Proskauer

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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.

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

The September § 7520 rate for use with estate planning techniques such as CRTs, CLTs, QPRTs and GRATs is 1.4%, which is the same as the August 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 having duration of 3-9 years (the midterm rate, compounded annually) is 1.22%, which is slightly higher than the August rate of 1.18% and lower than July's rate of 1.43%.

The relatively low § 7520 rate and AFRs continue to present potentially rewarding opportunities to fund GRATs, CLATs, sales to defective grantor trusts, private annuities, SCINs and intra-family loans in August with depressed assets that are expected 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 0.61% for loans with a term of 3 years or less, 1.22% for loans with a term of 9 years or less, and 1.90% 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 1.22%, the child will be able to keep any returns over 1.22%. These same rates are used in connection with sales to defective grantor trusts.

Case to Watch – Constitutional Challenge to New Jersey Statute. *Rucksapol v. Dir., Div. of Taxation*, N.J. Tax Ct., No. 009356-2015 (unpublished, May, 11, 2016), N.J. Super. Ct. App. Div., No. A-004089-15T2 (brief filed July 22, 2016)

As reported in our July newsletter, the New Jersey Tax Court denied a marital deduction to a New Jersey man whose partner of 31 years died six days before their scheduled wedding because the couple was neither married nor in a civil union. The couple, a

same-sex couple, was, however, in a registered domestic partnership, a status authorized by New Jersey before civil unions or marriages were authorized. Though this afforded the couple certain benefits, treatment as a surviving spouse for the surviving partner was not one such benefit. The Court held that the couple's conscious decision not to enter into a civil union (a status that would have treated the surviving partner as a surviving spouse for estate tax purposes) nor to marry immediately when marriage became available to same-sex couples in New Jersey had consequences. One of these consequences was that the surviving partner could not be treated as a surviving spouse for estate tax purposes.

On July 22, 2016, the surviving partner filed an appellate brief claiming that he has a constitutional right to the estate tax deduction. Under New Jersey law, same-sex couples registered as domestic partners are treated as a couple for purposes of the inheritance taxes but are not treated as such for the estate tax. For New Jersey estate tax purposes, a couple must be married or in a civil union to qualify for the estate tax deduction. In the brief, the surviving partner claimed: (1) New Jersey's Domestic Partnership Act of 2004 violated the equal protection guarantee under the New Jersey state constitution by failing to provide the marital deduction for estate tax purposes and (2) as the New Jersey inheritance tax and the New Jersey estate tax are fundamentally interlinked, there is no rational basis for differentiating the marital deduction between these two New Jersey death taxes. The surviving partner argued that, despite the fact that New Jersey later legalized marriage, whether or not the statute violates the equal protection clause of the New Jersey constitution should not be based upon subsequent legislation. Further, he indicated that, when the civil union statute was enacted, domestic partners were notified of their right to file for a civil union but they were never advised as to the difference in benefits for domestic partners and members of a civil union. Therefore, he argued that there was no fair notice to individuals regarding this issue.

Florida court interpreted Florida Statute 736.0602(3) to allow the revocation of a trust by a later executed Will where there is clear and convincing evidence of the Settlor's intent. *Bernal v. Marin*, Docket No. 3D15-171, 2016 Fla. App. Lexis 9229 (Fla. Dist. Ct. App. 3d Dist., June 15, 2016)

The Third District Court of Appeals of Florida interpreted Fla. Stat. 736.0602(3) regarding methods for revoking or amending a trust. The Court held that a will can revoke a trust if there is clear and convincing evidence of the Settlor's intent.

In this case, the decedent executed and funded a revocable trust which provided that, upon the decedent's death, a specific bequest be made and the residue distributed to charity. The trust was funded with the decedent's sole residence and a brokerage account. The trust did not provide a mechanism for revoking the trust. Subsequently, the decedent met with an attorney and executed a Will that read, in pertinent part, "I, decedent, a resident of Miami-Dade County, Florida, and a citizen of the US, declare this to be my Last Will and Testament, revoking all other wills, trust and codicils previously made by me." The Will did not specifically refer to her revocable trust by name.

Upon the decedent's death, the trustee of the trust claimed that the alleged revocation was ineffective. The trial court concluded that because the decedent's later Will did not

specifically name or expressly refer to the trust or specifically devise her real property and the brokerage account, the Will did not revoke the trust.

