Proskauer

Wealth Management Update

August 2021

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

Federal interest rates were largely stable in August of 2021. 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 three to nine years (the mid-term rate, compounded annually) is 1.00%, the same as July but up from 0.41% in August of 2020.

The August Section 7520 rate for use with estate planning techniques such as CRTs, CLTs, QPRTs and GRATs is 1.2%, as it has been every month since May 2021.

The AFRs (based on annual compounding) used in connection with intra-family loans are 0.19% for loans with a term of less than three years, 1.00% for loans with a term between three and nine years, and 1.89% for loans with a term of nine years or longer.

Thus, for example, if a 10-year loan is made to a child, and the child can invest the funds and obtain a return in excess of 1.89%, the child will be able to keep any returns over 1.89%. These same rates are used in connection with sales to defective grantor trusts.

Update on Federal Legislation

Congress is moving forward with two major pieces of fiscal legislation. The first, a bipartisan infrastructure spending package, does not include any significant tax increases. The second is expected to include income tax increases and possibly estate and gift tax changes. For the second bill, Democrats plan to employ the legislative procedure known as "reconciliation," which would allow Democrats to push the bill through the Senate without Republican support.

Senate Democrats say their goal is to vote on a budget resolution with reconciliation instructions – the first step toward passing the reconciliation bill – in August, setting up a vote on the substantive legislation for some time in the fall.

State Tax Cuts

A number of states have passed large tax cuts in recent weeks – including, notably, New Hampshire and Arizona.

On June 29, New Hampshire Governor Sununu signed legislation phasing out New Hampshire's 5% tax on interest and dividends. When the tax is fully phased out, in 2027, New Hampshire will become the ninth state with no individual income tax of any kind.

On June 30, Arizona Governor Ducey signed legislation capping his state's income taxes at 4.5% of an individual's or married couple's taxable income, in effect overturning a November ballot initiative that created an 8% tax bracket on income over $200,000 for individuals or $250,000 for married couples.

Pinkert v. Schwab Charitable Fund (N.D. Cal., Case No. 20-cv-07657-LB)

This case was a significant victory for sponsors of donor-advised funds ("DAFs"). The plaintiff, a donor to a Charles Schwab DAF, claimed that Charles Schwab Charitable had violated its fiduciary duties by making bad investments with DAF assets and paying excessive fees to various Charles Schwab investment entities. Charles Schwab moved for summary judgment, arguing that the plaintiff had relinquished control of the assets upon contributing them to the DAF, and therefore had not suffered the concrete injury necessary to establish standing. The district court granted summary judgment to Charles Schwab.

In the Matter of the Consolidated Appeals of O. Cremel and E. Koeppel (OTA Case Nos. 18042625 & 20076340)

Cremel and Koeppel (the "Appellants"), husband and wife, immigrated to California from France in the late 1990s. In 2001, Cremel began working at VMware, a cloud computing company. Cremel was paid in part with stock options. He exercised those options in 2011 and 2012. The stock options were community property, so the income Cremel recognized when he exercised those options was one-half Koeppel's income. But by that point, Koeppel had long since returned to France and was not a California resident (though Cremel still was and had been since he had moved to California more than a decade earlier). Appellants claimed that the one-half of the income attributable to Koeppel's community property was not California source income and therefore should not have been subject to California income tax. California's Franchise Tax Board disagreed. Appellants appealed the Franchise Tax Board's determination.

On appeal, the Office of Tax Appeals sided with the Franchise Tax Board. The Office of Tax Appeals held that the stock options were compensation for services performed in California, and therefore Koeppel's share of the income was California source income, even though Koeppel was not living in California when the options were exercised.

Estate of Michael J. Jackson v. Commissioner (Tax Court, May 3, 2021)

The Tax Court has resolved the valuation dispute between the IRS and the executors of Michael Jackson's estate.

The estate and the IRS disagreed regarding the fair market value of (1) Jackson's image and likeness, (2) his interest in New Horizon Trust II, which held an interest in Sony/ATV Music Publishing, and (3) his interest in New Horizon Trust III, which contained a music-publishing catalog with the copyrights to compositions that Jackson and/or other songwriters had composed. At trial, experts for the estate valued those assets at $5,300,000. The IRS valued them at $481,000,000.

The Tax Court determined that the assets were in fact worth $111,100,000, including just $4,100,000 for Jackson's image and likeness.

Although the Tax Court found that the disputed assets were worth $105,800,000 more than what the estate's executors had claimed, the court found that the executors' valuations were not unreasonable and, therefore, no valuation penalties applied.

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