Proskauer

Wealth Management Update

February 2012

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

The February § 7520 rate for use with estate planning techniques such as CRTs, CLTs, QPRTs and GRATs is 1.4%. This is the same as the January rate. The 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 of 9-year duration (the mid-term rate, compounded annually) is down slightly to 1.12%. Remember that lower rates work best with GRATs, CLATs, sales to defective grantor trusts, private annuities, SCINs and intra-family loans. The combination of a low § 7520 rate and a decline in the financial and real estate markets presents a potentially rewarding opportunity to fund GRATs in February with depressed assets you expect to perform better in the coming years.

Clients also should continue to consider "refinancing" existing intra-family loans. The AFRs (based on annual compounding) used in connection with intra-family loans are 0.19% for loans with a term of 3 years or less, 1.12% for loans with a term of 9 years or less, and 2.58% for loans with a term longer than 9 years.

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 1.12%, the child will be able to keep any returns over 1.12%. These same rates are used in connection with sales to defective grantor trusts.

IRS Issues Notice 2011-101

In Notice 2011-101, the IRS announced that it is studying the tax implications of "decantings" when there is a change in the beneficial interests in a trust. "Decanting" is the term of art used by estate planners to refer to when a trustee uses his or her power to appoint assets from an irrevocable trust (the "invaded trust") into a new trust or trusts with different terms (the "recipient trust"). The power to appoint may arise under statutory law, such as New York's Estates, Powers and Trusts Law § 10-6.6 and Florida Statute
§ 736.04117, or under the terms of the invaded trust.

The IRS is inviting comments from the public regarding the income, gift, estate and generation-skipping transfer tax issues arising from these types of decantings. The comments are due by April 25, 2012, and the IRS will not issue private letter rulings on the tax consequences arising from a decanting during this time.

The Notice lists 13 items that the IRS has identified as potentially affecting the income, gift, estate or generation-skipping transfer tax treatment of a decanting that results in a change of a beneficial interest. These 13 items include, in part:

- When a decanting results in a beneficiary's right to or interest in trust principal or income being changed;
- When new beneficiaries are added to the recipient trust;
- When a beneficial interest, such as a power to appoint, is added, deleted or altered;
- When the beneficiaries are required to consent to the trustee's decanting and when the beneficiaries are not required to consent to the trustee's decanting;
- When assets are decanted from a grantor trust into a non-grantor trust, or vice versa; and
- When a decanting does not effect any of the changes listed in the Notice, but a future power to make a change is created.

Some of the changes listed in the Notice are changes that are explicitly permitted under various state decanting statutes. For example, a trustee with unlimited discretion can use § 10-6.6(b) of New York's Estates, Powers and Trusts Law to eliminate a beneficiary's interest, which clearly results in a beneficiary's right to or interest in trust principal or income being changed.

Decanting is an important tool for estate planners, and we eagerly await the IRS's response to the comments it receives.

IRS Issues Final Form 8938

Treasury has issued a final Form 8938, which certain taxpayers will need to file in 2012 for the 2011 tax year. A taxpayer must file if he or she is a "specified person" with an "interest" in "specified foreign financial assets" that meet filing thresholds.

A "specified person" is a United States citizen or resident alien who is otherwise required to file a United States income tax return. A specified person only includes individuals. Therefore, domestic trusts need not file a Form 8938, and individual beneficiaries of a domestic trust are not treated as owning any specified foreign financial asset held by the trust. Grantors, however, are treated as owning the specified foreign financial assets held by their grantor trusts, subject to some exceptions.

An "interest" in a specified foreign financial asset exists if a taxpayer is considered to own the asset and would be required to report any income, gain, loss or expense for that item, regardless of whether there is actually income, gain, loss or expense for that year.

A "specified foreign financial asset" is either a financial account maintained by a foreign financial institution or an asset (not held in an account), held for investment, that is stock or a securities issued by a non-United States person, a financial instrument or contract with a non-United States issuer or counterparty or an interest in a non-United States entity. An interest in a foreign trust or estate is a specified foreign financial asset.

Specified foreign financial assets only need to be reported if they are valued at or above the filing threshold. For single taxpayers, the filing threshold is any specified foreign financial asset valued at over $50,000 on the last day of 2011 or in excess of $75,000 at any point during 2011. Higher thresholds exist for married taxpayers and for United States citizens who reside abroad. Taxpayers are permitted to use estimated values to determine whether they meet or surpass the filing threshold.

IRS Announces It Is Reopening the Offshore Voluntary Disclosure Program

The IRS announced it is reopening the offshore voluntary disclosure program to help people hiding offshore accounts get current with their taxes.

