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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.

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

The December § 7520 rate for use with estate planning techniques such as CRTs, CLTs, QPRTs and GRATs is 1.8%, up 0.2% from November. The December 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 annually) is 1.47%, up from 1.33% in November.

The relatively low §7520 rate and AFR 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 annual compounding) used in connection with intra-family loans are 0.74% for loans with a term of 3 years or less, 1.47% for loans with a term between 3 and 9 years, and 2.26% 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 1.47%, the child will be able to keep any returns over 1.47%. These same rates are used in connection with sales to defective grantor trusts.

2017 Annual Gift Exclusion

For 2017, the first $14,000 of gifts a taxpayer makes to any particular individual are not subject to gift tax. This "annual gift exclusion" amount is unchanged from 2016.

2017 Gift and Estate Tax Exemption Amount

For 2017, each taxpayer's unified gift and estate tax exemption amount is $5,490,000, a $40,000 increase from the 2016 exemption amount of $5,450,000.

This amount represents the maximum aggregate amount that a taxpayer may gift during his or her lifetime or bequeath at his or her death without the imposition of any federal gift or estate taxes.

New Jersey Eliminates State Estate Tax (P.L. 2016, Ch. 57)

On October 14, Governor Christie signed into law P.L. 2016, Ch. 57, which will ultimately eliminate New Jersey's state estate tax.

At present, New Jersey imposes a state estate tax at a maximum rate of 16%. Each taxpayer has a $675,000 exemption amount that is free from estate tax (the lowest exemption amount of any state that imposes an estate tax). Under the new law, the exemption amount is raised to $2,000,000 for decedents dying in 2017. The state estate tax is then repealed entirely effective January 1, 2018.

The elimination of the estate tax goes hand-in-hand with a 23-cent increase in New Jersey's gas tax, which has already gone into effect.

Although New Jersey's estate tax will be eliminated, the new law has no impact on the state's inheritance tax, which is imposed on beneficiaries who receive assets from an estate. No inheritance tax is generally imposed on amounts passing to the decedent's spouse, parents, grandparents or descendants. However, tax is imposed (at a rate between 11% and 16%) on bequests to unrelated individuals as well as to the decedent's siblings and other more remote relations. The inheritance tax is due eight months after a decedent's death and is typically paid by the estate out of the bequests otherwise payable to the beneficiaries.

Tax Court Includes Family Limited Partnership in Decedent's Estate, Finds Insufficient Non-Tax Reasons for Forming Partnership (*Beyer v. Comm'r*, T.C. Memo. 2016-183 (September 29, 2016))

Edward Beyer created a limited partnership in 2003 at the age 93 and funded it primarily with shares of stock of Abbott Laboratories (of which he had been the CFO), which had previously been held in Mr. Beyer's revocable trust. Mr. Beyer retained sufficient assets outside of the partnership to support his modest lifestyle for the remainder of his expected life, but it was clear those assets would be insufficient to satisfy Mr. Beyer's expected estate tax liability at death.

Mr. Beyer then created an irrevocable trust for the benefit of his nephews and niece (having no descendants of his own), which in 2005 purchased from him a 99% limited partnership interest in the partnership, using a promissory note to pay the $21 million purchase price (determined by reference to a professional appraisal that applied the usual valuation discounts).

The next year, the partnership made pro rata distributions to its partners, presumably in order to provide Mr. Beyer with the cash needed to pay a $660,000 gift tax liability arising from unrelated transactions. That amount was paid to the irrevocable trust, as limited partner, and the trust in turn distributed the cash to Mr. Beyer in partial repayment of the $21 million promissory note.

Mr. Beyer died in 2007, and his estate paid his $9.3 million federal estate tax liability with a check issued directly by the partnership.

On audit, the IRS determined that the entirety of the partnership should be included in Beyer's estate under Section 2036(a) of the Code. The IRS concluded that the sale of partnership interests to the irrevocable trust was not bona fide, since Beyer had retained enjoyment of the assets transferred to the partnership, as illustrated by the use of partnership funds to pay his gift and estate tax obligations. These payments (including the direct payment of estate tax by the partnership) showed an implied agreement that partnership assets would be used for Beyer's benefit when needed.

The IRS also concluded that there was no legitimate and significant non-tax reason for creating the partnership. Beyer's executors argued that the partnership allowed Beyer to achieve two non-tax goals: (a) to keep all of the Abbott Laboratories shares managed as a single block and (b) to allow for "continuity of management" of Beyer's assets by his nephew, who controlled partnership investments.

The Tax Court rejected both arguments, noting that the shares had previously been held in a revocable trust, and that Beyer could easily have achieved both goals by changing the terms of his revocable trust and designating his nephew as Trustee. The court also noted that nothing in the partnership agreement specifically mandated retention of the shares as a block or required the general partners to follow any particular management philosophy.

The court concluded that the sale of partnership interests to the irrevocable trust should be disregarded for estate tax purposes, and that the full value of the partnership as of Beyer's date of death should be included in his estate.

Beyer has the typical hallmarks of a failed partnership transaction, where the formalities of the partnership were disrespected (as shown by the direct payment of estate tax by the partnership and the partnership's failure to maintain accurate capital accounts) and insufficient assets were retained by the creator. However, *Beyer* is notable in its examination of whether alternative arrangements (such as revocable trusts and powers of attorney) could have been used to achieve the same purported non-tax goals as the partnership. In light of *Beyer*, practitioners will need to take even more care to document the legitimate non-tax goals for creation of a family partnership, including a rationale for why a partnership is the best mechanism for achieving those goals.

