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Planning During Turbulent Times

April 26, 2012

4:00–4:30 p.m. Registration
4:30–6:00 p.m. Panel discussion
6:00–7:00 p.m. Reception

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Katten Muchin Rosenman LLP Trusts and Estates Seminar

Planning During Turbulent Times

April 26, 2012

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Planning in an Uncertain Tax Climate

Ronni G. Davidowitz

- Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 – passed December 17, 2010, effective January 1, 2011.
- Scheduled to sunset December 31, 2012.
- Creates for two years, 2011 and 2012, window of opportunity for favorable tax planning opportunities for taxpayers by (a) increasing estate, gift and generation-skipping tax ("GST") exemptions to $5 million per individual, subject to inflation adjustment for 2012 and (b) dropping maximum rate to 35%.
- Absent Congressional action, effective January 1, 2013, revert to pre-2001 levels, resulting in (a) estate and gift exemptions of $1 million dollars; (b) a 55% estate and gift tax rate, and GST rate; and (c) GST exemption of $1 million adjusted for inflation of approximately $1.42 million. President Obama's budget proposals look to compromise current tax benefits against pre-2001 by imposing $3.5 million estate and GST exemption at top rate of 45% and gift exemption of $1 million at 45% rate.
- Take advantage of likely unique tax benefits by considering myriad planning opportunities available for remainder of 2012, coupled with lower or depressed value of assets due to current economic times. Minimally, get appreciation and income earned on property out of estate. Ability to transfer large sums of wealth by transferring assets, currently experiencing decline in value, coupled with potential use of discounts to enhance actual wealth transfer. Example – leverage reduced value in real estate by use of exemption amount or purchase life insurance through qualified insurance trust with large death benefit.
- Married couples may gift today a maximum of $10,240,000, adjusted for prior gifting that ate into lifetime exemption.
- 2012 available exemption of $10,240,000 is not an insignificant sum; need to assess if can afford to give up assets – as part of consideration, look over all assets. Consider (a) non-income producing assets; (b) gifting portion of exemption amount; and (c) the contrast between low basis assets against higher basis assets as donee receives donor's basis as gift vs. adjustment in basis received by heir at death.
- Need for qualified appraisal – per IRS Code and Regulations should be done within 60 days of transfer. Appraisers are busy and are projected to get busier. Need to act now to ensure that appraisal can be completed before year end.
- How to gift – directly or in trust – pros and cons.
- Non-reciprocal spousal trusts – gifting opportunity that utilizes exemption but keeps door open by including spouse as discretionary beneficiary.
- Dynastic trusts – to take advantage of GST augmented exemption. Look to Delaware as possible situs. No rule against perpetuities, asset protection and directed trust options among other benefits.
- Other tax considerations – current low income tax rates, likely to be increased after election – accelerate receipt of income including recognizing gain from deferred carried interests. Combine benefits of increased gifting with grantor trust status for income tax purposes to have the gift that keeps on giving.

Taking Advantage of Current Historic Low Interest Rates and Values

Beth D. Tractenberg

Some of these transfer types do not generate gift tax and so can be in addition to gifts using your exemption.

Interest Rates for May 2012

- Short-Term AFR (up to three years) .... .28%
- Mid-Term AFR (up to nine years) 1.3%
- Long-Term AFR 2.89%
- IRS assumed rate of return for certain trusts (7520 Rate) 1.6%

Loans

- The spread between the interest rate on the note and earnings passes transfer-tax free.

Use Assets with Depressed Values

- The appreciation after the date of the gift will pass transfer-tax free.

Grantor Retained Annuity Trusts

- Retain an annuity equal to 100% of value of property transferred, plus IRS assumed rate of return.
- Can "re-GRAT" each annuity payment.
- Consider segregating by types of investments.
- Portfolio of GRATs with different annuity terms.

Sale to Intentionally Defective Grantor Trust ("IDGT")

- Sell asset with depressed value to a IDGT (treated as identical to you for income tax purposes); asset may also be discounted.
- Take back a note for up to 90% of the trust's purchase price for the asset.
- To the extent that the asset outperforms the interest on the note and the asset. appreciates, you have made transfer-tax-free gift.
- Note: Have to use some exemption for "seed money"; 10% of value of transaction.
- Can apply GST Tax Exemption, which can't be done with GRAT.

Charitable Lead Trusts

- Contribute securities or other assets you think will appreciate into a trust that benefits a charity for a number of years.
- At the end of the charitable term, the remainder goes to family or other individuals.
- Gift tax can be minimized or eliminated depending on the term selected.
- The lower the 7520 rate, the lower the amount of the annuity that has to be paid to the charity.

Private Annuities

- No gift tax.
- Parent sells to children.
- Use depressed value assets.
- Children promise to pay parent a lifetime annuity based on life expectancy and 7520 rate.
- Present value of lifetime annuity payments equals the value of the property sold.
- To the extent the asset outperforms the 7520 rate, value is transferred with no gift tax.

Reporting Requirements of U.S. Persons with Interests in Foreign Entities

Kathryn von Matthiessen

Planning with additional exemption amounts with foreign entities can lead to a host of traps for the unwary. In addition to requiring sophisticated tax planning, having U.S. persons create or have interests in foreign entities will result in plethora of reporting requirements of U.S. persons, several of which came into effect with the Hiring Incentives to Restore Employment ("HIRE") act, passed in March 2010, which contained many provisions from the previously proposed Foreign Account Tax Compliance Act ("FATCA").

Foreign Trusts

- All foreign trusts with U.S. settlors and U.S. beneficiaries will be grantor trusts (*i.e.*, a flowthrough to settlor for income tax purposes).
- Reporting on 3520 by settlor and 3520-A by Trustee each year or greater of $10,000 and 35% penalty of amount transferred to trust for settlor (5% of trust in a year when no transfer) and 5% penalty for settlor for Trustee's failure to file 3520-A.
- 3520-A is due March 15.
- 3520 is due when settlor's income tax return is filed.
- Also, U.S. foreign trust beneficiaries must file 3520 when receive distribution or be subject to greater of $10,000 and 35% penalty on amount distributed.
- If a foreign trust is not created by U.S. person and trust is a non-grantor trust (*i.e.*, not a flowthrough to the grantor for U.S. income tax purposes), also punitive income tax consequences to U.S. beneficiaries on payments of income accumulated in a prior year.
- Result may be "throwback tax," with an interest charge and loss of capital gains tax treatment.

Ownership of Foreign Corporations

- Corporations formed under foreign trusts are often used in foreign planning, but cause many potential problems for a U.S. settlor or a U.S. beneficiary.

CFC

- Controlled foreign corporation ("CFC").
- More than 50%/10% threshold.
- Flowthrough to grantor if a foreign trust is a grantor trust.
- If non-grantor trust flowthrough to trust beneficiaries for income tax purposes even if no distributions were made to them.
- Loss of capital gains tax treatment.
- Same result if outright ownership instead of through a trust.
- 5471 filing or $10,000 penalty.

PFIC

- If a foreign corporation is not a CFC it could still be a passive foreign investment company ("PFIC").
- 75% income/50% of assets test.
- Interest charge like throwback tax and loss of capital gains tax treatment.
- Potential issue with foreign investments held directly or indirectly by U.S. taxpayers.
- Enhanced PFIC reporting under HIRE – still on hold.
- 8621 filing on disposition of PFIC interest or dividend or when making certain elections.

TD F 90-22.1 ("FBAR")

- Financial interest in or signature authority over foreign financial accounts.
- Separate filing, must be received by Treasury by June 30.
- Filing threshold is foreign accounts greater than $10,000.
- Trust beneficiary must have more than 50% present beneficial interest in income or assets of trust to trigger financial interest in trust's accounts.
- A beneficiary of a trust who is merely discretionary will not have a financial interest in the trust's accounts.
- Grantor of a grantor trust has interest in the trust's foreign accounts.
- A trust beneficiary with a financial interest in the trust's foreign accounts is not required to report the trust's foreign financial accounts on an FBAR if the trust, trustee of the trust or agent of the trust is (1) is a U.S. person and (2) files an FBAR disclosing the trust's foreign financial accounts.
- Civil penalty for willful failure to file is greater of 50% of account or $100,000.
- Civil penalty for nonwillful failure to file is $10,000.
- Criminal penalties may be assessed as well.

Form 8938

- In addition, a new filing, Form 8938, is required for specified foreign financial asset reporting.
- Filing threshold is interests in specified foreign assets greater than $50,000 at the end of year or $75,000 any time during year (for unmarried taxpayer or married taxpayer filing separately).
- U.S. persons who file U.S. income tax returns are to file with income tax return.
- 8938 covers more than foreign accounts, also includes interests in foreign securities and other foreign entities, including foreign trusts.
- Valuation of interest in a foreign trust – value of assets actually distributed plus actuarial value of right to distribution.
- U.S. settlor of foreign grantor trust has lookthrough to trust's assets.
- Only file if know of trust – distribution constitutes knowledge.
- In effect for 2011 for individuals.
- For certain domestic entities, in effect beginning 2012.

FATCA Withholding

- U.S. government instituted policy so foreign banks will be forced to disclose U.S. account holders or face 30% withholding on U.S. source income, including gains from disposition of U.S. assets not currently subject to withholding.
- In effect for fixed, determinable, annual or periodic income (normally subject to withholding when paid to non-resident aliens) on January 1, 2014.
- In effect for all U.S. source income on January 1, 2015.

Offshore Voluntary Disclosure Program ("OVDP")

- Not coincidentally, in light of all of this reporting, IRS has left OVDP open indefinitely.
- OVDP takes criminal penalties off the table.
- Taxpayers accepted into program pay a penalty of 27.5% on unreported foreign assets, plus an accuracy penalty, back taxes and interest.
- Some exceptions to 27.5% penalty – 12.5% if assets are less than $75,000 or 5% if taxpayer (1) inherited funds on which all U.S. taxes were paid on funds deposited, with limited withdrawals and contact with the account; (2) does not know he or she is a U.S. citizen or (3) is living abroad, paying taxes abroad and has $10,000 or less of U.S. source income each year.

Comparison of Form 8938 and FBAR Requirements

The new Form 8938 filing requirement does not replace or otherwise affect a taxpayer's obligation to file Form TD F 90-22.1 (Report of Foreign Bank and Financial Accounts). Individuals must file each form for which they meet the relevant reporting threshold.

	Form 8938, Statement of Specified Foreign Financial Assets	**Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (FBAR)**
Who Must File?	Specified individuals, which include U.S citizens, resident aliens, and certain non- resident aliens that have an interest in specified foreign financial assets and meet the reporting threshold	U.S. persons, which include U.S. citizens, resident aliens, trusts, estates, and domestic entities that have an interest in foreign financial accounts and meet the reporting threshold
Does the United States include U.S. territories?	No	Yes, resident aliens of U.S territories and U.S. territory entities are subject to FBAR reporting
Reporting Threshold (Total Value of Assets)	$50,000 on the last day of the tax year or $75,000 at any time during the tax year (higher threshold amounts apply to married individuals filing jointly and individuals living abroad)	$10,000 at any time during the calendar year
When do you have an interest in an account or asset?	If any income, gains, losses, deductions, credits, gross proceeds, or distributions from holding or disposing of the account or asset are or would be required to be reported, included, or otherwise reflected on your income tax return	Financial interest: you are the owner of record or holder of legal title; the owner of record or holder of legal title is your agent or representative; you have a sufficient interest in the entity that is the owner of record or holder of legal title. Signature authority: you have authority to control the disposition of the assets in the account by direct communication with the financial institution maintaining the account. See instructions for further details.
What is Reported?	Maximum value of specified foreign financial assets, which include financial accounts with foreign financial institutions and certain other foreign non-account investment assets	Maximum value of financial accounts maintained by a financial institution physically located in a foreign country
How are maximum account or asset values determined and reported?	Fair market value in U.S. dollars in accord with the Form 8938 instructions for each account and asset reported Convert to U.S. dollars using the end of the taxable year exchange rate and report in U.S. dollars.	Use periodic account statements to determine the maximum value in the currency of the account. Convert to U.S. dollars using the end of the calendar year exchange rate and report in U.S. dollars.
When Due?	By due date, including extension, if any, for income tax return	Received by June 30 (no extensions of time granted)
Where to File?	File with income tax return pursuant to instructions for filing the return	Mail to: Department of the Treasury Post Office Box 32621 Detroit, MI 48232-0621 For express mail to: IRS Enterprise Computing Center ATTN: CTR Operations Mailroom, 4th Floor 985 Michigan Avenue Detroit, MI 48226 Certain individuals may file electronically at BSA E-Filing System
Penalties	Up to $10,000 for failure to disclose and an additional $10,000 for each 30 days of non-filing after IRS notice of a failure to disclose, for a potential maximum penalty of $50,000; criminal penalties may also apply	If non-willful, up to $10,000; up to the greater of $100,000 or 50 percent of account balances; criminal penalties may also apply
Types of Foreign Assets and Whether They are Reportable		
Financial (deposit and custodial) accounts held at foreign financial institutions	Yes	Yes
Financial account held at a foreign branch of a U.S. financial institution	No	Yes

