Proskauer

Wealth Management Update

May 2018

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

The May § 7520 rate for use with estate planning techniques such as CRTs, CLTs, QPRTs and GRATs is 3.2%, no change from the April rate of 3.2%. The May 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 2.67%, down from 2.70% in April.

The still relatively low § 7520 rate and AFR continue to present potentially rewarding opportunities to fund GRATs in May 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 2.17% for loans with a term of 3 years or less, 2.67% for loans with a term between 3 and 9 years, and 2.92% 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 2.67%, the child will be able to keep any returns over 2.67%. These same rates are used in connection with sales to defective grantor trusts.

Alaskan Supreme Court Rules Alaska Cannot Grant Itself Exclusive Jurisdiction over Fraudulent Transfer Actions against an Alaskan DAPT. *Toni 1 Trust v. Wacker*, 2018 WL 1125033.

An Alaska statute purported to grant the State of Alaska exclusive jurisdiction over fraudulent transfer actions against an Alaska trust. The Alaska Supreme Court ruled in *Toni 1 Trust v. Wacker* that such provision is invalid and that the Alaskan legislature cannot "... prevent other state and federal courts from exercising subject matter jurisdiction over fraudulent transfer actions against such trusts."

A Montana court had issued a series of judgments against Tangwall and his family. After these judgments were issued, Tangwall transferred two pieces of property to an Alaskan Domestic Asset Protection Trust (DAPT). Both a Montana State Court and an Alaskan Bankruptcy Court found that the transfers to the DAPT were made to avoid a judgment and were thus fraudulent. Tangwall argued that AS 34.40.110(k) gave the Alaskan State Court exclusive jurisdiction over the determination of whether the transfers were fraudulent.

The Supreme Court of Alaska ruled that Alaska could not require that Alaskan State Courts have exclusive jurisdiction of fraudulent transfer actions against a DAPT created in Alaska. This case did not address the validity of Alaskan DAPTs; rather it was a question of Alaskan court jurisdiction. It did not invalidate self-settled trusts created in Alaska.

When Faced with Sparse Documentary Evidence, the Tax Court May Apply the *Cohan* Rule to Estimate Taxpayer's Basis in an IRA. *Shank v. Commissioner*, T.C. Memo. 2018-33.

Taxpayer withdrew $27,000 from his IRA and did not report any of it on his tax return. He testified at trial that he opened the account in the 1990s when he was a high earner and could not deduct the contributions. The court understood that the taxpayer lacked records from the 1990s to establish his basis. Based on his credible testimony, the Tax Court applied the *Cohan* Rule to estimate the taxpayer's basis.

The Tax Court concluded that the taxpayer's IRA established basis in an amount equal to his initial nondeductible contributions for a portion of a lump-sum distribution from the account, but that the IRS had determined correctly the bulk of the distribution is taxable.

Tax Court Held in Substance Foreign Sales Corporation Dividends Were Income to the Taxpayers; Taxpayer Liable for Tax on Contributions to Roth IRA. *Mazzei v. Commissioner*, 150 TC No. 7 (Mar. 5, 2018).

Pursuant to a prepackaged plan, Taxpayers had their Roth IRAs purchase stock in a Bermuda-based Foreign Sales Corporation (FSC), routed funds from their family business into the FSC, and then contributed those funds from the FSC to the Roth IRAs. Taxpayers claimed these funds were dividends from the family business to the FSC, followed by dividends from the FSC to the Roth IRA.

The Tax Court, sustaining the IRS determination that the Taxpayers were the owners of, and liable for tax on, the transferred funds, ruled that in substance these transfers were contributions to a Roth IRA and the dividends exceeded the Roth IRA contribution limit. The Tax Court looked to the actual owner of the funds, questioning who had power and control over the FSC and over receipt of dividend income.

The court declined to uphold penalties under Section 6651(a) and (b), but held the taxpayers were liable for excise tax under Section 4973 for excess contributions to Roth IRAs.

Failure to Correct Error in Gift Tax Return with Subsequent Late GST Allocation Could Result in GST Inclusion Ratio Greater than Zero. PLR 201811002.

A husband created four trusts for his four children. The husband transferred $x dollars to each of the four trusts. Husband and Wife elected to split the gifts under § 2513. However, the Forms 709 reported the gifts incorrectly. Husband's 709 reported that he made a gift of three-quarters of $x and Wife's 709 reported her gift to be one-quarter of $x. No GST exemption was allocated on either 709.

Several years later, Accounting Firm realized no GST exemption was allocated to the four trusts. Husband filed a late allocation in Year 2 equal to the amount of one hundred percent of his Year 1 transfers. Wife made no such allocation. The period of limitations expired on the Year 1 and Year 2 709s.

The IRS determined that because the period for assessment had expired on the amount of the original gift, under § 2504(c) and § 25.2504-2(b) the husband was deemed to have gifted the incorrectly reported amount as this was the amount that finally was determined for gift tax purposes and such amount may not be thereafter adjusted. As to the late allocation, however, the husband's late allocation is effective only as to one-half of the gift transferred to the trusts for his children.

IRS to End Offshore Voluntary Disclosure Program

In IR-2018-52, the IRS announced it will close the 2014 Offshore Voluntary Disclosure Program (OVDP) on September 28, 2018. The IRS urges U.S. taxpayers with undisclosed foreign financial assets to use the OVDP before the program closes. Once the program ends, the IRS will continue to use other methods (including taxpayer education, whistleblower leads, civil examination and criminal prosecution) to combat offshore tax avoidance.

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