Proskauer

Wealth Management Update

December 2022

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

Federal interest rates increased quite significantly for December of 2022. 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 3-9 years (the mid-term rate, compounded annually) is 4.27%, up from 3.97% in November and up from 1.26% in December of 2021.

The December 2022 Section 7520 rate for use with estate planning techniques such as CRTs, CLTs, QPRTs and GRATs is 5.2%, up from 4.8% in November.

The AFRs (based on annual compounding) used in connection with intra-family loans are 4.55% for loans with a term of 3 years or less, 4.27% for loans with a term between 3 and 9 years, and 4.34% for loans with a term of longer than 9 years.

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 4.34% the child will be able to keep any returns over 4.34%. These same rates are used in connection with sales to defective grantor trusts.

Inflation Adjustments for 2023

The IRS has released the 2023 inflation adjustments (Rev. Proc. 2022-38):

- Estate/Gift Tax Exemption: $12,920,000 (increase of $860,000 from 2022)
- Annual Gift Tax Exclusion: $17,000 ($16,000 in 2022)
- Annual Gift Tax Exclusion for a Non-Citizen Spouse: $175,000 ($164,000 in 2022)
- Top (37%) Income Tax Bracket for Trusts and Estates: Beginning at $14,450 ($13,450 in 2022)

FinCEN – Beneficial Ownership Information Reporting Requirement

On September 29, 2022, FinCEN issued a final rule implementing the Corporate Transparency Act's (CTA) beneficial ownership information (BOI) reporting provisions.

- Effective date: January 1, 2024.
    - Reporting companies created or registered before January 1, 2024 will have one year (until January 1, 2025) to file their initial reports.
    - Reporting companies created after January 1, 2024, will have 30 days after receiving notice of their creation or registration to file their initial reports.
    - Reporting companies have 30 days to report changes to the information in their previously filed reports and must correct inaccurate information in previously filed reports within 30 days of when the reporting company becomes aware or has reason to know of the inaccuracy of information in earlier reports.
- The rule requires reporting companies to file reports with FinCEN that identify two categories of individuals: (1) the beneficial owners of the entity and (2) the company applicants of the entity.
- The rule identifies two types of reporting companies: domestic and foreign.
    - A domestic reporting company is a corporation, LLC, or any entity created by the filing of a document with a secretary of state or any similar office under the law of a state or Indian tribe.
    - A foreign reporting company is a corporation, LLC, or other entity formed under the law of a foreign country that is registered to do business in any state or tribal jurisdiction by the filing of a document with a secretary of state or any similar office.
    - FinCEN expects that these definitions will include limited liability partnerships, limited liability limited partnerships, business trusts, and most limited partnerships.
    - Trusts are excluded from the definition to the extent that they are not created by the filing of a document with a secretary of state or similar office.
- "Beneficial owner" includes any individual who, directly or indirectly, either (1) exercise substantial control over a reporting company, or (2) owns or controls at least 25% of the ownership interests of a reporting company.
    - Substantial control – the list of activities that could constitute substantial control captures anyone who is able to make important decisions on behalf of the entity, including the trustee of a trust.

- 25% ownership interests – standards and mechanisms are provided to make this determination.
    - The rule identifies the trustee of a trust is an individual who will be deemed to control trust assets for the purpose of determining which individuals own or control 25% of the ownership interests of the reporting company.
    - In addition, other individuals with authority to control or dispose of trust assets are considered to own or control the ownership interests in a reporting company that are held in trust.
    - If the beneficiary is the sole permissible recipient of income and principal from a trust, or if the beneficiary has the right to demand a distribution of, or withdraw substantially all of, the assets of a trust, ownership interest held in trust will be considered as owned or controlled by the beneficiary.
    - Trust assets will be considered as owned or controlled by a grantor of a trust who has the right to revoke the trust or withdraw its assets.
- A “Company applicant” is:
    - The individual who directly files the document that creates the entity (or in the case of a foreign reporting company, the document that first registers the entity to do business in the United States).
    - The individual who is primarily responsible for directing or controlling the filing of the relevant document by another.
- BOI report requirements with respect to each beneficial owner and each company applicant:
    - Name
    - Birthdate
    - Address
    - Unique identifying number and issuing jurisdiction from an acceptable identification document (and the image of such document)

Note: it is possible to obtain a “FinCEN identifier”, which can be provided to FinCEN on a BOI report.