Financial account held at a U.S. branch of a foreign financial institution	No	No
Foreign financial account for which you have signature authority	No, unless you otherwise have an interest in the account as described above	Yes, subject to exceptions
Foreign stock or securities held in a financial account at a foreign financial institution	The account itself is subject to reporting, but the contents of the account do not have to be separately reported	The account itself is subject to reporting, but the contents of the account do not have to be separately reported
Foreign stock or securities not held in a financial account	Yes	No
Foreign partnership interests	Yes	No
Indirect interests in foreign financial assets through an entity	No	Yes, if sufficient ownership or beneficial interest (i.e., a greater than 50 percent interest) in the entity. See instructions for further detail.
Foreign mutual funds	Yes	Yes
Domestic mutual fund investing in foreign stocks and securities	No	No
Foreign accounts and foreign non-account investment assets held by foreign or domestic grantor trust for which you are the grantor	Yes, as to both foreign accounts and foreign non-account investment assets	Yes, as to foreign accounts
Foreign-issued life insurance or annuity contact with a cash-value	Yes	Yes
Foreign hedge funds and foreign private equity funds	Yes	No
Foreign real estate held directly	No	No
Foreign real estate held through a foreign entity	No, but the foreign entity itself is a specified foreign financial asset and its maximum value includes the value of the real estate	No
Foreign currency held directly	No	No
Precious Metals held directly	No	No
Personal property, held directly, such as art, antiques, jewelry, cars and other collectibles	No	No
'Social Security'-type program benefits provided by a foreign government	No	No

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Foreign Trusts

- A U.S. beneficiary who receives any direct or indirect distribution from a foreign trust must file Form 3520 with the IRS reporting information regarding the name of the trust, the aggregate amount of distributions received from the trust, and such other information as the IRS may require. (Internal Revenue Code (the "Code") § 6048(c).) For the purposes of Form 3520, a distribution includes a distribution of either income or corpus.
- The IRS describes the additional information required in Notice 97-34, which should be listed in whichever is applicable of a Foreign Grantor Trust Beneficiary Statement or a Foreign Non-grantor Trust Beneficiary Statement.
- Reporting is required only if the U.S. beneficiary knows or has reason to know that the trust is a foreign trust. (Notice 97-34, 1997-1 C.B. 422.)

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Foreign Trusts (cont.)

- Pursuant to Code § 6048(c), the IRS will treat a distribution received by a U.S. beneficiary from a foreign trust as an accumulation distribution, subject to the punitive "throwback" rules, unless the IRS receives enough information to allow it to determine the correct tax treatment of such distribution.

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Foreign Trusts (cont.)

- If a U.S. beneficiary obtains from the foreign trust the Foreign Grantor Trust Beneficiary Statement or the Foreign Non-grantor Trust Beneficiary Statement as mentioned (which statement must be attached to Form 3520), the U.S. beneficiary may avoid subjecting a distribution to the throwback rules.
- The U.S. beneficiary also may provide information about actual distributions from the trust for the prior three years. If information about actual distributions is provided, the U.S. beneficiary may treat a portion of the distribution as current income based upon the average of distributions from the prior three years, with only the excess amount of the distribution treated as an accumulation distribution subject to the throwback tax. (Notice 97-34, 1997-1 C.B. 422.)

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Foreign Trusts (cont.)

- If a U.S. beneficiary does not report distributions from a foreign trust under Code § 6048(c), she will be subject to a penalty equal to the greater of $10,000 and 35% of the amount distributed. (Code § 6677.) The IRS may impose additional penalties if there is continued failure to report.
- The total penalties may not exceed the reportable amount.

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Foreign Trusts (cont.)

- If the failure to file was due to reasonable cause (and not due to willful neglect), the IRS may waive the penalty. (Code § 6677(d).)
- If the foreign trustee refuses to provide information, this does not constitute "reasonable cause." (Notice 97-34.)
- The U.S. grantor of a foreign grantor trust must also file Form 3520 with the IRS. A foreign grantor trust with a U.S. grantor must file Form 3520-A with the IRS by the 15th day of the third month after the end of the trust's tax year, and should give a Foreign Grantor Trust Owner Statement to the foreign grantor. The U.S. owner is subject to a penalty of the greater of $10,000 and 5% of the trust's assets owned by the U.S. grantor if the 3520-A is not timely filed.
- A 3520 must be filed by an individual when the individual's own Federal income tax return is due, including extensions.

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CFCs

- A foreign corporation is a controlled foreign corporation ("CFC") if more than 50% of the combined voting power of all classes of its stock or more than 50% of the value of its stock is owned directly or indirectly by a "U.S. Shareholder."
  - A U.S. Shareholder is a U.S. person who owns either directly or indirectly, or through constructive ownership rules, 10% or more of the total combined voting power of all classes of stock in the CFC. (Code §§ 957(a), 951.)
- A U.S. Shareholder must include in her own income her pro rata share of certain income of the CFC. This income is the "passive" income, or Subpart F income, of the company.

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Form 5471

- A U.S. Shareholder is required to file a Form 5471 in each year in which he owns the CFC stock for more than thirty days and at the end of the year.

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Form 5471 (cont.)

- In addition, a U.S. person will need to file Form 5471 if he is:
  - A U.S. person who is an officer or director of a foreign corporation in which (i) a U.S. person acquired stock so that he now owns 10% of the vote or value of such corporation, or (ii) a U.S. person acquired additional stock that represents 10% of the vote or value of such corporation;
  - a (i) U.S. person who acquires stock in a foreign corporation so that he now owns 10% of the vote or value of such corporation, (ii) a U.S. person who acquires additional stock that represents 10% of the vote or value of such corporation, or (iii) a U.S. person who was a 10% shareholder of the corporation and sells stock so that he no longer is a 10% shareholder of the corporation; or
  - a U.S. person that controlled (more than 50% of the vote or value), directly or indirectly, a foreign corporation for 30 days during the corporation's annual accounting period.
- Failure to file results in a $10,000 penalty with respect to each foreign corporation for which no return was filed.

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PFICs

- A foreign corporation is a passive foreign investment company ("PFIC") if:
  - 75% or more of its gross income for the taxable year is passive income; or
  - the average percentage of assets (by value) held by the corporation for the production of passive income is at least 50%. (Code § 1297(a).)
- If a foreign company already is a CFC, discussed above, the PFIC asset test is made on basis, instead of value. (Code § 1297(f).)

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PFIC Reporting

- On March 18, 2010, the President signed the Hiring Incentives to Restore Employment Act (“HIRE”), which contained a version of the previously proposed Foreign Account Tax Compliance Act (“FATCA”) of 2009. These provisions are meant to combat offshore tax evasion by U.S. taxpayers by requiring increased information reporting. One of the provisions of HIRE provides for enhanced reporting by shareholders of PFICs.

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PFIC Reporting (cont.)

- Prior to the enactment of HIRE, a U.S. shareholder of a PFIC had to file Form 8621 only if he or she made a “QEF” or “mark-to-market election" or received a distribution from the PFIC or sold PFIC shares. Under HIRE, every PFIC shareholder will be required to file an annual informational return with the IRS. In Notice 2010-34, the IRS indicated that these rules will apply for calendar year 2011 for reporting in 2012, and, in fact, the IRS recently further suspended the filing requirement until the form for reporting is released. Nevertheless, this development highlights the focus of the IRS and Congress on PFICs.

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Specified Foreign Financial Asset Reporting

- In addition, HIRE provides enhanced reporting requirements with respect to U.S. “owners” of “specified foreign financial assets,” defined as foreign accounts, and to the extent not held in an account at a financial institution, foreign issued stock or securities, interests in a financial instrument or contract held for investment with a foreign issuer or counterparty and interests in other foreign entities.

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Specified Foreign Financial Asset Reporting (cont.)

- Under HIRE, any individual who during any taxable year holds any interest in a specified foreign financial asset must attach to his or her income tax return for such year information, including in the case of any account, the name and address of the financial institution in which such account is maintained and the number of such account, and in the case of any stock or security, the name and address of the issuer and such information as is necessary to identify the class or issue of which such stock or security is a part. The maximum value of each specified foreign financial asset must also be reported.

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Specified Foreign Financial Asset Reporting (cont.)

- For any other specified foreign financial asset, such as an instrument, contract or other interest, the taxpayer will have to provide such information as is necessary to identify such asset, the maximum value of such asset during the taxable year and the names and addresses of all issuers and counterparties with respect to such instrument, contract or interest. The filing is required if the aggregate amount of the individual's specified foreign financial assets exceeds $50,000 on the last day of the taxable year or $75,000 at any time during the year. The penalty for failure to file is $10,000, with additional penalties for non-compliance after notification. The filing is required for individuals for taxable year 2011 and forward. For 2012 there will be specified foreign asset reporting for certain domestic entities as well. The relevant information should be reported on a Form 8938.

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Form 8938

- Special rules apply for reporting the maximum value of an interest in a foreign trust or a foreign estate.
- If a specified individual is a beneficiary of a foreign trust, the maximum value of the specified individual's interest in the trust is the sum of the fair market value, determined as of the last day of the taxable year, of all of the distributions from the foreign trust during the taxable year to the specified individual, plus the value as of the last day of the taxable year of the specified individual's right as a beneficiary to receive mandatory distributions from the foreign trust.
- The maximum value of a specified individual's interest in a foreign estate is the fair market value, determined as of the last day of the taxable year, of the specified individual's beneficial interest in the assets of the foreign estate. If the specified individual does not know or have reason to know based on readily accessible information the fair market value of the individual's interest in a foreign estate during the taxable year, the maximum value is the fair market value, determined as of the last day of the taxable year, of the distributions made during the taxable year to the specified individual as a beneficiary. Similar rules also apply to foreign retirement plans.

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FBARS

- Any U.S. person who has a financial interest in or signature authority or other authority over any financial account in a foreign country, if the aggregate value of these accounts exceeds $10,000 at any time during the calendar year, must file Form TD F 90-22.1 (Report of Foreign Bank and Financial Accounts, commonly known as an “FBAR”).

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FBARS (cont.)

- Beneficiaries of trusts (among other indirect holders of financial interests) are required to file an FBAR with respect to foreign financial accounts of the trust if the accounts meet the reporting threshold and the beneficiary either has a present beneficial interest in more than 50% of the assets of the trust or receives more than 50% of the trust’s income. A U.S. grantor of a trust for U.S. income tax purposes is also deemed to have a financial interest in the trust’s accounts. In the preamble to the recent new FBAR regulations, the Financial Crimes Enforcement Network clarified that mere status as a beneficiary of a discretionary trust should not trigger an interest in the trust’s accounts.

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FBARS (cont.)

- If the IRS discovers a violation of the FBAR filing rules, there will be significant civil penalties and may be criminal penalties. The willful failure to file an FBAR and the filing of a false FBAR are both violations that are subject to criminal penalties under 31 U.S.C. § 5322.

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FBARS (cont.)

- Willfully failing to file an FBAR subjects a person to a prison term of up to 10 years and criminal penalties of up to $500,000.
- The civil penalty for willfully failing to file an FBAR for any year can be as high as the greater of $100,000 or 50% of the total balance of the foreign account for such year. See 31 U.S.C. § 5321(a)(5). This penalty may apply for every annual violation, and for every taxpayer who failed to disclose an account.
- An FBAR is to be filed for any year by June 30 of the following year. The FBAR must be received by the IRS by this date, as opposed to merely being mailed by the taxpayer on or prior to this date.

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FATCA Withholding

- In order to deter U.S. persons from using offshore accounts to avoid U.S. income tax, FATCA also created a new withholding regime. FATCA will impose a 30% U.S. withholding tax on any "withholdable payment" or "passthru payment" made to a foreign entity unless that entity complies with stringent U.S. reporting requirements or otherwise qualifies for an exemption.
- Separate rules apply to foreign financial institutions ("FFIs") and to non-financial foreign entities ("NFFEs"). FFIs generally are subject to a much higher compliance burden in order to avoid the imposition of the 30% FATCA withholding tax.
- An FFI will be subject to the 30% FATCA withholding tax unless it either qualifies for an exemption or becomes a "participating FFI" (a "PFFI") by entering into an agreement with Treasury (an "FFI Agreement") pursuant to which it agrees to perform specific due diligence, reporting and withholding functions.
- A PFFI must obtain and report certain information with respect to "financial accounts" held by "specified U.S. persons" or "U.S.-owned foreign entities" ("U.S. accounts") and must withhold FATCA tax from "passthru payments" (that is, withholdable payments or other payments that are "attributable to" withholdable payments) that it makes to "recalcitrant" accountholders or to non-participating FFIs. A U.S.-owned foreign entity includes a foreign entity which has one or more "substantial U.S. owners."

