



newsletter

Wealth Management Update

February 2016 in this issue

A monthly report for wealth management professionals.

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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.

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 2.2%, which is the same as January’s 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 3-9 years (the mid-term rate, compounded semiannually) is 1.81%, up from 1.80%.

The relatively low § 7520 rate and AFRs continue to present potentially rewarding opportunities to fund GRATs in December with depressed assets that are expected to perform better in the coming years.

The AFRs (based on semiannual compounding) used in connection with intra-family loans are 0.81% for loans with a term of 3 years or less, 1.81% for loans with a term between 3 and 9 years, and 2.63% for loans with a term of 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 1.81%, the child will be able to keep any returns over 1.81%. These same rates are used in connection with sales to defective grantor trusts.

IRS Issues Final Form 8971 and Instructions for New Consistent Basis Reporting Rules

On January 29, 2016, the IRS promulgated the final version of the new Form 8971 and its accompanying instructions. Form 8971 tells estate executors and others required to file a Form 706 how to report the final estate tax value of the decedent’s property to the IRS and beneficiaries (including other estates and trusts) receiving said property from the estate. The accompanying Schedule A must also be provided to the estate’s beneficiaries by the executor. A Form 8971 and the accompanying Schedule(s) A must be filed by all estates that are required to file an estate tax return; it is unclear whether executors filing portability returns also must comply with the consistent basis reporting regime. Generally,

the filings are due 30 days after the earlier of the estate's required or actual estate tax return filing date. Pursuant to Notice 2015-57, the deadline for estates subject to this regime with estate tax return filing deadlines between August 30, 2015 and February 29, 2016 is February 29, 2016.

The instructions state that all property acquired or expected to be acquired by a beneficiary must be listed on that beneficiary's Schedule A, but that if the executor has not determined which beneficiary is to receive specific property as of the filing deadline, the executor must list all items of property that could be used, in whole or in part, to fund the beneficiary's distribution. As such, the same property may be reflected on more than one Schedule A.

Tax Court Draws a Fine Line on the Taxation of Gifts Made to Resolve Intra-Family Litigation, *Sumner Redstone v. Commissioner*, T.C. Memo. 2015-237 (December 9, 2015).

The Tax Court prevented the IRS's attempt to characterize a transfer in trust made by the petitioner, Edward Redstone, to his children in settlement of highly contentious litigation with his brother, Sumner, and father, Mickey, as a taxable gift. The Tax Court looked to various "subsidiary factors" to determine that Edward's transfer (mandated by the settlement agreement) was made in settlement of genuine litigation was not a taxable gift because it met the Treas. Reg. § 25.2512-8 gift tax exception for transfers for full and adequate consideration as a result of being made in the ordinary course of business (i.e., transactions which are bona fide, at arm's length, and free from any donative intent). Notably, the Tax Court rejected the Service's argument that consideration must flow from the transferees for this consideration exception to apply.

3 weeks after the settlement agreement was signed, Edward's brother, Sumner, created irrevocable trusts for his children that mirrored trusts mandated by the settlement agreement to be created by Edward for Edward's children. Importantly, the trusts were not mandated by the settlement agreement but, rather, were made to abide by the wishes of the family patriarch, Mickey. The IRS issued a deficiency notice relative to the transfer and Sumner litigated the case before the Tax Court (*Sumner Redstone v. Commissioner*). On December 9, 2015, the Tax Court held for the Service, ruling that Sumner's voluntary creation of the irrevocable trusts were not free from donative intent and, as such, were taxable gifts for Federal gift tax purposes.

"Fluke" Art Auction Price Argument Fails to Protect Taxpayer in Tax Court, but "Depressed Market" Discount Is Allowed, *Estate of Newberger v. Commissioner*, T.C. Memo. 2015-246 (December 22, 2015).

This Tax Court case involved the sale of a Picasso, a Motherwell, and a Dubuffet at auction in what was universally agreed to be a "down market." Sotheby's and Christie's competed over the right to sell the Picasso, originally purchased by the decedent in 1981 for \$195,000, offering guaranteed payments of approximately \$3,500,000 and \$4,750,000 in the event the painting did not sell.

Christie's, which ultimately sold the Picasso, provided the estate with a date of death value of \$5,000,000 and advertised an expected sales price in its catalogue of approximately \$4,750,000 to \$6,400,000. The Picasso actually sold for about \$13,000,000. The Motherwell and Dubuffet also sold for more than their appraised or reported values; the Motherwell was appraised and reported with a date of death value of \$450,000 and actually sold for about \$1,400,000, while the Dubuffet's date of death value was appraised and reported at \$500,000 when it actually sold for \$825,000.

The IRS's appraisers determined that the Picasso, the Motherwell, and the Dubuffet had date of death values of \$13,000,000, \$1,500,000, and \$750,000, respectively. The estate argued that the actual sales price of the Picasso was an unpredictable "fluke" and, so, the Tax Court should disregard the sale as evidence of value because it could not reasonably be anticipated on the date of death. The Tax Court roundly rejected this argument and arrived at a value of \$10,000,000 after applying a market condition discount to the IRS's valuation.

To discuss anything mentioned herein, please contact one of the lawyers in the Private Client Services Department at Proskauer Rose LLP.

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.

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This publication is a service to our clients and friends. It is designed only to give general information on the developments actually covered. It is not intended to be a comprehensive summary of recent developments in the law, treat exhaustively the subjects covered, provide legal advice, or render a legal opinion.

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