Matter of Estate of Manchester, 172 N.Y.S. 3d 918 (Sur. Erie Aug. 18, 2022)

Decedent’s wife and his daughter from a prior marriage disputed whether the wife was a joint owner of a joint bank account with right of survivorship, or whether her name had been placed on the account for convenience only. The Court noted New York Banking Law Section 675 and reviewed the account signature card, which contained language providing for a right of survivorship. The Court stated: “when an account has been established in accordance with statute, and the "'survivorship'" language appears on the account signature card, a presumption arises that the parties intended to create a joint tenancy with right of survivorship.” The Court found that the daughter failed to rebut the presumption and ruled for the wife. This case illustrates the importance of obtaining and reviewing the bank account signature card to see if it contains right of survivorship language.

Heinrich C. Schweizer v. Commissioner, T.C. Memo. 2022-102

The donor taxpayer in this case contributed an African art sculpture to a museum for which he claimed a charitable income tax deduction for $600,000. The IRS disallowed the claimed deduction in its entirety because of the donor’s failure to properly substantiate the deduction, including by (i) not obtaining a qualified tax appraisal, (ii) failing to provide a properly completed Form 8283 Noncash Charitable Contributions, and (iii) not attaching a qualified tax appraisal to the income tax return. The Tax Court granted summary judgment to the IRS on the basis of each of these failures independently being sufficient to warrant disallowance of the charitable deduction.

- The one-and-a-half page “appraisal” which he obtained was not prepared by a certified appraiser. The preparer of the appraisal (a dealer in African art) testified that this was the only fair market value appraisal he had ever done.
- When a taxpayer donates property (other than publicly traded securities) valued in excess of $5,000, Form 8283 instructs the taxpayer to include the following information on section B of the form: (1) a description of the donated property, (2) a brief summary of its physical condition, (3) the appraised fair market value of the property, (4) the date the property was acquired by the donor, (5) the manner of acquisition, and (6) the donor’s “cost or adjusted basis.” The instructions to Form 8283 state that, “if you have reasonable cause for not providing the information . . . , attach an explanation so your deduction will not automatically be disallowed.”
    - The Form 8283 that was attached to the donor’s income tax return was missing most of this information. The sculpture was listed on section A of the

form, where taxpayers are instructed to report “Donated Property of $5,000 or Less and Certain Publicly Traded Securities.” On the line calling for a “description of the donated property,” the words “see attached” appeared but no such attachment was included with the return.

- The donor did not attach to his return an appraisal of the artwork as required by section 170(f)(11)(D) for gifts valued in excess of $500,000.

The Tax Court denied summary judgement on the issue of whether the claimed charitable income tax deduction could be allowed if it could be shown that the failure to substantiate the deduction was due to “reasonable cause and not willful neglect” on the basis of the donor having received, and reasonably relied upon, advice provided to him from his accountant. After trial on this issue, the Tax Court determined that no such advice was given and that, even if it had been given, it would have been implausible for the donor to have actually relied on such advice in good faith. The donor was a highly educated and sophisticated individual. He worked at Sotheby’s, and he had considerable experience in matters involving art appraisals. The Tax Court determined that any such reliance by the donor would have been an example of “willful blindness.” The Tax Court emphasized that taxpayers have a duty to review their tax returns before signing and filing them, and the duty of filing accurate returns cannot be avoided by placing responsibility on a tax return preparer.

Pinkert v. Schwab Charitable Fund, 130 AFTR 2d 2022-5986

The U.S. District Court for the Northern District of California dismissed the donor’s lawsuit against the Schwab Charitable Fund, holding that the donor had no standing to challenge Schwab’s choice of investments in his Donor Advised Fund. The Ninth Circuit Court of Appeals affirmed that dismissal and agreed that the donor did not retain any right to direct how the fund was invested. Schwab Charitable Fund was not required to follow the donor’s recommendations. The donor also argued that Schwab’s management of the account (including through charging excessive fees) would reduce the value of the fund, harming his reputation for charitable giving and diminishing the impact of donations from the fund. The Appellate Court found no need to reach those issues, holding the donor had not adequately alleged standing based on those theories.

Related Professionals

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