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FATCA Withholding (cont.)

- After extensions, on January 1, 2014, withholding will begin on U.S. source (FDAP) income. On January 1, 2015, withholding will begin on U.S. source gross proceeds income.
- In the case of a trust, a "substantial U.S. owner" is defined as "(A) Any specified U.S. person treated as an owner of any portion of such trust under sections 671 through 679 of the Code; or (B) Any specified U.S. person that holds, directly or indirectly, more than 10% of the beneficial interests of such trust." Indirect ownership occurs when ownership by a corporation, partnership or trust is considered as being held proportionately by its shareholders, partners, grantors or others treated as owners under Code sections 671 through 679, and a beneficial interest in the trust is the right to receive, directly or indirectly, either mandatory or discretionary distributions. Note that for trusts treated as FFIs because they are primarily engaged in the business of investing, the 10% threshold used to determine substantial U.S. ownership is replaced with a 0% threshold.

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Offshore Voluntary Disclosure Program

- The Internal Revenue Service recently reopened its Offshore Voluntary Disclosure Program (OVDP) in order to help people who have been hiding offshore accounts, or have become aware of their interests in and obligations with respect to such accounts, become current with their taxes.
- The IRS reopened the OVDP following continued strong interest from taxpayers and tax practitioners after the closure of the 2011 and 2009 programs. This program will be open for an indefinite period until otherwise announced.
- The program is similar to the 2011 program in many ways, but with a few key differences. Unlike last year, there is no set deadline for people to apply. However, the terms of the program could change at any time going forward. For example, the IRS could increase penalties in the program for all or some taxpayers or defined classes of taxpayers, or decide to end the program entirely at any point.
- The overall penalty structure for the new program is the same as it was for 2011, except for taxpayers in the highest penalty category. For the new program, the penalty framework requires individuals to pay a penalty of 27.5% of the highest aggregate balance in foreign bank accounts/entities or value of foreign assets during the eight full tax years prior to the disclosure. This number has increased from 25% in the 2011 program. Some taxpayers will be eligible for reduced 5 or 12.5% penalties under the same criteria of the 2011 program.

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OVDP

- Taxpayers with an account balance of less than $75,000 will qualify for a 12.5% penalty.
- The following taxpayers qualify for a 5% penalty:
  - Taxpayers who meet all four of the following conditions: (a) did not open or cause the account to be opened (unless the bank required that a new account be opened, rather than allowing a change in ownership of an existing account, upon the death of the owner of the account); (b) have exercised minimal, infrequent contact with the account, for example, to request the account balance, or update accountholder information such as a change in address, contact person, or email address; (c) have, except for a withdrawal closing the account and transferring the funds to an account in the United States, not withdrawn more than $1,000 from the account in any year for which the taxpayer was non-compliant; and (d) can establish that all applicable U.S. taxes have been paid on funds deposited to the account (only account earnings have escaped U.S. taxation). For funds deposited before January 1, 1991, if no information is available to establish whether such funds were appropriately taxed, it will be presumed that they were.

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OVDP (cont.)

- Taxpayers who are foreign residents and who were unaware they were U.S. citizens.
- Taxpayers who are foreign residents and who meet all three of the following conditions for all of the years of their voluntary disclosure: (a) taxpayer resides in a foreign country; (b) taxpayer has made a good faith showing that he or she has timely complied with all tax reporting and payment requirements in the country of residency; and (c) taxpayer has $10,000 or less of U.S. source income each year. For these taxpayers only, the offshore penalty will not apply to non-financial assets, such as real property, business interests, or artworks, purchased with funds for which the taxpayer can establish that all applicable taxes have been paid, either in the U.S. or in the country of residence. This exception only applies if the income tax returns filed with the foreign tax authority included the offshore-related taxable income that was not reported on the U.S. tax return.

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Charitable Giving Using Alternative Assets

Jasmine M. Campirides Hanif

The tax deduction afforded a donor for gifts to charity is generally dependant on two factors – the type of organization receiving the donation and the type of property donated. The following briefly summarizes certain factors donors might take into account in determining whether to make donations to a public charity or private foundation and unique considerations presented by certain alternative assets.[1]

Comparing Gifts to Public Charities, Gifts to Private Foundations and Loans to Charity

Gift to a Public Charity:

Advantages:

- Deduction available for full FMV of donated property for both gift and estate tax purposes.
- Lifetime gift of appreciated property has potential to afford donor greatest income tax deduction.
- Donor is relieved of all ongoing responsibility with respect to the property, including insurance, storage and security costs.
- Virtually no administrative costs to making gift either during life or at death.

Disadvantages:

- Donor no longer has control or use of the property.
- Donor subject to deduction recapture if donated property sold by charity within three years.
- Income tax deduction for gifts of tangible property subject to related use rules.
- Relatively new rules significantly limit the income tax advantages to a donor in making a partial interest gift of appreciated tangible property to a public charity.

Gift to a Private Foundation:

Advantages:

- Deduction available for full FMV of donated property for both gift and estate tax purposes.
- Founder and/or founder's family can maintain control over management and disposition of assets contributed.
- Private foundation can be named for the individual or family who creates it and affords founder the chance to carry on his or her name, or the family name, long after his or her death.
- Control of the foundation and its sources of revenue may remain in the family over generations.

Disadvantages:

- Private foundations are subject to excise taxes for investment income, self-dealing, excess business holdings, jeopardizing investments and taxable expenditures and must make minimum distributions annually.
- Deductions for cash donations are limited to 30% of AGI.
- Deductions for gifts of long term capital gain property (with the exception of certain publicly traded stocks) are limited to donor's cost basis and 20% of donor's AGI.
- Deductions are available for the full FMV of certain publicly traded stocks but deductions are still limited by 20% of the donor's AGI.

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1 This outline is by no means an exhaustive summary and is intended only to offer an example of what donors may consider. Other charitable giving options include donations to donor advised funds, private operating foundations and supporting organizations. Furthermore, the types of assets discussed are also not exhaustive and were selected only because they present interesting issues for discussion.

- Creating a new private foundation involves start up costs.
- Ongoing administrative requirements for private foundations can be significant.

Charitable Loans

Advantages:

- Donor maintains ownership and control of property and may gift it to family or to charity at a later date.
- Charity usually picks up carrying charges on the property including delivery, insurance, storage and security.
- Loans to charity are exempt from gift tax.

Disadvantages:

- The donor does not get an income or estate tax deduction for rent-free use of the property.
- Loans to private foundations may violate self-dealing rules applicable to private foundations.

Summary of gift, estate and income tax deductions available for gifts made to public charities and private foundations:

Type of Organization and Type of Property Donated	Amount of Contribution for Gift and Estate Tax Purposes	Amount of Contribution for Income Tax Purposes	Basic Income Tax Deduction Limits
Gift to Public Charity			
Cash	FMV	FMV	50% of AGI
Ordinary Income Property*	FMV	FMV less Ordinary Income	50% of AGI
Long Term Capital Gain (LTCG) Property – Either tangible property used for a related use or real property	FMV	FMV (or FMV less 100% of Unrealized LTCG if 50% limit is elected)	30% of AGI (or 50% of AGI)
LTCG Tangible Property – Unrelated Use	FMV	FMV less 100% of Unrealized LTCG	30% of AGI
Gift to Private Foundation			
Cash	FMV	FMV	30% of AGI
Ordinary Income Property*	FMV	FMV less Ordinary Income	20% of AGI
LTCG Tangible Property – Real or tangible, related or unrelated use	FMV	FMV less 100% of Unrealized LTCG	20% of AGI
Qualified Appreciated Publicly Traded Stock	FMV	FMV	20% of AGI
Loan to Charity	N/A	None	N/A

* "Ordinary income property" is property the sale of which would have resulted in ordinary income or in short-term capital gain. Examples of ordinary income property are inventory, works of art created by the donor, manuscripts prepared by the donor and capital assets held one year or less.

Unique Asset Considerations

LLCs & Partnerships

- Donor’s deduction may be reduced by the donor’s proportionate share of the liabilities of the partnership.
- If donor has suspended passive activity losses from partnership, may be better off selling partnership interest and donating net proceeds to charity.
- Donor must give an undivided portion of his entire interest in the entity including a pro rata share of all attributes such as capital, allocation of income and expense and distributions.
- Transfers subject to governing agreement.
- Charity may not want to accept interest due to unrelated business taxable income.

Closely Held Stock

- After donation, shares may later be redeemed by the corporation; however, contribution and redemption must not be prearranged.
- If sale of business is contemplated, gift should be made before any formal decisions are made by shareholders.

S Corp Stock

- If gift of S-corp stock is made, all items of income and gain passed through to charity during period charity holds stock will constitute unrelated business taxable income to charity.
- Any gain recognized by charity on sale of S-corp stock will be taxable.
- Gifts by the S-corp of its own assets do not present these same tax issues.
- Income tax deduction for gifts of S-corp stock to a public charity is equal to fair market value reduced by shareholder’s share of S-corp’s appreciated inventory and unrealized receivables, including depreciation recapture.
- Charitable deduction for gifts of S-corp assets is limited to shareholder’s basis in shares.

Restricted Securities

- Charity will be subject to restrictions.
- Restrictions will affect fair market value of the securities.
- Restrictions will affect whether the securities will be treated as qualified appreciated stock for purposes of a contribution to a private foundation.

Real Estate

- Before accepting gift, charity will consider management and carrying costs, environmental and other statutory liabilities, lack of liquidity and marketability, and ability to produce income.
- Depreciation recapture rules may reduce donor’s income tax deduction if donated property was depreciated using an accelerated depreciation method.
- Donors may make gifts of undivided fractional interests.

Retirement Accounts

- Lifetime Gifts of IRA Assets
  - » Pension Protection Act of 2006 gave taxpayers ability to make direct contributions of IRA assets to a qualified charitable organization. No income tax charitable deduction for contribution but donors avoided ordinary income taxes on funds contributed.
  - » Provision was extended retroactively and applicable for charitable contributions occurring between January 1, 2010, and December 31, 2011.
  - » Provisions expired December 31, 2011, and unclear whether they will be retroactively reinstated.

- Testamentary Gifts of Retirement Assets
    - Upon death, both income and transfer taxes are assessed against assets remaining in retirement accounts.
    - Testators can save up to $0.80 on the dollar by specifically leaving retirement assets to charity and other appreciated assets to noncharitable beneficiaries.

Tangible Property

- Must consider whether charity will use donated property for related use.
- Ordinary income property subject to lower deductibility limits.
- Works of art created by the donor or received by the donor as a gift from the creator are considered ordinary income property.
- Fractional interest gifts of tangible property may be made subject to restrictions.
    - All owners must make a proportional contribution to the charity.
    - Charity must have right to possess property for an amount of time equal to pro rata ownership share.
    - Deductible value of fractional gifts of the same tangible property made in future years will be determined as of the date of initial year contribution if value on initial date is lower than value on the date of subsequent contributions.
    - 100% of property must be received by the charity within the earlier of 10 years or the donor taxpayer's death.
    - Donor subject to recapture of income and gift tax charitable deductions, with interest, and 10% recapture penalty.
- Donors of art who own both physical work and copyright must generally donate proportionate interest in both.

Stock Options

- Donors may only make testamentary gifts of incentive stock options and only if the option plan allows for such gifts.
- If donor wants to make lifetime gift of options, must exercise options first and then, after requisite holding period, donate the shares.
- To get fair market value deduction for the shares and avoid income and capital gain recognition, shares must first be held for at least two years from date option was granted and one year from date option was exercised.
- Nonqualified stock options may be donated during donor's lifetime. But when options are exercised by charity, donor must recognize the income at that time.

Planning to Avoid Litigation: 10 Tips

Neil V. Carbone

1. Have a plan.

- Without a plan, state law controls.
- State law will not:
  - » adequately address dispositions to minors, who will inherit at 18;
  - » eliminate disputes over who gets specific items of tangible property or what happens to a closely-held, family-run business;
  - » provide anything for a non-marital partner; or
  - » avoid disputes over who will serve as your fiduciary where more than one person is eligible.
- In addition to dispositive documents, plan should include:
  - » power of attorney;
  - » health care proxy;
  - » living will; and
  - » appointment of agent to control disposition of remains.

