Wealth Management Update

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Edited by Henry J. Leibowitz
Contributor: Peter J. Tucci

As part of our ongoing efforts to keep wealth management professionals informed of recent developments related to our practice area, we have summarized below some items we think would be of interest. Please let us know if you have any questions.

May 2023 Interest Rates for GRATs, Sales to Defective Grantor Trusts, Intra-Family Loans and Split-Interest Charitable Trusts

The May Section 7520 rate for use in estate planning techniques such as CRTs, CLTs, QPRTs and GRATs is 4.4%, a sharp drop from the April rate of 5.0%. The May applicable federal rate ("AFR") for use with a sale to a defective grantor trust or infra-family loan with a note having a duration of:

- 3 years or less (the short-term rate, compounded annually) is 4.30%, down from 4.86% in April.
- 3 years to 9 years (the mid-term rate, compounded annually) is 3.57%, down from 4.15% in April.
- 9 years or more (the long-term rate, compounded annually) is 3.72%, down from 4.02% in April.

IRS Rules that Assets in Irrevocable Grantor Trusts Do Not Receive Basis Step-Up at Death

Section 1014(a) of the Internal Revenue Code provides that upon a decedent's death, property inherited from the decedent generally receives a "step-up" in income-tax basis. This allows the heirs to sell the inherited assets without generating much, if any, capital gain liability. The view of most practitioners—and our view—has long been that assets transferred to *a grantor trust that is outside of the grantor's estate for estate-tax purposes* do not receive an income-tax basis step-up on the grantor's death. But a small group of practitioners have argued for years that under the terms of Section 1014(a), assets held in such a trust should receive a step-up in basis upon the grantor's death.

Until a few weeks ago, the Internal Revenue Service (the "IRS") had never taken a position on this issue. That changed on March 29, when the IRS issued Revenue Ruling 2023-2, clarifying its stance. As expected, the IRS has taken the position that assets held in a grantor trust that is outside of the grantor's estate do not receive a step-up in basis upon the grantor's death, despite the fact that such assets are owned by the grantor for income-tax purposes during his or her lifetime. (Assets held in a grantor trust that is inside the grantor's estate, like revocable trusts or GRATs that have not yet terminated, do receive a basis step-up.)

This revenue ruling is a reminder that the income tax implications of lifetime gifts must be weighed carefully before a transfer is made. All else equal, we recommend that clients transfer high-basis assets, rather than low-basis assets, to mitigate the cost of any foregone basis step-up. Individuals who have settled irrevocable trusts that now hold highly appreciated assets (with low basis) should consider substituting higher-basis assets in their place so that the low-basis assets are owned by the individual personally, rather than the trust, on his or her death.

Florida Court Rules that Non-Homestead Property Transferred to Entity May be Reassessed

It is common for high-net-worth individuals to transfer real estate to entities, such as limited liability companies, for asset-protection reasons. But, as a Florida couple learned in a recent case, in some states, these transfers can have adverse property tax consequences.

In *S and A Property Investment Services, LLC v Pedro Garcia et al* (Miami-Dade County Property Appraiser) (FL 3rd DCA case No. 3D22-835, issued March 15, 2023), a couple sought to reverse the reassessment of their investment property. The case centered around Florida's 10% cap on annual ad valorem tax increases to non-homestead property. The assessor argued that the cap was lifted when the couple transferred the property to the limited liability company, resulting in a 160% increase in the property's assessed value. The court agreed with the assessor.

Florida law in this area remains unsettled. Nonetheless, it is important that individuals consult with attorneys before transferring properties into legal entities or trusts.

IRS Releases Strategic Operating Plan

On April 6, the IRS released its "Strategic Operating Plan" detailing how it plans to begin spending the $80 billion of additional funding that Congress allocated to the agency as part of the Inflation Reduction Act, enacted last year. The IRS plans to hire 19,545 staff with funds from the legislation over the next two years, including 7,239 enforcement staff. The additional enforcement agents will focus on auditing large companies and high-net-worth people, including estate and gift tax audits.

The Private Client Services Department at Proskauer is one of the largest private wealth management teams in the country and works with high-net-worth individuals and families to design customized estate and wealth transfer plans, and with individuals and institutions to assist in the administration of trusts and estates.

If you have any questions regarding the matters discussed in this newsletter, please contact any of the lawyers listed below:

BOCA RATON

Albert W. Gortz
+1.561.995.4700 — agortz@proskauer.com

David Pratt
+1.561.995.4777 — dpratt@proskauer.com

LOS ANGELES

Mitchell M. Gaswirth
+1.310.284.5693 — mgaswirth@proskauer.com

Andrew M. Katzenstein
+1.310.284.4553 — akatzenstein@proskauer.com

NEW YORK

Nathaniel W. Birdsall
+1.212.969.3616 — nbirdsall@proskauer.com

Kimberly Ann Braun
+1.212.969.3396 — kbraun@proskauer.com

Stephanie E. Heilborn
+1.212.969.3679 — sheilborn@proskauer.com

Henry J. Leibowitz
+1.212.969.3602 — hleibowitz@proskauer.com

Caroline Q. Robbins
+1.212.969.3638 — crobbins@proskauer.com

Jay D. Waxenberg
+1.212.969.3606 — jwaxenberg@proskauer.com