Proskauer

Wealth Management Update

August 2019

August 2019 Interest Rates for GRATs, Sales to Defective Grantor Trusts, Intra-Family Loans and Split Interest Charitable Trusts AFRs

Important federal interest rates continued to drop for August 2019. 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 1.87%, down from 2.08% in July.

The August Section 7520 rate for use with estate planning techniques such as CRTs, CLTs, QPRTs and GRATs is 2.2%, down from 2.6% in July.

The AFRs (based on annual compounding) used in connection with intra-family loans are 1.91% for loans with a term of 3 years or less, 1.87% for loans with a term between 3 and 9 years, and 2.33% for loans with a term of longer than 9 years. With the mid-term rate now *less than* the short-term rate, clients will likely prefer the mid-term rate in their estate planning transactions.

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 1.87%, the child will be able to keep any returns over 1.87%. These same rates are used in connection with sales to defective grantor trusts.

Estate of *Kollsman v. Commissioner of Internal Revenue*, No. 18-70565 (June 21, 2019)

The U.S. Circuit Court of Appeals, Ninth Circuit has affirmed an estate tax deficiency with respect to the undervaluation of art by a qualified appraiser.

Eva Franzen Kollsman, a resident of New York, died testate and named Jeffrey Hyland, a family member, as Executor. In addition to acting as Executor, Mr. Hyland was also the beneficiary under Ms. Kollman's Will of two 17th century Old Master oil paintings. Mr. Hyland did not wish to retain the paintings, so he hired Sotheby's to sell them at auction.

An employee of Sotheby's had seen the paintings prior to Ms. Kollsman's death, and, based thereon, provided a written estimate of the predicted sales price: $600K-$800K for one painting ("Painting One") and $100K-$150K for the other painting ("Painting Two"). Thereafter, the same Sotheby's employee then inspected the paintings and provided a second letter that was to supersede the first letter (the "Second Letter"). The new sales predictions were $500K for Painting One and $100K for Painting Two. The second letter was eventually attached to Ms. Kollsman's estate tax return as evidence of the value of the paintings.

Mr. Hyland wanted frames for the paintings, so he hired a restoration company that frequently worked with Sotheby's. A representative of the restoration company said that the paintings were dirty with nicotine and heavy surface dirt but could safely and easily be cleaned. In fact, one of the paintings looked like it had already been cleaned.

Painting One eventually sold at auction for $2.4M, which triggered the IRS deficiency.

The Estate defended the Second Letter and the disparity between the appraised value and the purchase price by making several arguments against the imposition of the deficiency. First, the Estate emphasized the dirty quality of Painting One at the time that it was appraised. The Court responded that a hypothetical buyer of the level of sophistication that would buy a piece of art like Painting One would know that Painting One could be cleaned, which would result in a significant increase in value.

Second, the Estate argued that, after Ms. Wollman's date of death, there was an increase in demand for Old Master paintings. The Court pointed out that there was, in general, no increase in the sales prices of Old Master paintings at Sotheby's between Ms. Wollman's date of death and the sale of Painting One, which suggested that demand was not, in fact, greater. Also, Sotheby's documents filed with the SEC actually contradicted the Estate's contention.

The Court took issue with (i) the absence of comparables presented by the Estate's experts and (ii) the opinion of the Estate's experts that comparables were not important in valuing art.

Famiglio v. Famiglio, [TBD] So.3d [TBD] (May 10, 2019)

The Florida Court of Appeals held that a provision in a prenuptial agreement providing for a lump sum payment based on the date of the filing of a Petition for Dissolution of Marriage (a "Petition") could refer to a previously filed Petition that did not culminate in a divorce, provided that a Petition were eventually filed that did result in a divorce.

An engaged couple signed a prenuptial agreement before their 2006 wedding (the "Agreement"), which provided for a lump sum alimony payment depending on number of years of marriage. Specifically, Section 5.3 of the Agreement stated, "Mark shall pay to Jennie, within 90 days of the date either party files a Petition for Dissolution of Marriage the amount listed below next to the number of full years they have been married at the time **a** Petition for Dissolution of Marriage is filed." If Mark and Jennie were married for seven full years but less than ten full years, the amount was $2.7 million, and if they were married for ten full years, Jennie would receive $4.2 million.

In 2013, Jennie filed a Petition but never served it on Mark and eventually dismissed the Petition. However, in 2016, Jennie filed another Petition, at which point the parties had been married for ten full years. She did not dismiss the second Petition.