2. Have your documents prepared by an attorney.

- The use of do-it-yourself Wills and Trust Agreements has gained popularity.
- Do-it-yourself forms create opportunity for a good fight.
- The legal fees spent with an attorney who specializes in trusts and estates matters will be far less than the legal fees spent defending or construing documents prepared by someone who is not.
- In addition, having your documents prepared by an attorney should help to overcome objections to your Will, the three primary objections being (1) that the document wasn't duly executed; (2) that the will was the product of undue influence; and (3) that the testator lacked the requisite mental capacity to execute a Will.
- When an attorney supervises the execution of a Will, there is a rebuttable presumption in the law that the Will was duly executed.
- Locating your own attorney, travelling to and from the attorney's office on your own and communicating with the attorney directly could help to defeat allegations of undue influence.
- An attorney who prepares your Will be required to testify about the details of the preparation and execution of the Will. In most cases, this testimony will help to overcome objections as to capacity.
- If you draft it yourself and make a mistake, your estate has no recourse. If your attorney makes a mistake, your executor can explore a claim against your attorney based on a recent change in the law.

3. Don't procrastinate.

- Don't wait until there can be questions about your capacity.
- Annual examinations by a physician and even a psychological evaluation can help eliminate doubt about your capacity.
- Even if you're not sure about every single aspect of your plan, don't let that stop you from moving forward with those aspects that you are certain about.

4. Review your plan.

- Review your plan periodically and make appropriate revisions following a death, divorce, changes in circumstances and/or changes in the law.
- Having a number of successive Wills that are similar can be a deterrent to a potential objectant.

5. Communicate with your heirs/beneficiaries.

- Dashed expectations and confusion or concern over whether the documents truly reflected your wishes can lead to litigation.
- A direct discussion with your loved ones will help to avoid disappointment and surprise later on and may therefore also help to prevent a contest.
- If you plan to disinherit someone or treat someone differently than the others in the same class, consider communicating that to someone who is not financially interested in your estate (in addition to your attorney) so that person can come in and testify at a trial, should one be necessary.

6. Be direct about disinheritance and disparate treatment.

- If you are going to disinherit someone or treat someone differently than someone else of the same class, be specific about it in the Will or Trust Agreement to show that the omission was not an oversight.
- Someone who is completely disinherited has nothing to lose by challenging the Will. Instead of complete disinheritance, consider a bequest to that person coupled with a "no contest" clause.

7. Consider a "no contest" clause.

- A no contest clause provides that anyone who contests the Will or Trust or interferes with the administration of the Estate or Trust forfeits the inheritance provided therein. The deterrent effect exists only if the person receives something sufficient under the Will or Trust to make the potential objectant think twice about objecting. If the document is successfully challenged, then the no contest provision also fails and the objectant takes in intestacy or under the prior Will.
- No contest clauses do not eliminate all inquiry into the validity of a Will. Statutory safe harbor exists allowing for pre-objection document discovery and examinations of:
  - » the attesting witnesses;
  - » the drafting attorney;
  - » if the will contains a no contest clause, the proponent of the Will and the nominated executors; and
  - » upon application to the Surrogate demonstrating that special circumstances exist, a person who may produce information respecting the validity of the Will that is of substantial importance or relevance to a decision to file objections. (This is a recent change in the law.)
- A recent New York Court of Appeals case (Matter of Hyde) could help to stave off fishing expeditions and unwarranted litigation because it held that legal fees incurred by the fiduciary in an estate or trust litigation may be allocated against the share of a particular beneficiary who brought the litigation. The case has since been applied to a probate contest. Matter of Poletto, 31 Misc 3d 1206 (Sur Ct, Monroe County 2011).

8. Make provisions for tangible personal property.

- Tangible personal property often has greater sentimental value than monetary value and its division can lead to disputes and delay the administration of an estate.
- Consider making specific bequests of family heirlooms and other items of sentimental value.
- Consider including a provision that requires a sale of the tangible personal property if beneficiaries cannot agree on its division.

9. Document lifetime transfers.

- If you transfer property to someone else during your lifetime, document the transfer and identify the nature of the transfer, *i.e.*, indicate whether it was a gift, a loan or an advancement against an inheritance, to help avoid disputes during the administration of the Estate, when you are no longer available to provide information as to the transfer.
- If a loan is to be forgiven at death, the Will should so provide.
- If a lifetime transfer is to be a deducted from a beneficiary's inheritance as an advance, there must be a contemporaneous writing to that effect and the Will should so provide.

10. Select your fiduciary carefully.

- Select someone who will refrain from antagonizing heirs, family members and creditors.
- The selection of one child over the others to serve as fiduciary can lead to hard feelings among your children. A child who serves as fiduciary could face allegations of abuse of power or the perception of abuse, which can lead to litigation. If you do name children, name an odd number to break tie votes or name a third person whom you trust to serve as tie-breaker.
- For some families, it may be best to chose a fiduciary who has no financial interest in the estate, such as a corporate fiduciary, a trusted professional or a family friend.
- To the extent possible, appoint successor fiduciaries or provide a mechanism for the appointment of successors.

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Joshua S. Rubenstein is National Head of the firm's Trusts and Estates Practice. He handles a wide variety of private client matters on a local, national and international level, including personal and estate planning, the administration of estates and trusts, and contested Surrogate's Court and tax proceedings for high net worth individuals, professionals, entrepreneurs, artists and others with unique intellectual property interests, and is a frequent lecturer and author on these topics. He is an Academician, member of the Executive Council and Treasurer of the International Academy of Estates and Trusts Law (IAETL), a Fellow and Regent, and incoming chair of the International Committee of the American College of Trusts and Estates Counsel (ACTEC), an officer of the Family Law Section of the International Bar Association (IBA), a member of the U.K.-based Society of Trust and Estate Practitioners (STEP), and a Fellow of the New York Bar Foundation. He is a former chair of the Trusts & Estates Law Section of the New York State Bar Association and of the International Committee of the Real Property and Probate Section of the American Bar Association.

Mr. Rubenstein is also extremely active in the community. He is a vice president of the Jewish Board of Family and Children's Services, a past president of the Irvington Institute for Immunological Research, and a past chair of the Trust & Estates Division of UJA Federation. In addition, Mr. Rubenstein is a member of the professional advisory councils of the Central Park Conservancy, Columbia Law School, Columbia University Health Sciences Center, Lincoln Center for the Performing Arts, the Metropolitan Museum of Art, the Museum of Art and Design, the Museum of Modern Art, the New York City Ballet, the New York Office of Court Administration, the New York Philharmonic, The New York Public Library and the Practising Law Institute.

Mr. Rubenstein is a former adjunct professor at Brooklyn Law School. He is the author of the *LexisNexis AnswerGuide on New York Surrogate's Court Practice* and a contributing author of *A Family's Guide to Wealth: Insights from Thought Leaders and Pioneers*. He serves on the editorial board of *Warren's Heaton* and the conference advisory board of *Legal Week*, and is a presiding judge for the 2011 STEP Annual Private Client Awards. He is often featured or quoted in prominent publications such as the *The New York Times*, *The Wall Street Journal*, *Bloomberg*, *Forbes*, *Kiplinger's*, *Crain's*, *New York Law Journal*, *The Washington Post* and *Citywealth*, and on broadcast and cable news programs such as FOX, Bloomberg, CNBC and WPIX. He is listed in *The Best Lawyers in America*; Euromoney Institutional Investor PLC *Expert Guides' The Best of the Best* in Trusts & Estates; *Who's Who in American Law*; *Who's Who in the World*; "Top 100 New York Super Lawyers" in *New York Super Lawyers*; *Chambers USA: America's Leading Lawyers for Business* at the Band One level for the Eastern Region in Wealth Management as one of the "Leaders in their Field"; *Lawdragon*'s 3000 Leading Lawyers in America; and has been named as one of the "Best Lawyers in New York" by *New York Magazine*. In addition, Mr. Rubenstein has been listed as one of the "Best Lawyers in America" by *American Lawyer*; one of the "Top 100 U.S. Attorneys" by the *Robb Report*, *Worth Magazine*; the only American in the "Top 20 International Wealth Advisors," an "Internationally Prominent Figure," and a "2011 Leader" by *Citywealth* (a U.K. weekly); the head of the Best Private Client Practice in North America by the Society of Trust and Estate Practitioners; an "Endorsed Individual" in private client services (USA) by Practical Law Company; and one of the "Top 100 Americas Wealth Advisors," in connection with which he was named "U.S. Private Client Attorney of the Year," also by *Citywealth*.

Mr. Rubenstein received his Bachelor of Arts degree in Greek and Latin, *magna cum laude*, in 1976 from Columbia University, where he was elected to Phi Beta Kappa, and his Juris Doctor from Columbia Law School in 1979, where he was a Harlan Fiske Stone Scholar. He is admitted to practice law in New York (1980), New Jersey (1980) and before various Federal Courts, including the United States Tax Court.

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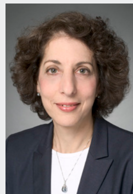

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Qualifications and Career Profile

Ronni G. Davidowitz concentrates her practice in trusts and estates law, with a focus in private client services. Ms. Davidowitz has extensive experience in complex estate and trust administration, including estate and gift tax audits and petitions and protests for redetermination of assessed deficiencies, estate litigation, basic to sophisticated estate planning, charitable, non-profit and private foundations representation, contested and uncontested judicial and informal fiduciary accountings and elder law.

Ms. Davidowitz serves as Head of the New York Trusts and Estates Practice.

Ms. Davidowitz is admitted to practice in New York State and before the United States Tax Court. Reported case - *Matter of Estate of Othmer*, 710 N.Y.S.2d 848, 2000 N.Y. Misc. 263.

Associations and Committees

Ms. Davidowitz is a fellow of the American College of Trust & Estate Counsel and serves on the Charitable Organization Committee of ACTEC. Ms. Davidowitz is also a member of The Association of the Bar of the City of New York and served as chair of its Estate and Gift Taxation Committee (2004-2007). She is also a member of the Trusts and Estates Section of the New York Bar Association and of its Executive Committee. She serves on the New York State Bar Association's Committee on Estate Administration and on its Charitable Organizations Committee. Ms. Davidowitz served as chair of the New York State Bar Association's Charitable Organizations Committee (January 2008-January 2011).

Lectures and Articles

Ms. Davidowitz is a contributing author to *LexisNexis AnswerGuide New York Surrogate's Court* procedure handbook published in 2004 by Matthew Bender & Company, Inc., a member of LexisNexis Group. Ms. Davidowitz's most recent article, "Representing Charitable Organizations, A Primer in Fundamentals," was written for the American Bar Association - Real Property Probate & Trust Law Section - "E State" - Vol. No. 2004, Issue No. 1. In addition, Ms. Davidowitz is a frequent lecturer for the Practising Law Institute, the New York State Bar Association and other organizations and groups.

Other Activities

Ms. Davidowitz is a member of the Professional Advisors Council for Calvary Fund Inc. of Calvary Hospital; a member of the Professional Advisory Council of the American Heart Association and of the New York Tolerance Center Advisory Group, of which she serves as Co-Chair. Ms. Davidowitz is currently the Chair, and had served as Vice-Chair (2007-2011), of the Trusts and Estates Committee for the United Jewish Appeal-Federation of Jewish Philanthropies, as well as Co-Chair of its Dinner Committee (2002, 2003 and 2005).

Honors and Awards

In 2006, Ms. Davidowitz was listed as one of the Top 50 Female New York Super Lawyers in the *New York Times* and *New York Super Lawyers — Metro Edition*. Ms. Davidowitz has been named a New York Super Lawyer from 2007 to 2011. In addition, she was listed in *Best Lawyers in America* from 2007 to 2012. Ms. Davidowitz was honored in 2001 for *pro bono* legal services provided to the Great Neck Center for the Visual and Performing Arts and in 1999 by South Brooklyn Legal Services for *pro bono* legal services provided to individuals infected with HIV and their families.

Education

Ms. Davidowitz earned her undergraduate degree (B.A., 1975) from Queens College of the City University of New York and her law degree (J.D., 1978) from St. John's University School of Law.

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Beth D. Tractenberg concentrates her practice in the field of estate planning, with a specialty in international estate planning, estate administration, prenuptial agreements and not-for-profit organizations. She advises high net worth individuals and family enterprises on all aspects of estate planning and cross-border and international tax planning, as well as on personal issues such as prenuptial agreements. She represents a number of wealthy individuals and families with significant real estate and business holdings in the United States and abroad. Drawing on her tax and trusts and estates experience, Beth serves as family advisor on numerous business, management and related personal issues for her clients.

Lectures and Articles

Ms. Tractenberg has written and lectured extensively to firms as to developments in the law and unique estate planning techniques. Ms. Tractenberg's lectures have included presentations to the Practising Law Institute, the Trusts and Estates Law Section of the New York State Bar Association, National Financial Partners and New York Society of Securities Analysts. She is frequently invited to speak before professional groups including accountants, investment advisors and insurance brokers. She has served as an adjunct professor at Fairleigh Dickinson University teaching Tax Exempt Organizations in the Graduate Taxation Program. She is listed as a New York Super Lawyer in *New York Super Lawyers — Manhattan Edition* (2006-2010).

