Proskauer

Wealth Management Update

January 2012

IRS issues Revenue Ruling 2011-28

On December 5, 2011, the IRS issued Revenue Ruling 2011-28, holding that a grantor's retention of the power, exercisable in a non-fiduciary capacity, to acquire a life insurance policy held in a trust by substituting other assets of equal value will not cause inclusion of the policy in the grantor's gross estate under IRC Section 2042, as long as certain guidelines are met.

This is significant because IRS Section 2042 includes as a taxable asset in one's gross estate any share of life insurance proceeds to which the decedent possessed at the decedent's date of death any incidents of ownership in the policy, exercisable either alone or in conjunction with any other person.

In Revenue Ruling 2011-28, the IRS held that substituting an asset of equal value for life insurance held in a trust was not an incident of ownership when the decedent was prohibited from serving as Trustee of the trust. Further, the trust explicitly stated that the decedent's power to substitute assets of equivalent value is held in a non-fiduciary capacity.

In addition, the Revenue Ruling assumes: (1) that the Trustee has a fiduciary obligation (under local law or the trust instrument) to ensure the grantor's compliance with the terms of the substitution power by satisfying itself that the properties acquired and substituted by the grantor are in fact equivalent in value; and (2) the substitution power cannot be exercised in a manner that can shift benefits among trust beneficiaries.

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

The January applicable federal rate ("AFR") for use with estate planning techniques such as CRTs, CLTs, QPRTs and GRATs is 1.4%. This is down from the December rate of 1.6%. The rate for use with a sale to a defective grantor trust, self-cancelling installment note ("SCIN") or intra-family loan with a note of a 9-year duration (the mid-term rate, compounded annually) is also down slightly, to 1.17%. Remember that lower rates work best with GRATs, CLATs, sales to defective grantor trusts, private annuities, SCINs and intra-family loans. The combination of a low AFR and a decline in the financial and real estate markets presents a potentially rewarding opportunity to fund GRATs in January with depressed assets you expect 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 0.19% for loans with a term of 3 years or less, 1.17% for loans with a term of 9 years or less and 2.63% for loans with a term of longer than 9 years.

Thus, for example, if a nine-year loan is made to a child and the child can invest the funds and obtain a return in excess of 1.17%, the child will be able to keep any returns over 1.17%. These same rates are used in connection with sales to defective grantor trusts.

IRS Issues Proposed Treasury Regulations 20.2032-1

The IRS withdrew and reissued proposed Treasury Regulations Section 20.2032-1 on November 18, 2011. These proposed Regulations would allow estates to use the 6-month alternate valuation date more broadly. The alternate valuation date is available to use if it produces a lower gross estate than date of death values, which will result in less estate tax payable to the government. This taxpayer friendly provision states that the alternate valuation date is in general the date six months after the date of death unless an asset was sold during that time period. In those circumstances, the selling date is the alternate valuation date.

The new rules allow the alternate valuation date to be used in some cases where property is exchanged in corporate deals, and also in cases involving retirement benefits.

Comments are requested by February 16, 2012, and the IRS hearing is scheduled for March 12, 2012.

Pruco Life Ins. Co. v. Brasner **(S. D. Florida, November 14, 2011)**

A U.S. District Court in Florida held that an investor who acquired a life insurance policy under a stranger owned life insurance ("STOLI") arrangement lacked an insurable interest, and that the insurer did not have to pay the $10 million death benefit.

In *Pruco*, the insured, Mrs. Berger, did not want or need insurance but was interested in receiving a fee for allowing insurance to be bought on her life. The insurance broker decided how much insurance to buy ($10 million) and the schedule of premiums to be paid. Mrs. Berger knew the policy would be owned by somebody else and she did inquire who the owner would be. The policy application grossly overstated Mrs. Berger's net worth and annual income. For the first two years the premiums were paid by a sub-trust with money lent by Bank of America. Mrs. Berger never knew the loan amount or the identity of the lender. After the 2-year contestability period expired, the insurance broker wired a large sum to the Bergers and Bank of America became the owner of the policy. Coventry then bought the policy from Bank of America.

The District Court held that the policy lacked an insurable interest at its inception and was, therefore, void ab initio, as a wagering contract. The Court further held that the policy was acquired in bad faith. A policy is obtained in bad faith "if it is procured with the intention that it will be assigned to a person or entity with no insurable interest." Factors include: (1) pre-existing arrangements, (2) payment of some or all of the premiums by someone other than the insured (especially the assignee), and (3) the lack of a risk of actual future loss.

In addition, while Florida law normally requires the return of premiums paid to the insured when a policy becomes void, the Court held that where a policy is void ab initio because of fraudulent procurement, some courts permit the insurer to retain the premiums, and therefore ordered that the premiums need not be returned in this case.

Estate of Liftin **(November 8, 2011)**

The US Court of Federal Claims held that an estate adequately alleged facts that its failure to timely file a federal estate tax return was due to reasonable cause and not willful neglect, where the estate relied in good faith on expert advice of an estate planning attorney.

The decedent's widow was a U.S. resident, but not a citizen. She indicated to the Executor that she would apply for U.S. citizenship to take advantage of the marital deduction. A law firm advised the Executor to file the estate tax return after the extended due date to preserve the marital deduction. The attorney said no penalty would be triggered so long as the return was filed within a "reasonable" time after the widow became a U.S. citizen.

Approximately two years after the deadline, and after the widow became a U.S. citizen, the Executor filed the estate tax return. The IRS issued a notice of adjustment, reflecting a penalty for late filing. The estate filed a claim for refund.

The Court held that the IRS was not entitled to summary judgment because the estate may be able to prove facts demonstrating that its failure to file timely did not result from willful neglect.

Private Letter Ruling 201144040 (November 4, 2011)

In PLR 201144040, the IRS waived the 60-day deadline for a rollover where the plan administrator gave the participant incorrect tax information.

The employee received a lump sum distribution from his 401(k) account, which was fully invested in common shares of the employer. Within 60 days he rolled over that number of shares having a value equal to the amount the plan administrator advised him was the taxable amount portion. The employee later received a corrected 401(k) Taxable Account Information, showing a larger amount.

The IRS can waive the 60-day rollover deadline where the failure to waive such requirement would be against equity or good conscience, including casualty, disaster or other events beyond the reasonable control of the taxpayer. The IRS considered the erroneous taxable account information received by the plan administrator to be outside the taxpayer's control and therefore granted the waiver request.

Related Professionals

- **Andrew M. Katzenstein**
  Partner
- **Jay D. Waxenberg**

Partner

- **Henry J. Leibowitz**
  Partner
- **David Pratt**
  Partner
- **Mitchell M. Gaswirth**
  Partner
- **Albert W. Gortz**