Unlike the 2009 and 2011 programs, the 2012 program will remain open for an indefinite period of time. The terms of the program, however, may change at any point in the future. For example, penalties may increase. Currently, individuals pay a penalty of 27.5% of the highest aggregate balance in foreign bank accounts and entities or value of the foreign assets during the 8 full tax years prior to the disclosure. This is an increase from the 25% penalty in 2011. Lower rates apply for offshore accounts or assets that are valued at less than $75,000.

Remember: There is nothing unlawful about having offshore bank accounts so long as they are listed on the account holder's tax returns and on a separate Reports of Foreign Bank and Financial Accounts ("FBARs") disclosing the existence and size of the accounts.

***Tannen v. Tannen* (December 8, 2011)**

The Supreme Court of New Jersey affirmed the Appellate Division's holding that, for purposes of determining alimony, it was not appropriate to impute income to a wife based on her beneficial interest in an irrevocable trust created and funded by her parents.

During the marriage of the husband and wife, the wife's parents settled an irrevocable, discretionary support trust for the wife, as sole beneficiary. The wife and her parents were the co-trustees of the trust. The trust provided that the trustees shall pay or apply for the benefit of the wife's health, support, maintenance, education and general welfare all or any part of the net income therefrom and any or all of the principal thereof, as the trustees determine to be in the wife's best interests, after taking into account the other financial resources available to the wife for purposes known to the trustees. The trust also provided that the wife was not permitted, under any circumstances, to compel distributions of income and/or principal prior to the time of final distribution, and contained a spendthrift provision.

The trial court applied the Restatement (Third) of Trusts to determine that support and maintenance required the trustees to distribute such sums as are necessary to maintain the wife's lifestyle. The trial court said it would not be equitable for a beneficiary to maintain assets held in trust and not provide for his or her family. If such income is imputed to the beneficiary and the trustee refuses to act accordingly, the beneficiary would certainly be unjustly enriched if she were to first receive alimony, have a limited child support obligation, and ultimately receive the entire trust income anyway.

The Appellate Division reversed, in part, and affirmed, in part. It held that the Restatement (Third) of Trusts had not been adopted by any reported decision in New Jersey and, if adopted, would change the law in New Jersey. The Appellate Division suggested that adoption of the Restatement (Third) of Trusts would be more appropriate by the New Jersey Supreme Court. It then held that by applying existing law, which has incorporated various provisions of the Restatement (Second) of Trusts, the wife's beneficial interest in the trust was not an asset held by her for purposes of New Jersey's alimony statute and she could not, merely by being a named co-trustee, without the consent of her parents, compel discretional distributions. Thus, no income from the trust should have been imputed to the wife. The New Jersey Supreme Court affirmed.

California Board of Equalization To Release Information to IRS

A California district court recently ruled that the IRS can serve "John Doe" summons on the California Board of Equalization in order to obtain a list of the names of California property owners who gifted real estate to family members between 2005 and 2010. The Board of Equalization has this information because taxpayers must file certain documentation (which is eventually turned over to the Board of Equalization) if they wish to retain a 2% cap on property tax increases after having transferred property to descendants.

The IRS is expected to use this information to track down taxpayers who failed to file gift tax returns.

New York State Changes Personal Income Tax Rates

New York has modified the personal income tax rate schedule for tax years 2012 through 2014.

Under the statute, the state lowers its top "permanent" personal income tax rate from 6.85% to 6.45% for portions of income over $40,000 but not over $150,000 and to 6.65% for portions of income over $150,000 but not over $300,000. The top "permanent" rate is raised to 8.82% for those earning more than $2 million, and the current top rate of 6.85% remains in effect for those earning over $300,000 but not over $2 million. Each of these rates is less than the temporary rates that have been in effect since 2009.

The new rates will expire December 31, 2014. After 2014, unless New York's legislature acts, the top tax rate of 6.85% will apply to any portion of income exceeding $40,000.

New York Legislature To Consider New Uniform Trust Code

A new uniform trust code will be submitted to the New York state legislature for its consideration. The new code will modernize New York's trust law, clarify existing law, and provide greater accessibility for out-of-state lawyers. The proposed uniform trust code will be a default statute that a testator or settlor can elect not to apply. According to Judge C. Raymond Radigan, with respect to the uniform trust code's provisions on the rights of creditors in the case of spendthrift or discretionary trusts, much of New York's law is retained and the uniform trust code provisions are not adopted by the committee submitting the legislation. One important change is that a trust will be considered revocable or amendable by the settlor unless a contrary direction is given in the trust agreement.

The uniform trust code will have retroactive effect covering existing trusts.

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