Associations and Committees

Ms. Tractenberg is active in the exempt organization community. She has created and obtained tax-exempt status for scores of charitable entities and serves as counsel to numerous charitable entities advising on issues including compliance and fund-raising. In addition to serving as a founding director of LOVE, US, and of Dreamgate Children's Movement, she is a founding member of The Little One Foundation. Ms. Tractenberg is also a board member for both the Lar Lubovitch Dance Company and The A. Woodner Fund. Ms. Tractenberg has served as chair of both the Committee on International Estate Planning and the Committee on Charitable Organizations of the Trusts and Estates Law Section of the New York State Bar Association. She is a Fellow of the American College of Trust and Estate Counsel where she is a member of the Charitable, the International Estate Planning, and the Asset Protection Planning Committees. Ms. Tractenberg is also a member of the UK-based Society of Trust and Estate Practitioners (STEP).

Education and Bar Admissions

Ms. Tractenberg earned her Bachelor of Arts degree from Wesleyan University, where she was elected to Phi Beta Kappa and her Juris Doctor from New York University School of Law, where she was elected to the Order of the Coif. She is admitted to practice in New York.

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Qualifications and Career Profile

Kathryn von Matthiessen is a partner in the Trusts and Estates Practice of Katten Muchin Rosenman LLP. She focuses primarily on sophisticated personal and estate planning for high net worth individuals and the administration of complex estates and trusts, including the representation of trust companies on fiduciary matters. Ms. von Matthiessen handles extensive estate planning for both domestic and international families, utilizing a wide variety of techniques (both charitable and non-charitable in nature) to minimize taxes and achieve her clients' goals. Her international estate planning experience is extensive, with respect to both inbound and outbound planning.

Associations and Committees

Ms. von Matthiessen is a member of the New York State Bar Association and of the American Bar Association. She is the Vice-Chair of the International Estate Planning Committee of the Trusts and Estates Law Section of the New York State Bar Association. Ms. von Matthiessen also is a member of the internationally focused U.K.-based Society of Trust and Estate Practitioners (STEP); she is also a member of the Estate Planning Council of New York, Inc.

Education

Ms. von Matthiessen received her undergraduate degree *magna cum laude* (B.A., 1993) from Carleton College, where she was elected to *Phi Beta Kappa*. She earned her law degree (J.D., 1997) from Columbia Law School, and an LL.M. in Taxation from the New York University School of Law (2005). Ms. von Matthiessen is admitted to practice in New York (1999).

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Jasmine M. Campirides Hanif concentrates her practice in all areas of trusts and estates law, including personal and tax driven estate planning, probate and complex estate and trust administration. In addition, Ms. Hanif's practice includes a focus on charitable, non-profit and private foundation representation with specific experience in the formation, administration and dissolution of private foundations.

Associations and Committees

Ms. Hanif is a member of the Trusts and Estates Law Section of the New York State Bar Association and serves on its Charitable Organizations Committee. She is also a member of the Association of the Bar of the City of New York and previously served as Assistant Secretary to its Trusts and Estates Surrogate's Court Committee (2001-2003).

Lectures and Articles

In the fall of 2006, Ms. Hanif lectured for the New York State Bar Association on "Dissolving the New York Not-for-Profit Organization."

Ms. Hanif is the author of the following:

- "New York's Power of Attorney Law Undergoes Change," *Trusts & Estates* magazine (September 27, 2010).
- "What Clients Should Know Before You Set Up Their Private Foundation," *NYSBA Trusts and Estates Law Section Newsletter* (Fall 2010).
- "New York's New 'Power of Attorney' Law Is Effective September 1, 2009," *Insurance Advocate* magazine (August 17, 2009).

Education and Bar Admissions

Ms. Hanif received her Bachelor of Arts degree, *summa cum laude*, from Queens College in 1996, and her Juris Doctor from New York University School of Law in 1999, where she was Editor of the *Moot Court Casebook* (1998-1999). She is admitted to practice in New York.

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Qualifications and Career Profile

Mr. Carbone concentrates his practice in trust and estates law, with a focus in estate planning, administration and litigation, including issues pertaining to taxation, business organizations, property rights, estate plans, wills, trusts, insurance trusts, living wills, health care proxies and powers of attorney. He has an extensive background in litigation and in Surrogate's Court matters and procedures. Prior to entering private practice, Mr. Carbone was a Senior Court Attorney at the New York Court of Appeals.

Associations and Committees

Mr. Carbone is admitted to practice law in the State of New York and before the United States District Court for the Northern District of New York and the United States Tax Court. He is a member of the American Bar Association's Real Property, Probate and Trust Law Section; the New York State Bar Association's Trusts and Estates and Elder Law Sections; and a member of the Nassau County Bar Association.

Lectures and Articles

Mr. Carbone is the author of "Medicaid Planning Under Mental Hygiene Law Article 81", 70 St. John's L. Rev. 823 (1996) and of "Matter of Cohen: Contract to Make Joint Will Unenforceable Against Survivor Where Will is Presumed Revoked", 68 St. John's L Rev. 811 (1994).

Education

Mr. Carbone received his undergraduate degree (B.A., 1990) from St. John's University where he was elected to the Golden Key National Honor Society. He received his law degree cum laude (J.D., 1995) from St. John's University School of Law, where he was a recipient of the American Jurisprudence Award for Excellence (Contracts), and on the staff of St. John's Law Review.

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Qualifications and Career Profile

Robert E. Friedman concentrates his practice in estate and tax planning, estate, gift and generation-skipping transfer taxation and the administration of complex estates and trusts.

Associations and Committees

Mr. Friedman is a member of The Association of the Bar of the City of New York and the American Bar Association, where he participates in the Section on Real Property, Probate and Trusts Law. He is admitted to practice in New York State and before the United States District Court in the Southern and Eastern Districts of New York and the Supreme Court of the United States.

Mr. Friedman is also an Adjunct Professor of Law at Fordham University School of Law where he teaches income taxation of estates and trusts.

Mr. Friedman is a member of the Boards of Trustees of the Adirondack Nature Conservancy/Adirondack Land Trust, the Natural History Museum of the Adirondacks and the Adirondack Landowner Association.

Lectures and Articles

Mr. Friedman is the author of “Effective Estate Planning and Administration in New York” and the co-author of “Planning Opportunities With Living Trusts in New York.” Mr. Friedman has lectured on estate planning for the Cambridge Institute, the National Business Institute, the New York State Bar Association and before numerous other professional associations

Education

Mr. Friedman earned his undergraduate degree (A.B., 1965) from Harvard University and his law degree *cum laude* (J.D., 1975) from Fordham Law School, where he was a member of the Fordham Law Review (1973-1975).

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TRUSTS AND ESTATES

With attorneys in four offices—Charlotte, Chicago, Los Angeles and New York—Katten offers an integrated network of trust and estate practitioners that enables us to service local, national and international clients most efficiently.

WHO WE ARE

Over 45 attorneys strong, the Trusts and Estates Practice at Katten Muchin Rosenman LLP is one of the largest in the United States. We have the depth of knowledge and experience necessary to handle the most basic to the most sophisticated of trust and estate matters, and to do so in a comprehensive, integrated and efficient manner.

The attorneys in our Trusts and Estates Practice have years of practical experience and are published practitioners, accomplished lecturers, seasoned litigators, skilled negotiators, experienced administrators and thoughtful, practical and creative planners and advisors. Our attorneys have been honored with a number of prestigious academic and professional distinctions and have earned the recognition of professionals in the trust and estate and wealth management industry, including financial advisors, accountants, consultants, family office executives, academicians and other legal practitioners. Many have been invited to join elite national and international trust and estate organizations; some teach or have taught as members of the adjunct faculty of universities across the nation; many regularly lecture to both the legal and non-legal communities in the areas of trusts and estates and nonprofit organizations; and a number have advanced degrees in taxation.

WHAT WE DO

Katten's Trusts and Estates Practice provides creative and comprehensive representation in all areas of private client services, including personal and tax-driven estate planning for both the domestic and international client, business succession and charitable planning, probate, complex estate and trust administration, estate and trust litigation and charitable organization representation. Dedicated to our clients' interests, our attorneys possess great tact, discretion, and stellar analytical and interpersonal skills,

enabling us to assess and explain clients' options and to provide innovative solutions to their problems in the face of complex legal issues.

Comprehensive Estate Planning: Estate, Gift and Generation-Skipping Tax Planning, Planning for Business Succession and Charitable Planning

Katten attorneys prepare wills and trusts that enable our clients to avoid the need for probate, appoint guardians for their minor children, protect assets from creditors, ensure that children do not receive too much before an appropriate age, and minimize the taxes incurred when transferring wealth to successive generations. We are committed to advising clients on how to plan in light of a rapidly changing tax and economic climate. In this role, our group seeks not only to advise clients of changes in the law, but also to develop planning strategies that enable clients to take full advantage of those changes for the benefit of themselves and their families. For many clients, establishing an effective estate plan requires a good deal more than the preparation of wills and trusts. For that reason, Katten offers comprehensive estate planning, which may include any combination of the following services:

- Developing innovative mechanisms to shift the future growth in a client's business to younger-generation family members on a tax-efficient basis
- Using buy-sell agreements, voting trusts, limited liability companies, family partnerships, corporate recapitalizations and employee stock ownership plans to effect a client's wishes regarding the control and succession of private and publicly held businesses in a tax-efficient manner
- Structuring domestic and offshore personal family investment companies to act as holding companies for active trade businesses or purely passive investment vehicles and integrating such entities with the client's overall estate and trust planning
- Assisting clients in life insurance planning, including the use of irrevocable life insurance trusts, offshore life insurance techniques, "split-dollar" life insurance and the purchase of life insurance within profit sharing plans
- Assisting clients with significant business interests in the formation and implementation of captive insurance companies to address property and casualty self-insurance risks in an economically tax-efficient manner
- Creating private foundations and other charitable structures, including charitable lead trusts and charitable remainder trusts, enabling clients to leverage the tax benefits from charitable gifts and to support and effectuate both personal and tax-driven estate planning objectives
- Designing trusts to shift the future growth of a client's net worth out of the client's estate while minimizing the exposure to income and gift tax on the sale and transfer of assets
- Consulting with clients regarding tax-efficient structuring of corporate entities, including 'C' corporations, 'S' corporations, limited liability companies, limited partnerships and hybrid-type entities with a particular focus on the integration of a client's estate and trust planning into the overall corporate enterprise, including a determination of the appropriate taxation of these entities for income and estate and gift tax purposes
- Planning for individuals in special industries including real estate developers, hedge fund managers, retailers, manufacturers, taxi and livery fleet owners, artists, art collectors, actors and musicians
- Planning for family members with special needs
- Advising executives of publicly traded companies on effective tax planning for the exercise of stock options and for structuring distributions from retirement plans
- Serving as a legal liaison for clients to provide efficient one-point access to the various experts employed by the client in the achievement of the estate and business planning goals, including the coordination of all legal and non-legal services provided to clients by attorneys of different disciplines and other financial, insurance and corporate consultants

> "An extraordinarily client-focused group. The lawyers are always available and answer our queries with the utmost promptness. They work remarkably hard to meet our every need."
>
> — *Chambers USA* 2011 (nationally ranked in Wealth Management)

International Considerations

Comprehensive planning requires that we consider and address domestic as well as international issues. Our attorneys counsel foreign and domestic clients on tax and estate planning issues relating to their multinational holdings:

- Planning for U.S. citizens and resident aliens with regard to marriage to a non-citizen spouse
- Planning for U.S. citizens with foreign connections, including being resident or having family members or assets located in a foreign country or other foreign government connections
- Planning for U.S. citizens who use foreign trusts in their overall business, investment and estate planning
- Creating qualified domestic and other trusts to assist non-U.S. citizens in avoiding or deferring estate taxes to the greatest extent possible
- Advising clients who are resident and non-resident aliens on the most tax-efficient manner for investing in U.S. entities and real property and for transferring property to U.S. citizen family members
- Representing U.S. beneficiaries of foreign family trusts
- Pre-immigration planning for foreign persons who plan on moving to the United States
- Advising U.S. citizens and resident aliens on the income, gift and estate tax consequences of expatriation

Litigation Services

Unfortunately, despite the best laid estate plans, disputes often arise among beneficiaries and between beneficiaries and fiduciaries. Our talented team of trust and estate litigators offers the full panoply of litigation services:

