Proskauer

Wealth Management Update

December 2015

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 2.0%, which is the same as November's rate. 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 1.68%, up from 1.59% in November.

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 annual compounding) used in connection with intra-family loans are 0.56% for loans with a term of 3 years or less, 1.68% for loans with a term between 3 and 9 years, and 2.61% 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 1.68%, the child will be able to keep any returns over 1.68%. These same rates are used in connection with sales to defective grantor trusts.

New York State Issues Guidance Regarding the Treatment of Certain Deductions for New York Estate Tax Purposes for Decedents Dying after April 1, 2014 (TSB-M-15(4)(M))

On October 27th, New York State issued guidance regarding the treatment of certain deductions for New York State estate tax purposes. The rules imposed by this new guidance apply to resident and nonresident decedents dying on or after April 1, 2014. If the rules result in a change in the allowable deductions for an estate of such a decedent and that estate has already filed its New York estate tax return, an amended return must be filed.

The guidance divides deductions into three categories: (1) Deductions that relate directly to real and tangible property, such as a charitable deduction, a marital deduction or a deduction for mortgages; (2) Deductions that relate directly to intangible property, such as a charitable deduction, a marital deduction or a deduction for broker fees; and (3) Deductions that indirectly relate to real, tangible or intangible property, such as executor commissions, accounting fees, attorney's fees, funeral expenses or debts of the decedent. This third type also is referred to as "indirect expenses" here and in the guidance.

For New York resident estates, the New York taxable estate is the decedent's gross estate for federal tax purposes, excluding real or tangible property located outside of New York, less federal deductions other than those that relate to real or tangible property located outside of New York. Therefore, deductions directly related to real or tangible property located outside of New York are disallowed. In addition, deductions indirectly related to real or tangible property located outside of New York are disallowed. To calculate what portion of the indirect expenses relates to the real or tangible property located outside of New York, multiply the indirect expenses by a fraction, the numerator of which is the value of the real and tangible property located outside of New York and the denominator of which is the value of the entire federal gross estate.

The rule imposed on New York nonresident estates is similar, except that intangible property is excluded. Therefore, deductions directly related to real or tangible property located outside of New York are disallowed. Deductions directly related to intangible property are disallowed. And deductions indirectly related to real or tangible property located outside of New York are disallowed. To determine what portion of the indirect expenses relate to the real or tangible property located outside of New York the calculation is as follows: Multiply the indirect expenses by a fraction, the numerator of which is the value of the real and tangible property located outside of New York *plus the value of the intangible property,* and the denominator of which is the value of the entire federal gross estate.

Treasury Issues Proposed Regulation that Offers an Alternative to Contemporaneous Written Acknowledgment Obligation Imposed on Charitable Organizations

In 1993, the Internal Revenue Service added § 170(f)(8)(A) to the Internal Revenue Code. Said section sets forth the general rule that no deduction is allowed for charitable contributions of $250 or more unless the taxpayer substantiates the contribution with a contemporaneous written acknowledgment by the charitable organization. This acknowledgment must contain the information set forth in subparagraph (B) of that section, such as the amount of the contribution and whether the taxpayer received any goods or services in return. The purpose of this section was to curb abuses where taxpayers were contributing to charitable organizations and taking full deductions even though they received items of value in return.

There is an exception to this general rule in subparagraph (D), which states that the contemporaneous written acknowledgment is not required if the charitable organization files a return, on such form and in accordance with such regulations as the Secretary may prescribe, which includes the information described in subparagraph (B).

Prop. Reg. § 1.170A-13(f)(18) is the Internal Revenue Service's attempt at prescribing the substance of this form. However, it has stated that given the effectiveness and minimal burden of the contemporaneous written acknowledgment process, it is expected that this donee reporting method will be used in an extremely low percentage of cases. It also should be noted that prior to this proposed regulation, neither the Internal Revenue Service nor the Secretary has identified any existing forms for charitable organizations to use in connection with the exception.

Before finalizing the proposed regulation, the Internal Revenue Service intends to develop a specific-use information return. Charitable organizations will be required to provide a copy of the return to the donor at the address the donor provides, and the return will only contain the information related to that donor.

The proposed regulation requires that charitable organizations who opt to use donee reporting must report the information in subparagraph (B) as well as the donor's name, address and tax identification number. Unlike the contemporaneous written acknowledgment, which is not sent to the Internal Revenue Service, the donee reporting information return will be sent to the Internal Revenue Service. The information return must be filed by the charitable organization no later than February 28 of the year following the year of the contribution.

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

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