Mark filed a construction proceeding, claiming that the first Petition in 2013 was the operative year with respect to the measurement for the alimony payment. Jennie argued that the 2016 Petition controlled the provision because that was the Petition that resulted in the dissolution of the marriage.

The trial court held for Jennie, saying that there was no ambiguity in the Agreement and that it was clear that Mark's obligations thereunder would only arise after an actual dissolution of marriage. The trial court further opined that no rights arose from the mere filing of a Petition and that the use of "a" vs. "the" in modifying the word "petition" was unpersuasive. According to the trial court, the word "a" is obviously different from the word "the"; however, the Agreement must be looked at as a whole, and, when read as a whole, must be interpreted to only take effect if the marriage is actually dissolved because anything else would lead to absurd results. For example, Mark could have just filed and immediately withdrawn a Petition right after the parties got married, just to reserve the smallest alimony payment possible in the event the parties ever divorced. Conversely, Jennie could file and withdraw a Petition every year and receive a separate lump sum payment after each Petition.

Mark appealed, and the trial court's decision was reviewed de novo. The District Court of Appeals of Florida emphasized that the choice of the word "a" was of paramount importance because "a" is an indefinite article and is intended to indicate that the noun it modifies (here, "Petition") is unidentified or unspecified. The Court recognized that the provision was drafted to refer to just one Petition and that the alimony would only be payable if the parties were to eventually divorce, but said that the language used in the Agreement did not identify which Petition should be used to determine the length of the marriage, which would subsequently determine the lump sum payment.

The Court opined that the use of the word "a" may have been intentional on Mark's part. Furthermore, the Court criticized the trial court's use of the concept of absurdity and the use of examples because it is always possible to devise absurd interpretations of plain language while using hypotheticals. The Court used a golf metaphor in its analysis, stating that predicating an event on an occurrence is normally understood to mean the first time that that thing occurs. Golf courses usually have a rule that when a thunderstorm approaches, you must end your golf game, and that rule is universally understood to refer to the first clap of thunder and not any clap of thunder of the golfer's choosing.

In Re Rensin, 600 B.R. 870 (May 3, 2019)

The Bankruptcy Court of the Southern District of Florida held that Florida law applied to and that creditors could reach all assets of a foreign, self-settled trust, and that a bankruptcy estate would include exempt assets that were purchased with non-exempt assets with the intent to hinder creditors.

Joseph Rensin formed the Joren Trust, an irrevocable, self-settled, spendthrift trust that was governed by the laws of the Cook Islands (the "Trust").

Rensin founded a company many years after the Trust was created. The Federal Trade Commission filed suit against the company for defrauding retail customers.

While the suit was pending, Rensin purchased and sold several residences in Maryland, his home state, in quick succession. Eventually, he used the proceeds from the sale of one of the Maryland homes to purchase a residence in Florida.

A judgment was eventually entered into against Rensin for almost $14 million. A few months later, Rensin, individually, filed for bankruptcy under Chapter 7 of the Code. His only listed asset in the bankruptcy schedules was a bank account holding the proceeds from a fixed annuity owned by the Trust. He did, however, disclose his beneficial interest in the Trust. At the time, the Trust's only assets were two annuities payable to Rensin, but one of the annuities had not yet started, which meant that the Trustee could cancel the annuity.

Rensin also wanted to exempt from the bankruptcy estate his home in Florida as his homestead. Rensin claimed that he used assets from other exempt assets (residences) to purchase the home, but the bankruptcy trustee successfully argued that the pattern of buying and selling homes constituted the use of non-exempt assets to purchase the home with intent to hinder creditors. Therefore, the Florida home formed part of the bankruptcy estate.

Under Florida law, choice of law in a contract (or trust) is upheld unless it offends Florida public policy. Florida public policy strongly disfavors asset protection trusts, and Florida law will not enforce a spendthrift trust designed to permit a person to place his assets beyond the reach of creditors. Therefore, Florida law applied to all provisions of trust, and, under Florida law, notwithstanding spendthrift a provision in a trust, creditors can reach maximum amount of trust assets that could be distributed to or for the Settlor's benefit. If distributions to the Settlor are fully discretionary, creditors have the same rights as if the trust were never created. Because this was a fully discretionary trust, the Trust formed part of the bankruptcy estate.

Nonetheless, only the remainder interest of the annuity, the start date of which had commenced, was includible in the bankruptcy estate because (i) annuity proceeds are exempt assets and (ii) the annuity that had not yet started could be cancelled by the Trustee of the Trust at any point prior to the start date. The bankruptcy trustee's claim that the annuities were purchased to hinder creditors was rejected because the Trustee of the Trust, and not Rensin, purchased the annuities.

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