- Representing both fiduciaries and beneficiaries in all forms of will and trust construction and in reformation proceedings and will and trusts contests
- Resolving creditors' claims and beneficiary-trustee disputes that arise in the post-death administration of assets in a tax-sensitive manner
- Working to acquire a decedent's assets from others who claim title to those assets upon the decedent's death
- Representing both fiduciaries and beneficiaries in fiduciary removal and surcharge proceedings and contested accounting proceedings
- Representing clients before the Internal Revenue Service and other federal, state and local agencies, and in any related tax litigation arising from the audit of federal estate, gift or generation-skipping tax returns
- Resolving intra-family disputes of all kinds
- Representing corporate fiduciaries in connection with class action, derivative, strike and other similar suits, and with compliance, regulatory and related issues
- Representing fiduciaries in connection with governmental inquiries

Administration of Trusts and Estates

Our attorneys also assist with the post-death administration and distribution of our clients' estates and trusts and represent both beneficiaries and fiduciaries in all trust- and estate-related matters. Services rendered include the following:

- Preparing and filing the necessary documents for the probate of a decedent's will or the administration of an intestate estate and the appointment of a fiduciary for the estate
- Collecting, valuing, managing and distributing assets
- Planning for and resolving national and international conflicts of law where a decedent had contacts with multiple states and/or nations
- Preparing and filing federal estate tax returns and state death tax returns
- Post-death funding of successor trusts created under wills and revocable trusts
- Providing advice to executors, administrators, trustees and guardians regarding the proper investments, tax reporting, and fiduciary responsibilities that apply to him or her in light of current statutory requirements and options and governing instrument restrictions
- Preparing and reviewing both informal and judicial fiduciary accountings upon the termination of a trust or death or resignation of a trustee from both a beneficiary's and fiduciary's perspective

Representation of Nonprofit Organizations

We have extensive experience involving the establishment and maintenance of charitable and other nonprofit entities. Representing clients both privately and before taxing and regulatory authorities, including both the IRS and the relevant attorney general or consumer protection agency, we offer the following services:

- Incorporating nonprofit entities and preparing bylaws, organizational minutes and initial filings in the state of incorporation
- Obtaining tax-exempt or tax-favored status for private foundations, private operating foundations, supporting organizations, public charities, political action committees, civic leagues and other types of nonprofit entities
- Advising the managers of private foundations regarding permissible activities and required actions in order to avoid the imposition of penalties and excise taxes imposed for self-dealing, taxable expenditures, jeopardizing investments, failure to make minimum distributions and excess business holdings
- Advising the managers of private foundations regarding the due diligence required to be exercised prior to making grants to foreign entities
- Advising the officers of public charities on statutory and regulatory requirements to avoid the imposition of penalty taxes known as "intermediate sanctions"
- Winding up and dissolving charitable entities or merging them to provide greater economies of scale in operation
- Splitting private foundations to accommodate the diverging interests of non-cooperative family member directors
- Petitioning the court to modify restrictions imposed on assets received by public charities through "cy pres" proceedings

"Everything about [Katten] is impressive: the size of its private client group; the breadth of its talent; the wide range of its experience with international families; and its overarching mission to be the best it can be."

— Society of Trust and Estate Practitioners (STEP)

WHO WE SERVICE

Katten represents high net worth individuals, entire families, family offices, banks, trust companies, wealth management advisors and nonprofit entities of all sizes. Our individual clients include entrepreneurs, corporate executives, hedge fund managers, philanthropists, real estate investors and developers, accountants, medical professionals, artists, collectors, authors, composers and musicians. We service clients that are either purely domestic or international as well as clients with ties to both the United States and foreign nations. We represent banks and trust companies in connection with their administration of both estates and trusts. We also advise nonprofit entities and their managers at every stage of operation, from formation to administration to dissolution.

AWARDS AND RECOGNITION

Katten's Trusts and Estates Practice has been rated:

- Band 2 Nationwide by *Chambers USA*
- North American Private Client Team of the Year by Society of Trust and Estate Practitioners (STEP)
- Tier 1 in the *U.S. News & World Report* and Best Lawyers Best Law Firms rankings
- A "Leading Firm" by Practical Law Company's *Which Lawyer?* guide, Private Client USA category

Our attorneys include:

- 11 "Super Lawyers"
- 6 peer-evaluated "Best Lawyers in America"
- 6 fellows of the American College of Trusts and Estates Counsel
- 5 members of the Society of Trust and Estate Practitioners
- 2 International Academy of Estate and Trust Law Academicians
- 1 *Citywealth* "Top 100 Leading Lawyer," "Top 20 International Wealth Advisor" and "U.S. Private Client Attorney of the Year"
- 1 named by *Chambers USA* as a "Nationwide Leading Lawyer"
- 1 named a "Endorsed Individual" by Practical Law Company's *Which Lawyer*? guide
- 1 recognized among *Best of the Best* in Trusts and Estates by Euromoney Institutional Investor PLC's *Expert Guides*
- 1 in the top "100 U.S. Attorneys" by *Robb Report Worth* magazine

Client Advisory

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Tax Planning/Trusts and Estates

February 1, 2012

IRS Releases Guidance on Foreign Financial Asset Reporting

The Foreign Account Tax Compliance Act, enacted in 2010 as part of the Hiring Incentives to Restore Employment (HIRE) Act, requires certain individuals to file a statement with their United States income tax returns to report interests in "specified foreign financial assets" (SFFA) if the aggregate value of those assets exceeds specific thresholds. This reporting requirement is separate from the requirement to file Form TD F 90-22.1 (FBAR).

Temporary regulations implementing this reporting requirement were issued recently. The reporting regime is applicable to U.S. citizens, resident aliens of the United States, non-resident aliens who have elected to be taxed as U.S. residents and certain residents of U.S. possessions (collectively, "specified individuals"). Specified individuals whose SFFA meet certain thresholds, discussed below, are required to complete and attach Form 8938, Statement of Specified Foreign Financial Assets, to their U.S. income tax returns. If a specified individual does not have to file a U.S. income tax return for the tax year, the individual does not have to file Form 8938 even if the value of their SFFA exceeds the reporting threshold. The reporting requirements are effective for tax years starting after March 18, 2010, which for most taxpayers will be their 2011 tax returns that are due to be filed this year.

Reporting Thresholds

Reporting thresholds vary based on whether a specified individual files a joint tax return or resides abroad, and are higher for married couples and taxpayers who qualify for foreign residency.

- Unmarried individuals living in the United States and married taxpayers filing separate returns living in the United States must file Form 8938 if the aggregate fair market value of SFFA exceeds either $50,000 on the last day of the taxable year or $75,000 at any time during the taxable year.
- Married individuals filing a joint return and living in the United States must file if the total value of SFFA is more than $100,000 on the last day of the tax year or more than $150,000 at any time during the tax year.
- For certain individuals living abroad whose "tax homes" are in a foreign country, the filing threshold is increased and the individual is not required to file until the total value of SFFA is more than $200,000 on the last day of the tax year or $300,000 at any time during the tax year. For certain married individuals filing a joint return where one or both spouses reside abroad and have a tax home in a foreign country, the threshold is $400,000 on the last day of the tax year or more than $600,000 at any time during the year.

If you hold foreign assets and believe you may be affected by the new reporting requirements, please contact any of the following Katten Muchin Rosenman LLP attorneys for assistance.

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To determine if you are a "specified individual," please contact your Katten Muchin Rosenman LLP attorney.

Interest in a Specified Foreign Financial Asset

A specified individual generally is considered to have an interest in any SFFA if any tax attributes (i.e., income, gains, losses, deductions, credits, etc.) or distributions from the asset or gross proceeds from the disposition of the asset are or would be required to be reported on the specified individual's U.S. income tax return (even if no tax attributes, gross proceeds or distributions are attributable to the asset for a particular taxable year).

A specified individual who is the owner of a disregarded entity is treated as having an interest in any SFFA held by the disregarded entity. A specified individual that is treated as the owner of a trust for U.S. income tax purposes (i.e., a "grantor trust") is treated as having an interest in any SFFA held by the trust. A specified individual is not treated as having an interest in any SFFA held by a partnership, corporation, non-grantor trust or estate solely as a result of the specified individual's status as a partner, shareholder or beneficiary.

Jointly Owned Assets

A joint interest in any SFFA is subject to reporting by each specified individual that is a joint owner of the asset. In general, each joint owner includes the full value of the jointly owned asset for purposes of determining whether the aggregate value of all SFFA in which the joint owner has an interest exceeds the reporting thresholds.

Married specified individuals who file a joint annual return for the taxable year will file a single Form 8938 that reports all of the SFFA in which either spouse has an interest. If the SFFA are owned jointly by both spouses, the SFFA should be reported once on the form.

Married specified individuals who file separate returns will file a separate Form 8938 that reports all SFFA in which the married specified individual has an interest, including assets jointly owned with the married specified individual's spouse. If the spouse is also a specified individual, each spouse includes only one-half of the value of any SFFA that the married specified individual jointly owns with his or her spouse for purposes of determining whether the aggregate value of all SFFA in which the married specified individual has an interest exceeds the reporting thresholds.

For more information about reporting thresholds, please contact your Katten Muchin Rosenman LLP attorney.

Specified Foreign Financial Assets

SFFA are foreign financial accounts and foreign assets not held in foreign accounts that are held for investment (as opposed to being held for use in a trade or business), such as stock or securities issued by a non-U.S. person, financial instruments issued by a non-U.S. person, contracts with non-U.S. persons and interests in foreign entities (such as foreign trusts, estates or partnerships).

There are certain assets of a foreign nature excepted from reporting on Form 8938. For example:

- A financial account maintained by a U.S. payor. For example, a specified individual is not required to report a financial account maintained by a U.S. branch of a foreign financial institution or a foreign branch of a U.S. financial institution.
- SFFA reported on other informational forms, such as Form 3520, Form 5471, Form 8621, Form 8865 or Form 8891. Specified individuals must identify on Form 8938 the form(s) on which they report the SSFA and how many of these forms are filed. The value of the SFFA reported on these forms is included in determining the total value of the assets for Form 8938 purposes.
- Exceptions from reporting are made for assets considered owned by a specified individual who is treated as the owner of certain trusts, such as a domestic widely held fixed investment trust or a domestic bankruptcy trust, certain assets held by a specified individual who is a bona fide resident of a U.S. territory, and assets or accounts for which mark-to-market elections have been made.
- Beneficial interests in a foreign trust or a foreign estate are not SFFA of a specified individual unless the specified individual knows or has reason to know of an interest based on readily accessible information. Receipt of a distribution from the foreign trust or foreign estate is deemed for this purpose to be actual knowledge of the interest.
- Interests in a social security, social insurance or other similar program of a foreign government are not SFFA.

If you are a specified individual and would like advice on whether or how to report SFFA, please contact your Katten Muchin Rosenman LLP attorney.

Asset Valuation

Taxpayers will need to determine the value of their SFFA in order to determine if the aggregate value exceeds the threshold applicable to them. Generally, a reasonable estimate of the highest fair market value (the "maximum value") of the asset during the tax year is reported, but special rules apply to ease valuation burdens.

- For reporting purposes, a specified individual may rely on a year-end financial account statement or the year-end value of a non-account asset if it reasonably approximates the maximum value of the account or asset during the tax year. A specified individual may determine the fair market value of any SFFA based on information publicly available from reliable financial information sources or from other verifiable sources. Even if there is no such information available, the regulations do not require a specified individual to obtain an appraisal by a third party.
- Special rules apply for reporting the maximum value of an interest in a foreign trust or a foreign estate.
  - If a specified individual is a beneficiary of a foreign trust, the maximum value of the specified individual's interest in the trust is the sum of the fair market value, determined as of the last day of the taxable year, of all of the distributions from the foreign trust during the taxable year to the specified individual, plus the value as of the last day of the taxable year of the specified individual's right as a beneficiary to receive mandatory distributions from the foreign trust.
  - The maximum value of a specified individual's interest in a foreign estate is the fair market value, determined as of the last day of the taxable year, of the specified individual's beneficial interest in the assets of the foreign estate. If the specified individual does not know or have reason to know based on readily accessible information the fair market value of the individual's interest in a foreign estate during the taxable year, the maximum value is the fair market value, determined as of the last day of the taxable year, of the distributions made during the taxable year to the specified individual as a beneficiary. Similar rules also apply to foreign retirement plans.

For more information on valuing your SFFA, including your interests in foreign trusts, estates and jointly owned assets, please contact your Katten Muchin Rosenman LLP attorney.

Non-compliance with Form 8938 Reporting Requirements

Taxpayers required to file Form 8938 who do not are subject to penalties. There is a $10,000 initial failure to file penalty and an additional penalty of up to $50,000 for continued failure to file after IRS notification. In addition, any underpayment of tax related to undisclosed SFFA may be subject to a 40 percent penalty. However, no penalty will be imposed if the failure to file Form 8938 or disclose SFFA is due to reasonable cause and not willful neglect. The fact that a foreign jurisdiction would impose a civil or criminal penalty on a specified individual if he or she discloses the required information is not reasonable cause.

