Proskauer

Wealth Management Update

March 2020

March 2020 Interest Rates for GRATs, Sales to Defective Grantor Trusts, Intra-Family Loans and Split Interest Charitable Trusts

Important federal interest rates continue to hold relatively steady. The March Section 7520 rate for use with estate planning techniques such as CRTs, CLTs, QPRTs and GRATs is 1.8%, representing a drop from 2.2% a month ago.

The March applicable federal rates ("AFRs") (based on annual compounding) used in connection with intra-family loans are 1.50% for loans with a term of 3 years or less, 1.53% for loans with a term between 3 and 9 years, and 1.93% for loans with a term of longer than 9 years. The compression of the short-term and mid-term rates is causing many clients to 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 1.93%, the child will be able to keep any returns over 1.93%. These same rates are used in connection with sales to defective grantor trusts.

The AFRs for March 2019 were 2.55%, 2.59%, and 2.91%, respectively, which outlines a drop in rates during the last year.

Gowdy v. Cook, 2003 WY 3, S-19-0005 (January 8, 2020) – Attempt to Decant Trust Triggers In Terrorem Clause

In *Gowdy v. Cook*, the Supreme Court of Wyoming concluded that a beneficiary's attempt to "decant" or modify an irrevocable trust triggered a no contest clause, causing the beneficiary, who had been the sole current beneficiary of the trust, to lose all rights as a beneficiary under the trust agreement. To "decant" a trust is to take its assets and transfer them to a second trust with similar (or not so similar) provisions.

The dispute began two years after the Settlor's death, when the beneficiary sued the Trustee of the trust for breach of fiduciary duty; a claim which was denied by the court due to the beneficiary's failure to prove any damages. During the proceedings, the beneficiary proposed a "decanted trust" form which proposed to relax the trustee requirements in order to allow the beneficiary greater flexibility in selecting a successor trustee, but to otherwise preserve the original trust's provisions. The Trustee responded by asking the court to enforce an "in terrorem" (no contest) clause in the trust agreement which provided that the rights of any beneficiary would be revoked in their entirety if said beneficiary sought to void or nullify any of the trust provisions.

Ultimately, the court ruled that such attempted decant amounted to the beneficiary seeking to void, nullify or set aside a trust provision, thereby ending the beneficiary's interest in the trust.

Loube v. Commissioner of Internal Revenue, T.C. Memo 2020-3 – Denial of Charitable Deduction

In *Loube v. Commissioner*, the Tax Court denied a $297,000 charitable contribution because the taxpayers failed to include basis information in the appraisal summary they were required to file with their income tax return. In this case, the taxpayers allowed a charity to deconstruct their residence prior to demolition, which the charity did as a way of teaching marketable skills to persons facing barriers to employment. However, when filing their tax returns, the taxpayers included documentation provided by the charity which did not include all of the required tax information. The IRS took the position that the failure to include such information caused the entire deduction to be denied. In the end, the Tax Court granted summary judgment to the IRS denying the entire income tax deduction because the basis information was a required item in an appraisal summary, and an appraisal summary that omits such information does not satisfy the substantiation requirements such gifts (this requirement applies for noncash gifts over $5,000).

Specifically, the Deficit Reduction Act of 1984 ("DEFRA") instituted heightened reporting requirements that were specifically enacted by Congress to combat inflated charitable deductions by requiring, where reasonably obtainable, the disclosure of "cost or adjusted basis" to "facilitate the Commissioner's efficient identification of overvalued property." Thus, a taxpayer's failure to provide the "cost or adjusted basis" on an appraisal summary is a failure to substantially comply with DEFRA because it does not "provide sufficient information to permit [the Commissioner] to evaluate the reported contributions, as intended by Congress. The Tax Court took the position that even in a situation where the relevant information could be found through a search of the documents attached to a tax return, a failure to include the relevant information on the form itself constituted a failure to adequately report the information.

U.S. v. Marin – Transferee Liability

In U.S. v. Marin, the government brought a lawsuit against an estate to recover unpaid estate tax liabilities from the three beneficiaries, two of whom were co-executors of the estate. The IRS relied on IRC 6324 which provides for transferee liability. The beneficiaries' motions to dismiss were denied by the court because the government was able to sufficiently argue that the executors knew of the estate's liabilities, that the estate was insolvent, and that the executors paid other estate debts while leaving higher priority tax liens unpaid.

There were a number of procedural defenses raised, most interestingly, the probate exception to federal jurisdiction, which provides that probate matters are excepted from the scope of federal diversity jurisdiction. Historically, this reserves to state probate courts the probate or annulment of a will and the administration of a decedent's estate, and precludes federal courts from endeavoring to dispose of property that is in the custody of a state probate court. However, in this case, the court ruled that the New York Surrogate's Court was not then currently exercising custody or jurisdiction over any estate property since its most recent pleading had been an interim accounting which had occurred years prior.

Related Professionals

- **Albert W. Gortz**

- **Nathaniel W. Birdsall**
  Partner
- **Stephanie E. Heilborn**
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  Partner
- **Jay D. Waxenberg**
  Partner