gift Tax Purposes. PLR 201901003.

The parties entered into a divorce more than six years prior to the transfer at issue. In the divorce, the parties entered into a valid settlement that was approved by the applicable state court. The settlement provided that the parties would own equal interests in a particular piece of real property, and that if either party wanted to sell his or her interest, the other party would have an option to purchase said interest in the real property. In this case, Spouse A purchased Spouse B's interest for one-half of the property's appraised value, less one-half of the difference in costs paid by Spouse A during the parties' co-ownership. Due to certain disputes relating to the sale, Spouse A also petitioned the applicable state court to ensure that the purchase complied with the original settlement agreement. The state court agreed and approved a revised settlement.

Generally, under Section 1041 of the Code there is no gain or loss recognized on a transfer of property from an individual to a spouse or a former spouse if the transfer is incident to divorce. Effectively this defers the tax consequences until the transferee disposes of the property. The transfer, however, must occur within six years from the date that the marriage ceases and be in accordance with the terms of a valid divorce or separation agreement. The presumption that the transfer is not incident to divorce if the transfer occurs more than six years after the divorce may be rebutted if it is shown that the transfer was made to effect the division of property owned by former spouses at the time of the marriage.

According to the IRS, the transfer between Spouse A and Spouse B was to effect the division of property owned by the parties during their marriage and subject to the original settlement agreement. The revised settlement was deemed a modification of the original settlement and therefore its terms carried out the original division of property.

Additionally, a transfer between spouses or former spouses is deemed to be for full and adequate consideration for gift tax purposes under Section 2516 of the Code if a husband and wife enter into a written agreement relative to their property rights and the divorce occurs within a three-year period beginning on the date one year before the agreement is entered into. Here, the transfer between Spouse A and B was entered into in accordance with the revised settlement agreement, which was deemed to effectuate the original agreement. Thus, the transfer was made pursuant to the original agreement which was deemed to comply with the time limit of Section 2516 of the Code and was therefore a transfer for full and adequate consideration for gift tax purposes.

NY State Legislature Enacts Various Tax Changes in Approving New Budget

Governor Cuomo and the New York legislature agreed to a budget deal on March 31, 2019 that, in relevant part, enacts various tax changes. In particular, the "mansion tax" on sales of homes in Manhattan is amended by the new budget. Previously, the mansion tax imposed a 1% tax on purchases of homes over $1 million. Now, the mansion tax will increase until it is capped at 3.9% on purchases of homes that are $25 million or above. The New York state residential transfer tax is also increased from $4.00 per $1,000 to $6.50 per $1,000, based on the sale price. Both of these amendments go into effect as of July 1, 2019, but do not apply to contracts signed before April 1, 2019, regardless of when closing occurs.

The budget deal also re-approves the three-year clawback for taxable gifts made by New York state decedents that included the value of those gifts in the decedent's New York taxable estate. Accordingly, gifts of New York property made at any time by a New York decedent whose date of death was on or after January 1, 2019 remain subject to being brought back into the decedent's New York taxable estate unless the gifts were made between January 1, 2019 and January 15, 2019.

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