If you fail to file Form 8938 or fail to report any SFFA that you are required to report, the statute of limitations for the tax year may remain open for all or part of your income tax return until three years after the date on which you file Form 8938.

Due to the sizeable penalties involved, specified individuals may wish to consult their Katten Muchin Rosenman LLP attorney before completing Form 8938.

Form 8938 Does Not Relieve Filers of FBAR Filing Requirements

U.S. persons with interests in foreign accounts may also be required to report foreign financial accounts on Form TD F 90-22.1 (FBAR). Certain foreign financial accounts will be reported on both Form 8938 and the FBAR. However, the information required by the forms is not identical in all cases. There are different categories of persons required to file Form 8938 and the FBAR, different filing thresholds for Form 8938 (i.e., minimum $50,000 threshold) and FBAR reporting (i.e., $10,000 reporting threshold), and different assets (and accompanying information) required to be reported on each form. There are also different triggers for filing. Because of these differences, certain foreign financial accounts may be reported on one but not both forms.

The due date for filing the FBAR is June 30 for financial accounts for which the filer had a financial interest or signature authority during the previous calendar year, while Form 8938 is due with the taxpayer's annual income tax return.

Proposed Regulations with Respect to Form 8938 Filing by Domestic Entities

HIRE also requires certain domestic entities to report SFFA in which they hold an interest. The IRS recently issued proposed regulations that set forth which domestic entities will be considered a "specified domestic entity" and subject to the reporting requirements. The proposed regulations relating to specified domestic entities apply to taxable years beginning after December 31, 2011.

Under the proposed regulations, "specified domestic entities" are domestic entities that are formed or used for the purposes of holding, directly or indirectly, SFFA. Specified domestic entities include certain closely held corporations and partnerships that meet passive income or passive asset tests. With exceptions, domestic trusts are included if they have a specified individual as a current beneficiary and exceed the reporting threshold. However, domestic estates are not specified domestic entities.

A domestic entity is not considered to be a specified domestic entity if it is excepted from the definition of the term "specified United States person." A "specified United States person" does not include publicly traded corporations and members of their affiliated groups, tax-exempt entities (other than charitable remainder trusts), and individual retirement accounts, banks, REITs and RICs.

A domestic trust is considered a specified domestic entity if it has an interest in SFFA (other than assets excepted from reporting) with an aggregate value exceeding the threshold for domestic single filers described above and at least one specified individual as a current beneficiary. A current beneficiary is any individual who, during the taxable year, is entitled to, or at the discretion of any individual may receive, a distribution from the principal or income of the trust (determined without regard to any power of appointment to the extent that such power remains unexercised at the end of the taxable year).

A domestic trust is not considered a specified domestic entity if the trustee or executor is a bank, financial institution or domestic corporation that is subject to certain examination, oversight or registration requirements, has supervisory authority over or fiduciary obligations with regard to the trust's SFFA, and files income tax returns and information returns on behalf of the trust. A domestic trust or any portion of the trust that is treated as owned by one or more specified individuals for U.S. income tax purposes is also not considered to be a specified domestic entity.

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November 2011

2011 Year-End Estate Planning Advisory

Once again, we have had a year of changes and planning possibilities as to federal estate, gift and generation-skipping transfer (GST) taxes. On December 17, 2010, President Obama signed into law The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the 2010 Act) that temporarily extended the Bush tax cuts for 2011 and 2012, and increased the gift, estate and GST tax applicable exclusion amounts for that period to an historic high level of $5 million. This temporary increase provides significant tax saving opportunities. Because of the uncertainty that these opportunities will remain available until the end of 2012, given the current, ever-changing economic and political landscape, we strongly recommend that you contact us as soon as possible if you have any interest in taking advantage of gifting opportunities. In addition to the increased applicable exclusion amounts, the 2010 Act retroactively reinstated the federal estate tax for decedents dying in 2010, with an option to opt out of the estate tax and receive only a limited basis step-up.

The Trusts and Estates Practice at Katten Muchin Rosenman LLP is pleased to provide you with a summary of some of the most significant state and federal developments from the past year, along with important, time-sensitive recommendations for you to consider for planning before year-end.

The "Super-Committee" and Other Proposed Legislation

Rumors have been flying that the Super Committee may follow its mandate to trim the deficit by reducing the applicable exclusion amounts, to as low as $1 million, possibly by the end of this year. While we have been unable to substantiate any of these rumors, and believe it is highly unlikely this turn of events will happen, the rumors illustrate the current uncertainty and the possibility that you need to "use it or lose it." To add to the uncertainty, on November 17, 2011, a senior Democrat tax writer in the House introduced legislation called the "Sensible Estate Tax Act of 2011" to push the estate tax applicable exclusion rate back to $1 million with a 55% marginal rate (with adjustments for inflation). The proposed legislation would go into effect on January 1, 2012. Gifting now rather than waiting can only be to your advantage.

Federal Estate, GST and Gift Tax Rates

The 2010 Act reunifies the gift and estate tax for the first time in years. The applicable exclusion amount for each of the gift, estate and GST taxes is $5 million with a top tax rate for each of 35%. For 2012, the $5 million is indexed for inflation and will increase to $5.12 million.

In addition, the 2010 Act creates "portability" between spouses for 2011 and 2012, meaning that when the first spouse dies any unused portion of his or her estate tax applicable exclusion amount may be used by the surviving spouse. However, the portability provision is of limited utility, as, under current law, the surviving spouse must also die by the end of 2012 in order to use the predeceased spouse's applicable exclusion amount.

Annual Gift Tax Exclusion

Each year individuals are entitled to make gifts of the Annual Gift Tax Exclusion Amount without incurring gift tax or using any of their lifetime applicable exclusion amount against estate and gift tax. The amount of the Annual Gift Tax Exclusion will remain at $13,000 per donee in 2012. Thus, a husband and wife together will be able to gift $26,000 to each donee.

The amount of the Annual Gift Tax Exclusion with respect to gifts made to non-citizen spouses will increase from $136,000 to $139,000 in 2012.

Retroactive Reinstatement of Estate Tax for 2010 Decedents

The estate tax was reinstated retroactively for estates of decedents dying in 2010, with an estate tax applicable exclusion amount of $5 million and a rate of 35%. However, there is an option to "opt out" of the estate tax and instead elect to have limited carryover basis rules (with certain adjustments) apply to property passing from the decedent.

In general, 2010 decedents with estates of less than $5 million or which pass to a surviving spouse would not opt out of the estate tax, as the estate would not owe federal estate tax and would receive a step-up in basis of the estate assets to their fair market value at the date of the decedent's death. Executors of estates of 2010 decedents with more than $5 million may want to opt out of the estate tax so that the estate does not pay estate tax, but advisers have to calculate whether paying capital gains tax on the appreciation over the decedent's basis upon sale of property yields a better tax result than paying the estate tax.

Basis Increase Allocations

If an executor opts out of the estate tax for a 2010 decedent, assets will have a limited carryover basis (but not in excess of date of death fair market value), but that basis can be adjusted to a certain extent. The executor can allocate several adjustments to increase the basis of assets received by recipients that are both "property acquired from the decedent" and "property owned by the decedent." The amount of increased basis from these allocations is referred to as the "Basis Increase."

There is $3 million of Spousal Basis Increase that may be allocated to "qualified spousal property" acquired from the decedent by a surviving spouse. Qualified spousal property includes outright transfers of property and qualified terminable interest property.

The General Basis Increase, which can be allocated to property going to anyone, is $1.3 million. However, for a decedent who was neither a resident nor a citizen of the United States, the General Basis Increase is only $60,000.

The Carryover Basis Election Is Made by Filing Form 8939

The election to opt out of the federal estate tax and elect the carryover basis regime may be made up until January 17, 2012. The election in effect on the due date is irrevocable (except as provided in Notice 2011-66).

Filing Due Dates for 2010 Decedents

For estates of decedents who died before December 17, 2010, the due date for filing a Form 706 was September 19, 2011. However, IRS Notice 2011-76 acknowledges that because of the length of time that has been required to implement the carryover basis legislative changes and to issue Form 8939 and the related instructions, 2010 estates may not have had sufficient time by September 19, 2011, to decide how to proceed. The Notice makes clear that an automatic six-month extension of the time to file is available by filing Form 4768 (Application for Extension of Time to File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes). There is no need to substantiate the reason an estate is requesting an extension. The automatic six-month extension makes the Form 706 due on March 19, 2012. For estates of decedents dying on or after December 17, 2011, the automatic six-month extension period will end 15 months after the decedent's date of death.

President's Budget Proposal for Fiscal Year 2012

The President's budget proposal for Fiscal Year 2012 includes three transfer tax-related items that were proposed in each of the past two years and two new items dealing with estate and gift taxes.

Consistency of Basis Valuation

The proposal to require consistency in value for transfer and income tax purposes requires that the basis for income tax purposes be the same as that determined for estate and gift tax purposes.

Eliminating Certain Valuation Discounts

The budget proposal adds a new category of "disregarded restrictions" that would be ignored for transfer tax valuation purposes in valuing an interest in a family-controlled entity transferred to a member of the family.

Grantor Retained Annuity Trusts (GRATs) to Be Subject to New Rules

Three additional requirements would be imposed on Grantor Retained Annuity Trusts (GRATs): (i) they must have a 10-year minimum term; (ii) they must have a remainder interest greater than zero; and (iii) the annuity amount cannot decrease in any year during the annuity term.

Make Portability Permanent

The budget proposal seeks to make portability permanent by extending the provisions of the 2010 Act regarding the portability of unused exclusion between spouses.

Limiting the Duration of the GST Exemption

The exclusion from the imposition of GST tax would last only 90 years, regardless of whether a trust has a longer duration.

Planning Opportunities to Consider Immediately

Make Outright Gifts to Take Advantage of Reduced Gift Tax Rate and Increased Applicable Exclusion Amount

You now have a total of $5 million ($10 million for a married couple) that you can gift in the aggregate during your lifetime, subject to reduction for any gifts in excess of the Annual Gift Tax Exclusion Amount you have previously made. Gifts in excess of that amount are subject to a federal gift tax rate of only 35%. The $5 million applicable exclusion amount is substantially in excess of the $1 million applicable exclusion amount for gifting that was previously available. Thus, making gifts before the end of 2011 may provide significant transfer tax savings. In addition to the reduced rate, it is always cheaper to make lifetime gifts rather than gifts at death. This result occurs because you do not pay a tax on the dollars used to pay gift tax, but you do pay estate tax on the dollars used to pay estate tax. The benefit is compounded further by the lower gift tax in 2011. We should note that under current law, there is a possibility that if the applicable exclusion amount is reduced in the future, there may be a "clawback" if amounts gifted during life exceed the applicable exclusion amount in place at the time of death. In that event, estate tax could be imposed on the amount gifted in excess of the applicable exclusion amount at the time of death. We believe this unintended "glitch" will be fixed. However, even if it is not, you will be no worse off than if you had not gifted and you will benefit by getting any appreciation on the gift out of your estate.

Gifts with Retained Interests

Many individuals are faced with a dilemma as to the temporarily increased gifting amounts. They want to take advantage of the estate planning opportunities but are concerned that they may in the future need access to the transferred funds. There are two options that you can consider to "have your cake and eat it too."

Domestic Asset Protection Trusts of Which You and/or Your Spouse Are Discretionary Beneficiaries.
If an individual creates a trust in one of the states that has asset protection legislation (Delaware, Nevada, New Hampshire, South Dakota and Alaska) with a trustee resident in the jurisdiction, the trust may be safe from estate taxation even if the settlor and/or the settlor's spouse is a discretionary beneficiary. In order to avoid estate tax, the settlor must not receive regular distributions, but the funds would be available in the event of an emergency. It should be noted that there have not yet been any cases addressing the effectiveness of this planning technique.

Husband and Wife Create Trusts for Each Other.
A husband and wife can create trusts of which the other and their descendants are beneficiaries. As long as each trust differs in some fairly significant way from the other, the trust assets should be safe from estate tax inclusion and each spouse will have access to trust assets.

Grantor Retained Annuity Trusts (GRATs)

GRATs remain one of our most valuable planning tools, particularly in this time of historically low interest rates. Because of the possibility that legislation may soon pass changing how GRATs may be structured and interest rates may rise, GRATs should be created as soon as possible.