IRS Allows Estates to Make QTIP Elections That Do Not Reduce or Eliminate Federal Estate Tax (Rev. Proc. 2016-49)

In 2001, the IRS issued Rev. Proc. 2001-38, which provided that a decedent's executors may make a "QTIP" election with respect to a marital trust for a surviving spouse only to the extent necessary to reduce or eliminate federal estate tax.

If a QTIP election is made with respect to a qualifying marital trust, any assets passing to the trust at the death of the first spouse will not be included in his or her estate for estate tax purposes. Instead, any assets remaining in the trust at the death of the surviving spouse will be included in the surviving spouse's estate.

In 2010, the Code was changed to allow a predeceasing spouse to pass his or her unused estate tax exclusion amount (the "Deceased Spouse's Unused Exclusion," or "DSUE") to the surviving spouse. Because of this new "portability" of the DSUE, in certain circumstances the executors of a predeceased spouse may wish to make a QTIP election even when not necessary to reduce federal estate tax (since doing so increases the amount of DSUE that can pass by portability to the surviving spouse).

New Rev. Proc. 2016-40 supersedes Rev. Proc. 2001-38 and provides that a QTIP election can be made even if there is no attendant reduction in federal estate tax, if made hand-in-hand with a portability election. In other circumstances, the rule against unnecessary QTIP elections still generally applies.

The new ruling still allows the revocation of an unnecessary QTIP election (where no portability election is made) upon request of (1) the executor of the predeceased spouse on a supplemental federal estate tax return, (2) by the surviving spouse on a federal gift tax return or (3) by the executors of the surviving spouse on his or her federal estate tax return.

U.S. District Court Examines When the IRS May Recover Unpaid Estate Tax Estate from Beneficiaries (*U.S. v. Paulson*, Case No. 15cv2057 AJB (NLS) (S.D. Cal. Sep. 6, 2016)

Allen Paulson died in 2000, leaving a revocable a trust that provided bequests to his third wife and to his children from prior marriages. Disputes arose between the beneficiaries, and in 2003 a settlement agreement was reached whereby Mr. Paulson's wife (Madeleine Pickens) received certain property outright, which was paid to her revocable trust (of which she was trustee) at her request. After receiving her settlement assets, it appears that Ms. Pickens was not involved in the management of the estate or of Mr. Paulson's revocable trust, which were overseen by one or more of Mr. Paulson's children.

The estate elected to pay its federal estate tax obligations in increments over a fifteen-year period, in accordance with Section 6166 of the Code. After the estate failed to meet its installment payments, the IRS brought suit in 2015 to recover over $10 million of unpaid taxes. At that time, there was no longer any executor acting on behalf of Mr. Paulson's estate.

The IRS, attempting to cast as broad a net as possible, sought to recover the unpaid tax from Ms. Pickens, as a beneficiary of the estate, even though she had received her settlement assets twelve years earlier. Ms. Pickens filed a motion in the United States District Court, Southern District of California, to dismiss the IRS's recovery action.

The IRS brought claims against Ms. Pickens under two separate provisions of the Code: (1) Section 2203, which provides that if no executor is then acting who has been appointed by the court, then any person "in actual or constructive possession of any property of the decedent" shall be considered an "executor" for tax purposes, and (2) Section 6324(a)(2) which provides, in part, that if any estate tax is not timely paid, any "trustee" or "beneficiary" who receives property from the estate is liable for payment.

The court declined to dismiss the IRS claim under Section 2203, since there was no executor then acting and Ms. Pickens was clearly holding property that formerly belonged

to the decedent. The more interesting issue is whether the IRS could also proceed against Ms. Pickens under Section 6324(a)(2).

The court noted that the word "beneficiary" as used in Section 6324(a)(2) had been limited by case law only to beneficiaries of insurance policies. Accordingly, the court concluded that the IRS could not seek to recover from Ms. Pickens with respect to any property she received outright from the estate. However, because the property had been transferred from the estate to Ms. Pickens' revocable trust, she was holding property legally as a "trustee," rather than a "beneficiary." Accordingly, the IRS could proceed against her under Section 6324(a)(2) as a trustee of her revocable trust.

This case raises the intriguing possibility that (ignoring the parallel recovery action under Section 2203) Ms. Pickens could have obtained a dismissal of the IRS recovery action if she had received the property outright, rather than in her revocable trust.

California Adopts the Uniform Fiduciary Access to Digital Assets Act (California Assembly Bill 691)

On September 24, 2016, California adopted the Uniform Fiduciary Access to Digital Access Act, effective as of January 1, 2017.

The act, which has the support of online juggernauts such as Facebook, Google and Yahoo, dictates who will have access to a decedent's digital property and online accounts.

If the decedent, during his or her lifetime, uses a service provider's online tool to directly designate a particular person to have post-death access to a digital account, that designation will be respected by the California courts. If the decedent did not utilize any such online tool, then any directions regarding digital assets set forth in the decedent's will or revocable trust will prevail. If the will and revocable trust are silent on the subject of digital assets, then post-death access will be determined according to the service provider's standard terms of service.

It is advisable that, going forward, wills and revocable trusts for California residents include provisions authorizing access to their online accounts, to avoid default application of any standard terms of service, which may entirely prohibit post-death access to online accounts.

To discuss any aspects of these cases or associated tax implications, please contact one of the attorneys 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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