Proskauer

Wealth Management Update

April 2023

April Interest Rates for GRATS, Sales to Defective Grantor Trusts, Intra-Family Loans and Split-Interest Charitable Trusts

The April Section 7520 rate for use with estate planning techniques such as CRTs, CLTs, QPRTs and GRATs is 5.0%. The April applicable federal rate ("AFR") for use with a sale to a defective grantor trust or intra-family loan with a note having a duration of:

- 3 years or less (the short term rate, compounded annually) is 4.86%;
- 3 to 9 years (the mid-term rate, compounded annually) is 4.15%; and
- 9 years or more (the long-term rate, compounded annually) is 4.02%.

The Section 7520 rate and the AFRs have been steadily rising with inflation although the rates are still relatively low. Clients contemplating any type of transaction whose success depends on these "hurdle rates" may wish to proceed sooner rather than later.

Bittner v. United States, 598 U.S. ___ (2023)

Alexandru Bittner is a dual US and Romanian citizen who was born in Romania, immigrated to the US in 1982, moved back to Romania in 1990 and then returned to the US in 2011. At some point after his return, he learned of his obligation under the Bank Secrecy Act to file FBARs. Bittner then retained a CPA to file FBARs for 2007-2011. Those FBARs reported his largest accounts but omitted certain accounts over which he had signatory authority. The government learned of the omission and Bittner then filed revised reports. The government assessed a $2.72 million penalty on the theory that the penalty was to be assessed on a per account and not a per return basis.

For willful failure to file an FBAR, the penalty is the greater of $100,000 or 50% of the balance of an unreported account. Before this Opinion, there was a circuit split with regard to the penalty for a non-willful failure to file an FBAR. The Ninth Circuit held that there is a $10,000 penalty per return (all foreign bank accounts with more than $10,000 are required to be listed on a single return); the Fifth Circuit held that there is a $10,000 per account penalty.

The Supreme Court ruled, that the penalty is assessed on a per return basis. The Court cited various theories of statutory interpretation and administrative law.

2023 Greenbook Proposals – As Relevant to Transfer Tax, Trusts and Valuation

The Greenbook is a publication released by the Department of Treasury (the "Department") outlining the Department's proposed changes to the revenue laws. The Greenbook merely contains proposal that do not carry the force of law. The proposals are below.

a. Expand the IRC definition of executor so "it [is] applicable for all tax purposes, and would authorize such an executor to do anything on behalf of the decedent in connection with the decedent's pre-death tax liabilities or other tax obligations that the decedent could have done if still living."

b. Increase the special valuation use limit from $750,000 (adjusted for inflation) to $13 million (the proposal does not state whether the new amount would be adjusted for inflation).

c. Extend the automatic lien for estate and gift taxes from 10 years to the termination of the period "during any deferral or installment period for unpaid estate and gift taxes."

d. Require all trusts with either (1) an estimated total value on the last day of the taxable year of $300,000 or more (adjusted for inflation) or (2) gross income of over $10,000 or more (adjusted for inflation) to report to the IRS:

i. The name, address and TIN of each Settlor and Trustee; and

ii. Information about the nature and estimated net worth of the trust as the Department determines. The value could be reported via a range estimation.

Furthermore, each trust (regardless of value or income) would be required to report on a return each year:

i. The inclusion ratio of the trust when a distribution is made to a non-skip person; and

ii. Any information regarding a trust modification or a transaction with another trust.

e. Formula clauses will be given no effect to the extent such a clause hinges on an IRS-related event.

f. The present interest annual exclusion as we know it would be eliminated. It would be replaced by a $50,000 (indexed for an inflation) per donor gift tax exclusion. There would be no requirement that such transfers be of present interests in property.

g. The GST tax exemption would be applicable only to direct skips and taxable distributions to (a) beneficiaries not more than two generations beneath the transferor and (b) to younger beneficiaries who were alive at the creation of the trust. GST tax exemption could also only be allocated to taxable terminations occurring while the aforementioned people are beneficiaries of a trust.

h. There would be a wholesale shift with respect to the tax treatment of GRATs:

i. GRATs would be required to have a minimum taxable gift equal to the greater of (1) 25% of the value of the assets transferred to the trust and (2) $500,000 (but not greater than the value of the assets transferred).

