Proskauer

Wealth Management Update

February 2022

February 2022 Interest Rates for GRATs, Sales to Defective Grantor Trusts, Intra-Family Loans and Split-Interest Charitable Trusts

The February Section 7520 rate for use with estate planning techniques such as CRTs, CLTs, QPRTs and GRATs is 1.6%, which is unchanged from the January rate. The February 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 1.4%, up slightly from 1.3% in January.

The low Section 7520 rate and AFRs continue to present potentially rewarding opportunities to fund GRATs in February 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 .59% for loans with a term of 3 years or less, 1.4% for loans with a term between 3 and 9 years and 1.92% for loans with a term of longer than 9 years. With the short- and mid-term rates remaining low, clients who have the liquidity to repay loans within three years will likely prefer the short-term rate for their estate planning transactions, and clients seeking a broader time horizon will likely prefer to use the mid-term rate.

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 1.4 %, the child will be able to keep any returns over 1.4%. These same rates are used in connection with sales to defective grantor trusts.

New York Surrogate's Court Denies Probate of Lost Will. *Estate of Palladino* (Bronx County Sur. Court September 15, 2021)

Decedent executed a Will in 2015, the original of which was given to him immediately following its execution. Upon the Decedent's death, the original Will could not be found and the Decedent's son sought to probate a photocopy of the Will. Where no evidence exists that the original Will was ever in the custody of another person and the original cannot be found, a presumption arises that the Decedent destroyed the will with an intention to revoke it. Court held that the Decedent's son failed to rebut said presumption and his petition was denied.

Tax Court Recharacterizes a Husband and Wife Gifting Transaction. *Smaldino v. Comm'r of Internal Revenue,* 122 T.C.M. (CCH) 298 (T.C. 2021)

In *Smaldino*, Husband held 10 real properties through an LLC which was comprised of voting and non-voting units. Husband wanted to transfer non-voting units in the LLC to a trust that he created for his children and grandchildren in December 2012 (the "Dynasty Trust"). In order to utilize both Husband and Wife's remaining federal lifetime gift tax exemptions, Husband transferred non-voting units in the LLC to (1) Wife and (2) the Dynasty Trust directly. Wife transferred the non-voting units in the LLC she received from Husband to the Dynasty Trust. The following is a summary of the timeline of the transactions:

- Effective April 14, 2013, Husband assigned that number of non-voting units in the LLC to Wife with a fair market value as determined for federal gift tax purposes equal to $5,249,118.42.
- Effective April 15, 2013:
    - Wife assigned that number of non-voting units in the LLC to the Dynasty Trust with a fair market value as determined for federal gift tax purposes equal to $5,249,118.42.
    - Husband assigned that number of non-voting units in the LLC to the Dynasty Trust with a fmv as determined for federal gift tax purposes equal to $1,031,881.58.
    - Exhibit A to the operating agreement for the LLC (the "LLC Agreement") is amended to reflect that the Dynasty Trust owned 49% of the LLC and Husband owned the remaining 51% of the LLC.
- An appraisal was received dated August 22, 2013 valuing a 49% interest in the LLC at $6,281,000.

- Husband and Wife each file a 2013 federal gift tax return (not electing to split gifts) reporting their respective transfers of non-voting units in the LLC to the Dynasty Trust.

The Tax Court held that the Husband did not effectively transfer membership interests in LLC to Wife because:

1. Wife was not a permitted transferee under the LLC Agreement and there was never any documentation approving the transfer to her in accordance with the terms of the LLC Agreement;
2. Wife never signed any document agreeing to be bound by the terms of the LLC Agreement as was required under the terms of the LLC Agreement;
3. Exhibit A to the LLC Agreement was never amended to reflect Wife as a member;
4. The assignment to the Wife of non-voting units in the LLC was effective April 14, 2013, but it used values from the appraisal dated August 22, 2013 (more than four months after the effective date of the assignments), so the Court believed the assignment to the Wife could not have been executed prior to August 22, 2013, which meant Wife never had an opportunity to exercise any ownership rights with respect to those non-voting units in the LLC; and
5. The LLC's tax returns for 2013 never reflected Wife as a member.

As a result, the Tax Court determined that Husband gifted the entire 49% LLC interest to the Dynasty Trust, which resulted in Husband owing gift tax as the value of the 49% LLC interest exceeded his remaining federal lifetime gift tax exemption.

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