Relying on Fla. Stat. 736.0602(3)(b)(2), which allows revocation of a trust by "any other method manifesting clear and convincing evidence of the settlor's intent", and extrinsic evidence of the Settlor's intent, the Third District Court of Appeals concluded that the Settlor intended, by clear and convincing evidence, to revoke the trust by the execution of the later Will. The extrinsic evidence considered by the court was the testimony of the attorney who drafted the later Will and an affidavit provided by an individual who had been friends with the decedent for forty-four years and had knowledge of the Settlor's intent.

IRS Indicates That Orders of State Courts Cannot Alter Federal Tax Consequences

PLR 201623001 (June 3, 2016).

The IRS issued a ruling indicating that an Order of a state court could not be accomplished under federal tax laws. In this ruling, the decedent and his spouse were married and lived in a community property state. Decedent named child as the sole beneficiary of his three IRAs. After the decedent's death, the surviving spouse filed a claim against the estate for her 1/2 interest in the community property of the decedent. The state court approved a settlement between the spouse and the decedent's estate and ordered the IRA custodian to assign a stated amount of a child's inherited IRA to the surviving spouse based on community property rights. IRS ruled that: (1) the spouse cannot be treated as a payee of the inherited IRA for the child because, under IRC Section 408(g), IRC Section 408 is to be applied without regard to the community property laws; (2) the spouse may not rollover any amounts from the inherited IRA for child because, under IRC Section 408(d)(3)(C), rollovers are not permitted for inherited IRAs; and (3) any assignment of an interest in the inherited IRA for child to spouse would be treated as a taxable distribution to child because the child is the named beneficiary of the IRA and the spouse's community property interest is disregarded under IRC Section 408(g). Accordingly, the PLR indicated that the Order of the state court could not be accomplished under federal tax law.

PLR 201628004, PLR 201628005 and PLR 201628006 (July 8, 2016).

The IRS indicated that a state court's retroactive reformation of an instrument is not effective to change the tax consequences of a completed transaction. In each of these PLRs, the decedent had an IRA with Custodian A and named Trust C as a 50% beneficiary and each of Trusts D and E as a 25% beneficiary of the IRA. The decedent's financial advisors later joined another firm and became affiliated with Custodian B. The financial advisors provided the decedent with a beneficiary designation form naming the decedent's estate as the sole beneficiary. Although the decedent signed the forms, he merely intended to move the assets from Custodian A to Custodian B and did not intend to change the beneficiaries.

After the decedent's death, the trustees petitioned the court to modify the beneficiary designations to carry out the intent of the decedent. The Court ordered that the beneficiary designations be revised to the original plan, effective as if they were originally made by the decedent when the decedent signed the new beneficiary designation forms.

The ruling requested confirmation that the life expectancy of the beneficiary of each trust could be utilized to determine the applicable distribution period with respect to the portion of the IRA payable to each trust. Generally, if an IRA owner dies on or after his required beginning date without having designated a beneficiary, then post-death distributions must be made over the remaining life expectancy of the IRA owner. An estate or charity is not a designated beneficiary but, if certain provisions are followed, a trust can be a designated beneficiary. The IRS ruled that, because the decedent's estate was named as the beneficiary of the IRA at the time of the decedent's death, there was no designated beneficiary of the IRA. Further, the IRS noted that, although the court order changed the designation of the IRA under state law, the order could not create a designated beneficiary for federal tax purposes. The IRS stated that, if the state court order could change the federal tax consequences, "there would exist considerable opportunity for 'collusive' state court actions having the sole purpose of reducing federal tax liabilities."

South Dakota – Special Spousal Trust Statute - SDCL 55-17

Effective July 1, 2016, a new South Dakota statute allows a married couple to create a special trust, called a South Dakota Special Spousal Trust, the assets of which upon transfer will be considered community property under South Dakota law. Further, the statute allows Settlors of such trusts to take advantage of the benefits of the 100% income tax basis step-up provided in IRC Section 1014(b)(6). There is no definitive authority regarding whether residents of non-community property states can avail themselves of this trust and get the benefits of the IRC Section 1014(b)(6) step-up at the first spouse's death. Finally, the statute indicates that a South Dakota Special Spousal Trust can be a spendthrift trust allowing for asset protection benefits for the assets transferred to the trust. The statute specifies the requirements for the creation of a South Dakota Special Spousal Trust.

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:

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