ii. If the Settlor acquires any GRAT assets in a substitution transaction, the Settlor would be required to recognize gain or loss.

iii. GRATs would be required to have 10-year minimum terms.

i. Transactions between the Settlor of a trust and a grantor trust would be taxable events and the payment of income tax by the Settlor would be a taxable gift.

j. A GST trust’s purchase of assets of a non-exempt trust would result in a mixed inclusion ratio.

k. The remainder interest of CLATs must be equal to at least 10% of the value of the property contributed (no zeroed-out CLATs) and CLAT annuity payments must be level (no shark-fin CLATs).

l. Loans made to a trust beneficiary would be considered a distribution carrying out DNI and the repayment of a loan by the Settlor or the Settlor's spouse would be considered a contribution to the trust.

m. There would be restrictions from claiming that a note has adequate interest for gift and income tax purposes but then discounting the note on a 706.

n. If a family member transfers non-publicly traded property to a family member, the value of the transfer would be equal to the pro-rata amount of the fair-market value of the entire interest held by the family. In essence, this would discard with discounting. This would only apply to entities of which a family own 25% of or more.

In re the Trust of Eva Marie Hanson Living Trust dated December 11, 1995 (Minn. Ct. App. Jan. 30, 2023)

Settlor established a revocable trust under Minnesota law in 1995. She had two children: Randy and Shari. After Settlor established the trust, Randy was in a car accident in which he became disabled and received government assistance.

In 2013, Settlor amended the trust to provide that if her spouse predeceased her, one-half of the residue would be distributed to her children, per stirpes.[1] In 2013, Settlor also executed a durable power of attorney granting Shari all standard powers, including "fiduciary transactions". However, the trust provided that the right "to amend or revoke my trust is personal to me, and may not be exercised by any legal representative or agent acting on my behalf."

In 2017, a series of transactions which created the controversy occurred. Randy's wife, Linda, established a special needs trust for Randy. Randy was the life beneficiary and Linda was the remainderman. Randy executed a Will in which he left his entire estate to Linda and disinherited his children.

Shari, via her power of attorney, amended the Settlor's trust to provide that on the Settlor's death, Randy's share was to be distributed to his special needs trust.

Randy died in 2019 and his children contested the 2019 amendment. The trial court held for Linda and Shari. On appeal, the Court of Appeals of Minnesota held that the 2017 amendment was invalid because the trust did not provide for the ability for amendment via a power of attorney.

Vouk v. Chapman, 521 P.3d 712 (Idaho 2022)

Bill and Margaret Chapman established an irrevocable trust for their seven children in 1993, which was funded with two life insurance policies. Each of the seven children were also named as trustees. From the opinion, the trust agreement appears to have created separate shares for each child, but the assets were held in one share.

In 2004, via a sec. 1035 exchange, one of the life insurance policies was exchanged for a new policy on the life of the Settlor with a $7,000,000 death benefit.

In 2007, the trust acquired 35 shares in Idaho Supreme Potatoes, Inc. Later in 2007, the trustees and beneficiaries entered into a Distribution Agreement wherein they agreed that the trust would terminate and the assets would be distributed equally between each beneficiary. The agreement stated that the assets of the trust were “35 shares of the common shares of Idaho Supreme Potatoes, Inc.” and “certain life insurance policies”.

Bill and Margaret Chapman both died in 2018. Thereafter, one of the Settlor’s children and a co-trustee, Wade Chapman, applied for the death benefit on behalf of the trust. He was informed that he and not the trust was named as the beneficiary.   However, the policy data page named the trust as the owner of the policy. Nevertheless, Wade Chapman applied for the death benefit and did not turn over any portion of the death benefit to the other trust beneficiaries.

The other siblings filed suit alleging, among other things, breach of fiduciary duty. The District Court held for the siblings and Wade appealed. On appeal, the Supreme Court of the State of Idaho held that Wade breached his fiduciary duty.

The Court dispensed with any argument that the policy was intended solely for Wade or that the Distribution Agreement signed in 2007 relieved Wade of the responsibility of distributing life insurance proceeds to the beneficiaries. Additionally, the Court noted that under Idaho law, Wade was required to obtain approval from an Idaho court before engaging in the life insurance transaction as it involved a conflict of interest.

[1] The opinion does not state whether such distribution was in trust or outright.

Related Professionals

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