Proskauer

Wealth Management Update

June 2021

June 2021 Interest Rates for Sales to Defective Grantor Trusts, Intra-Family Loans, Split-Interest Charitable Trusts and GRATs

The June 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 1.02%, down from 1.07% in May.

The June Section 7520 rate for use with estate planning techniques such as CRTs, CLTs, QPRTs and GRATs is 1.2%, unchanged since May. The still low Section 7520 rate continues to present potentially rewarding opportunities to fund GRATs in June with depressed assets that are expected to perform better in the coming years – but note that rates appear to be on the upswing from the mid-pandemic low of 0.4%.

The AFRs (based on annual compounding) used in connection with intra-family loans are 0.13% for loans with a term of 3 years or less, 1.07% for loans with a term between 3 and 9 years and 2.16% for loans with a term of longer than 9 years. Note that while rates for loans with a term of less than 3 years have held relatively steady since the beginning of the year, rates on loans with a term of 3 to 9 years or longer than 9 years have both increased with each month of this year.

American Families Plan (AFP)

On April 28, 2021, President Biden released his American Families Plan (AFP). The AFP includes a number of tax proposals including:

1. Increasing the top income tax rate from 37% to 39.6% (although it is unclear what the precise income thresholds would be, the White House says it would apply to the "top 1% of Americans").
2. Taxing long-term capital gains as ordinary income for any taxpayer with an annual income of more than $1 million.

3. Eliminating the step-up in basis at death for any gains more than $1 million (although there is an exclusion for family owned businesses and farms that are passed to heirs who continue to run the business).
4. Allocating additional resources to the IRS to enhance tax audits of households with more than $400,000 of income.

Revision of Publication 590-B

Prior to the SECURE Act becoming law at the end of 2019, an individual beneficiary who inherited an IRA could satisfy the required minimum distribution by stretching out the annual payouts over the beneficiary's lifetime. For IRA owners who died after 2019, the SECURE Act replaced this ability to stretch out payments with a 10-year payment rule that requires the entire IRA to be paid out by the 10th anniversary of the IRA owner's death. There are certain beneficiaries who are exempted from this 10-year limit and are allowed to follow the old rules and calculate the RMD based on the beneficiary's life expectancy. The five categories of beneficiaries who are exempt from this rule are: (i) surviving spouses; (ii) a person who is not more than 10 years younger than the IRA owner; (iii) a minor child of the IRA owner; (iv) a disabled person; and (v) a chronically ill person. No provision of the SECURE Act mandated yearly withdrawals, only that it would be depleted in the 10th year. As such, it was thought that the 10-year rule did not require annual RMDs, so long as all of it was paid out by the 10th anniversary. There was some confusion about this late last month, when the IRS published the 2020 version of Publication 590-B. There was an example on page 12 that suggested the 10-year rule did require RMDs:

> "***Example.*** The owner died in 2020 at the age of 80. The owner's traditional IRA went to his estate. The account balance at the end of 2020 was $100,000. In 2021, the required minimum distribution would be $10,870 ($100,000 ÷ 9.2). (The owner's life expectancy in the year of death, 10.2, reduced by 1.)"

A spokesperson for the IRS confirmed that this example was an error and that the error will be corrected with an updated release. It's unclear when that correction will be made, but the correction will be consistent with the material in the "What's New" section of Publication 590-B, which also states that the IRA merely needs to be depleted by the end of the 10th year after the IRA owner's death.

Chief Counsel Memorandum 202118008

In this case, when the Decedent died, three trusts were created. One of the trusts was funded with the residue of the Decedent's estate. The trust directed all income to be distributed to the Spouse at least annually and authorized principal distributions for health, maintenance and support in the Spouse's accustomed manner of living. It gave the Spouse a limited power of appointment in favor of the Decedent's descendants, and in the absence of this appointment the remainder would be distributed outright to the Decedent's Children. The Spouse, as personal representative of the Decedent's estate, made a QTIP election and claimed a marital deduction for the value of the trust.

A few years later, the Spouse entered into an Agreement with the Children. In this Agreement, the Children agreed that the trust property "could be more effectively utilized" by the Spouse holding the property outright. Under the terms of the Agreement, the trust was commuted and all of its property was distributed to the Spouse. Paragraph 3 of the Agreement stated:

> "By signing this Agreement and by virtue of the QTIP election for the Trust, the commutation of the Trust results in a deemed gift, for federal gift tax purposes, of the remainder interest in the Trust assets from [Spouse] to [Children] under Section 2519 of the Code. By virtue of the distribution of all of the Trust assets to [Spouse], the commutation of the Trust does not result in a deemed gift of [Spouse's] income interest in the Trust under Section 2511 of the Code. Additionally, by signing this Agreement and by virtue of the distribution of all of the Trust asset [sic] to [Spouse], the commutation of the Trust results in a gift, for federal gift tax purposes, of the remainder interest in the Trust from [Children] to [Spouse]. The deemed gift of the remainder interest from [Spouse] to [Children] and the gift from [Children] to [Spouse] results in a reciprocal gift transfer."

This commutation resulted in separate gift tax consequences for both the Spouse and for the Children. Under Section 2519(a) and (b), the disposition of all or part of a qualifying income interest for life in any property for which a marital deduction was allowed shall be treated as a transfer of all interests in such property other than qualifying income interest. Under Section 2511, the Spouse was treated as making a gift of all of the interests in the trust other than the qualifying income interest. Additionally, the Children were treated as making a gift under Section 2511 to the Spouse. Because, under the terms of the Agreement, all of the trust property was transferred to the Spouse outright, the Children effectively gave up their remainder interests without full and adequate consideration. Under *Commissioner v. Wemyss*, 324 U.S. 303 (1945), adequate and full consideration is that which replenishes, or augments, the donor's taxable estate—valuable contractual consideration in the hands of the donor is not sufficient.

These were treated as separate gifts by separate donors that did not offset each other as reciprocal gifts. Because the Children received nothing in exchange for their remainder interests, what resulted from this transaction was a one-sided gift from the Children to the Spouse.

In the Matter of the Petition of Boniface, N.Y. Div. of Tax Appeals, ALJ, Dkt No. 829018, 04/29/2021

An administrative law judge (ALJ) upheld the Division of Taxation's determination that taxpayers were domiciled in New York State and not in Florida for the 2014 tax year. The ALJ concluded that while the taxpayers had purchased a Florida home, completed a Florida homestead exemption application, and obtained Florida driving licenses, their "general habits" did not support a change in domicile.

The taxpayers retained their home in New York, which is evidence of a lack of intent to change domicile. The taxpayers claimed that most of their time spent in New York in 2014 was spent at the homes of their children and grandchildren, but there wasn't any timely credible evidence to support that claim. When determining a change of domicile when an individual has two residences, the length of time the individual spends at each location is also important. In this case, based primarily on the taxpayers' cell phone records, it was proven that the taxpayers spent more time in New York than in Florida in 2014 and were in New York for almost half of the year.

Additionally, the taxpayers' evidence consisted of largely unsworn hearsay testimony, pictures without statements or testimony, and a calendar that was inconsistent with the other documents and cell phone records. As such, the taxpayers did not meet their burden to prove a change in domicile and were deemed as residents of New York for the 2014 tax year.

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