Proskauer

Wealth Management Update

December 2019

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

The December Section 7520 rate for use with estate planning techniques such as CRTs, CLTs, QPRTs and GRATs is 2.0%, which is unchanged from the November rate. The December 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 annually) is 1.69%, up slightly from 1.59% in September.

The low Section 7520 rate and AFRs continue to present potentially rewarding opportunities to fund GRATs in December with depressed assets that are expected to perform better in the coming years.

The AFRs (based on annual compounding) used in connection with intra-family loans are 1.61% for loans with a term of 3 years or less, 1.69% for loans with a term between 3 and 9 years and 2.09% 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 1.69%, the child will be able to keep any returns over 1.69%. These same rates are used in connection with sales to defective grantor trusts.

United States v. Estate of Sidney Elson, 2019 WL 5061321 (D.N.J. Oct 9, 2019)

The Court held that under Internal Revenue Code Section 6324(b), in addition to there being a lien for unpaid gift taxes on all gifts made during the period for which a return was filed for a period of 10 years from the date the gifts are made, a donee of a gift can be held personally liable for unpaid gift tax to the extent of the value of the gift so long as the statute of limitations has not expired against the donor.

This ruling is a reminder to donees that not all gifts come with no strings attached, and it is possible that if there are unpaid gift taxes in connection with the gift, the donee could be held personally liable to the extent of the gift.

Matter of Cleopatra Cameron Gift Tr., Dated May 26, 1998, 931 N.W.2d 244 (S.D. 2019) – South Dakota Supreme Court Protects Trusts from California Child Support Order

Cleopatra Cameron's father set up various trusts for Cleopatra's benefit (collectively, the "Trusts"). Each of the Trusts were formed and funded in California, and they each contained a spendthrift provision which prohibited the trustee from making direct payments to Cleopatra's creditors.

In 2009, a California family court ordered the Trusts to pay Cleopatra's child support obligations directly to her former spouse, Christopher, as part of Cleopatra's divorce proceedings. The Trusts complied with this order and continued to do so until 2016. In 2012, the situs of each Trust had been moved to South Dakota, and in 2016, the Trust Protector determined that there were insufficient assets in the Trusts to pay Cleopatra's child support obligations and to continue supporting Cleopatra for her lifetime. The Trustee subsequently stopped making the child support payments.

Cleopatra petitioned the circuit court for a declaration as to whether the Trusts were prohibited from making the child support payments directly to Christopher. The circuit court concluded that the Trusts were prohibited from making child support payments directly to Christopher. Not surprisingly, Christopher appealed. On appeal, the Supreme Court of South Dakota considered whether the California court's direct payment order is entitled to full faith and credit in South Dakota. The Court held that the Full Faith and Credit clause does not apply to enforcement measures such as the California court's order for the Trusts to pay Cleopatra's child support obligation directly to Christopher. While Cleopatra's child support obligation remained in place, the South Dakota Supreme Court held that payment could not be made directly from the Trusts.

This case highlights the importance of choosing a trust situs when thinking about creditor protection. By moving the situs of the Trusts to South Dakota, Christopher, as a creditor of Cleopatra, could no longer reach the assets in the Trusts as a means of satisfying Cleopatra's child support obligation to him.

Estate of Kollsman v. Comm'r of Internal Revenue, 777 F. App'x 870 (9th Cir. 2019)

The Ninth Circuit affirmed the Tax Court's redetermination of the value of two paintings. The Tax Court had relied heavily on the IRS's expert and rejected the opinion of the estate's appraiser/expert because (a) the valuation was in the form of a letter and was not supported with comparable sales data, (b) the appraiser/expert exaggerated the risks associated with cleaning the artworks, (c) the appraiser/expert failed to explain how one of the paintings was sold five years later for five times the appraised value and (d) was conflicted and motivated by personal economic interests.

Hinds & Shankman, LLP v. Lapides, No. CV 18-10731-CJC(SKX), 2019 WL 4956148 (C.D. Cal. Oct. 8, 2019)

The US District Court for Central District of California held that the Texas homestead exemption applies such that creditors are unable to seek enforcement of a judgment against homestead property even when nonexempt assets were used to purchase the homestead property with the intent to frustrate creditors.

New York State Department of Taxation TSB-M-19(2)R

The New York State Department of Taxation issued a memorandum clarifying that the new rules requiring an LLC to identify its members, managers and authorized persons when it is a grantor or grantee in a deed will not apply to individual condo transfers.

Final Regulations Issued for Certain Life Insurance Contract Transactions and Transfer for Valuable Consideration Rules

The IRS issued final regulations providing guidance on (a) new information reporting obligations under Internal Revenue Code Section 6050Y related to reportable policy sales of life insurance contracts and payments of reportable death benefits and (b) the amount of gross income excluded under Internal Revenue Code Section 101 following a reportable policy sale. Clients are advised to consult with counsel before entering into any transfer or sale of an existing life insurance policy to ensure such transfer or sale is done in a tax efficient manner and all reporting requirements are complied with.

PLR 201941023

The IRS ruled that consistent with the Settlor's intent and due to a scrivener's error, with respect to each trust at issue, (a) as a result of a judicial reformation of the terms of the trust, each Crummey withdrawal power holder did not possess a general power of appointment over the trust's assets, (b) the judicial reformation did not cause a taxable lapse or release of a general power of appointment and (c) the judicial reformation allowed prior transfers to the trust to be entitled to the automatic allocation of generation-skipping transfer ("GST") tax exemption even where the prior transfers were reported on incorrect schedules of a gift tax return and no GST allocation was previously allocated.

2020 Estate and Gift Tax Exemptions

The IRS issued the following 2020 exemption amounts:

- Each person's federal estate and gift tax exemption amount will increase to $11,580,000 (up from $11,400,000 in 2019).
- The 2020 annual exclusion will remain at $15,000 per person per donee.
- The 2020 annual exclusion for gifts to a non-citizen spouse will increase to $157,000.

Related Professionals

- **Albert W. Gortz**
- **Nathaniel W. Birdsall**
  Partner
- **Stephanie E. Heilborn**
  Partner
- **Henry J. Leibowitz**
  Partner
- **Jay D. Waxenberg**
  Partner