A GRAT provides you with a fixed annual amount (the annuity) from the trust for a term of years (currently as short as two years). The annuity you retain may be equal to 100% of the amount you use to fund the GRAT, plus the IRS-assumed rate of return applicable to GRATs (**which for gifts made in November 2011 is 1.4% and for gifts made in December 2011 will be 1.6%**). As long as the GRAT assets outperform the applicable rate, at the end of the annuity term, you will be able to achieve a transfer tax-free gift of the spread between the actual growth of the assets and the applicable rate. Because you will retain the full value of the GRAT assets—as calculated using the IRS's assumptions for growth—if you survive the annuity term, the value of the GRAT assets in excess of your retained annuity amount will then pass to whomever you have named with no gift or estate tax, either outright or in further trust.

Sales to "Defective" Grantor Trusts

Another option for transferring assets without any transfer tax is an installment sale to a "defective" grantor trust (a trust as to which you would be treated as the owner for income tax purposes and would pay the income taxes on the income generated by the assets therefrom, but which is not included in your taxable estate upon your death).

You would sell assets likely to appreciate in value to the trust in exchange for a commercially reasonable downpayment and a promissory note for the balance. From an income tax perspective, no taxable gain would be recognized on the sale of the property to the trust because the trust is a defective grantor trust, which makes this essentially a sale to yourself. For the same reason, the interest payments on the note would not be taxable to you or deductible by the trust.

If the value of the assets grows at a greater pace than the prevailing Applicable Federal Rate (**which for sales in November 2011 is as low as .19% and for sales made in December 2011 will be .20%**), as with a GRAT, the appreciation will pass free of gift and estate tax. The current record-low interest rates make sales to defective grantor trusts most opportune to structure now.

Charitable Lead Annuity Trust (CLAT)

Another very effective planning tool in a low interest rate environment is a CLAT, which combines philanthropy with tax planning. A CLAT is an irrevocable trust that pays one or more named charities a specified annuity payment for a fixed term. At the end of the charitable term, any remaining assets in the CLAT pass to the remainder, non-charitable beneficiaries. As with a GRAT, to the extent the assets outperform the IRS assumed rate of return (1.4% for November and 1.6% for December), those assets can pass transfer-tax free to whomever you would like.

Gift Residence or Vacation Home Using Qualified Personal Residence Trusts and Other Trusts

A discounted and leveraged gift of a residence is possible using a Qualified Personal Residence Trust (QPRT). After the gift to the QPRT, you can continue to reside in the residence until the QPRT ends and, even thereafter, if the property is leased back at fair market rent from the new owners.

This planning is most effective when the value of the residence to be given is low and the IRS assumed rate of return is high. However, even though the IRS assumed rate of return is now low, housing prices are dropping across the country, which makes use of a QPRT beneficial. As a result, QPRT gifting is an important alternative to consider, particularly in light of the increased gifting applicable exclusion amount. In addition, one can retain a contingent reversionary interest in case the donor dies during the QPRT term, further discounting the taxable value of the transferred interest—sometimes by a substantial amount in the case of older donors.

Another possibility, given the depressed real estate prices and the increased applicable exclusion amount, is to make a gift of real estate outright or to a trust that is not a QPRT. You may rent the house back from the trust for its fair market rental value and thus continue to use the house. If the trust is drafted as a defective grantor trust, the rent will not be subject to income tax, as for tax purposes it will be treated as though you are renting from yourself. The rent proceeds may be used to pay maintenance and taxes (which you will still be able to deduct). To the extent rent payments exceed expenses, you will have made additional transfer tax-free gifts to the trust.

Alternatives to Section 1031 Exchanges: Gifts to Charitable Remainder Trusts

Many taxpayers owning certain kinds of appreciated real estate sell that property and "roll over" the gain—using Section 1031 of the Internal Revenue Code (IRC)—into another property, using this "like kind exchange" to defer income taxes. However, the economy is such that taxpayers desiring to sell properties now are finding it harder to find properties to purchase to accomplish this rollover.

An alternate approach to consider is a gift of the property to a charitable remainder trust, retaining for life a payment equal to up to 90% of the value of the gifted property. You would be allowed an income tax deduction equal to a portion of the gifted property. (In the case where 90% of the value is retained by you in the form of lifetime payments, the deduction is equal to 10% of the value of the gifted property.)

When the charitable remainder trust sells the property it recognizes no gain or loss. When you receive payments from the charitable remainder trust, part will be taxed as income, part as capital gain and (potentially) part will be treated as a distribution from principal of the trust and not taxable at all.

At your death, the charitable remainder trust can pay over to a family foundation, allowing your family to use those funds to accomplish the family's charitable goals.

Consider Buy-Back of Appreciated Low Basis Assets from Grantor Trusts

Some clients sold or gave (through a GRAT or other grantor trust) an asset that was expected to appreciate in value. The tax planning idea that motivated them was to pass that appreciation on to trusts for their children without gift or estate tax. The children's trust that ends up owning the asset typically has a very low basis, meaning that a significant capital gains tax will be due if the trust sells the appreciated asset.

Where those plans succeeded, that appreciated asset now sits in a defective grantor trust for the children. That grantor trust has a low basis in the asset. If you purchase the asset back from the grantor trust for fair market value, no gain or loss is recognized. The trust would then hold cash equal to the value of the appreciated asset that was repurchased, leaving the same amount to escape estate tax. Alternatively, many grantor trust instruments give the grantor the power to substitute the trust's assets with other assets, which would allow the appreciated assets to be removed from the trust.

The advantage is that, on your death, the purchased or reacquired asset will be included in your taxable estate and will receive a step-up in basis equal to fair market value. This means that the capital gains tax on sale of that asset is eliminated. The children benefit from the grantor trust's cash—and each dollar of cash has a dollar of basis—so truly the capital gain is eliminated forever.

Use of Intra-Family Loans

Because interest rates are so low, many techniques involving use of intra-family loans should be considered, including:

- The purchase of life insurance on the life of one family member by an irrevocable life insurance trust, with premium payments funded by loans from other family members.
- The creation of trusts by older generation members for the benefit of younger family members, to which the older generation members loan funds. The spread between the investment return earned by the trust and the interest owed will create a transfer tax-free gift.

Family Limited Partnerships

Many clients have taken advantage of family limited partnerships (FLPs)—family limited liability companies, which are substantially similar, are also used, and are referred to here also as FLPs. FLPs provide many advantages, such as protecting assets from creditors and consolidation of family held entities with centralized management, as well as other investment advantages as a result of investing a larger pool of assets. The value of partial interests held in an FLP may be substantially reduced by using lack of control and/or lack of marketability discounts. This reduction in value results in lower estate and gift tax liability. As it did with GRATs, the Obama Administration signaled that valuation discounts are targets to be eliminated or minimized. However, that has not yet happened. The fact that valuation discounts are on the Administration's radar screen suggests that FLP planning should be done sooner rather than later.

As in recent years, 2011 saw numerous IRS attacks on the use of FLPs, in various contexts, with mixed success.

In *Turner*, gifts of a limited partnership interests were transferred to family members. The decedent and his wife paid themselves management fees although they provided few services. No distributions were made to family members prior to the decedent's death but payments were made to the decedent and his wife and treated as repayment of advances made by the decedent. The Court concluded that one-half of the partnership assets were included in the decedent's estate. The Court found there was an express and implied agreement for retained enjoyment under 2036(a)(1) of the IRC. The Court also viewed the decedent as effectively being the sole general partner so that 2036(a)(2) of the IRC would apply.

In *Jorgensen*, the Ninth Circuit Court of Appeals rejected the taxpayer appeal of a Tax Court opinion, which held that Section 2036 of the IRC applied to all assets in two limited family partnerships that were attributable to capital contributions by the decedent. Although the decedent had assets outside of the partnerships for her day-to-day expenses, there was no evidence why one FLP was created, and, as to the other FLP, there was contemporaneous attorney correspondence referring to estate tax savings as the reason for creating it. The decedent had control of the FLP's checkbook even though she was not the general partner and she wrote checks out of the FLP accounts for her personal purposes.

In *Levy*, the Fifth Circuit affirmed a jury finding at the district court setting the value of a partnership at $25 million without allowing discounts for lack of control or marketability. In *Levy*, the estate owned an interest in a limited partnership that owned undeveloped land near Dallas, Texas, which the partnership had apparently sold about two years after the estate valuation date. The estate received $25 million from the sale. The jury concluded that the estate's interest was valued at $25 million and allowed no discounts for lack of control or marketability. The estate's arguments for setting aside the verdict were rejected by the court, which found that absent a change in economic conditions, actual subsequent sales of assets are highly persuasive in determining the value of an asset and whether any discounts should have been applied.

There was one taxpayer-favorable aspect of *Levy*. The court ruled against the IRS with respect to Section 2036, finding that there was a legitimate non-tax purpose of the partnership.

Year-End Checklist for 2011

In addition to the above planning ideas, consider the following before 2011 is over:

- Make year-end annual exclusion gifts of $13,000 ($26,000 for a married couple).
- Make year-end IRA contributions.
- Create 529 Plan accounts before year-end for children and grandchildren, and consider front-loading the accounts with five years' worth of annual exclusion gifts, taking into account any gifts made during the year to children and grandchildren. Pay tuition and medical expenses directly to the school or medical provider.
- Consider making charitable gifts before year-end to use deduction on 2011 income tax return.

Below is a discussion of national, international and local developments that occurred in 2011.

National Developments in 2011

Decision Regarding Asset Protection Trusts as Protection from Creditors and Estate Tax

A recent unreported Alaska Bankruptcy Court case, *In re Mortensen*, allowed creditors to reach the assets of an Alaska asset protection trust, despite its finding that Mr. Mortensen was solvent when he created the trust. Mr. Mortensen filed for bankruptcy in 2009, four years after creating the trust. Alaska's creditor statute precluded the bankruptcy trustee from recovering the trust property, but the Bankruptcy Court judge held that creditors could pierce the trust and reach the assets. The opinion focused on a new provision of the Bankruptcy Code which allows a 10-year "clawback" period and contains some troubling language suggesting that the trust's purpose to protect assets from creditors and from the estate tax was one of the reasons the court reached its conclusion. However, the debtor's facts were particularly egregious. We will have to watch and see if there are any further developments along these lines.

IRA Distributions to Charity

Qualified charitable donations of up to $100,000 may be made from an individual's IRA directly to charity and excluded from that individual's gross income if the individual is at least 70 ½ years old and certain other requirements are met. This provision was temporary, has been extended twice and is due to expire on December 31, 2011.

Respect for Marriage Act Approved by Senate Judiciary Committee

On November 10, 2011, federal legislation was introduced to repeal the Defense of Marriage Act (DOMA). DOMA precludes the recognition of same-sex marriages.

The bill now moves to the full Senate, but it remains to be seen whether Senate Majority Leader Harry Reid will bring the bill to the full Senate for a vote.

International Developments in 2011

UK Law Changes

The UK government has proposed a UK Statutory Residence Test (SRT), with the goal of implementing the SRT by April 6, 2012. This new test is designed to minimize uncertainty regarding what constitutes UK resident status. For questions regarding whether or not your status as a prospective UK resident has changed, please contact one of us.

In August 2011, IRS Revenue Ruling 2011-19 was released which allows for the GBP 30,000 Remittance Basis Charge to be credited against U.S. income tax for U.S. taxpayers.

Beginning April 6, 2012, the Remittance Basis Charge will be increased to GBP 50,000 for taxpayers resident at least 12 of 14 tax years.

French Law Changes

France enacted sweeping tax changes in 2011, with most changes to take effect as of January 1, 2012. The French wealth tax threshold was raised to net wealth exceeding EUR 1.3 million and its gift and inheritance tax rates changed. In addition, the so-called tax shield that guaranteed that a taxpayer would not pay taxes representing more than 50% of his or her income in a year was repealed. France also enacted an "exit tax" on certain residents effective March 3, 2011.

Under new French law, trustees are now obligated to declare the creation, modification and revocation of any trust if there is a French resident beneficiary or a French asset held in the trust. The trustee of such a trust must file an annual market value declaration of the trust assets and there is an annual wealth tax on such trusts under certain circumstances. Assets of a trust may also be included in the estate of a French resident settlor and there is other wide-reaching legislation to tax trusts, some of which are effective in 2011.

For further information concerning these extensive French tax changes, please contact one of us.

2011 Offshore Voluntary Disclosure Initiative

Admittance to the IRS's 2011 Offshore Voluntary Disclosure Initiative (OVDI) was extended through September 9, 2011, due to Hurricane Irene. Taxpayers who did not enter the 2011 OVDI but who want to disclose unreported offshore income should contact one of us to enter into the IRS Voluntary Disclosure Program.

Foreign Account Tax Compliance Act of 2009

On March 18, 2010, President Obama signed the Hiring Incentives to Restore Employment Act (HIRE), which contained a version of the previously proposed Foreign Account Tax Compliance Act of 2009 (FATCA). These provisions are intended to combat offshore tax evasion by U.S. taxpayers by requiring increased information reporting.

HIRE provides for withholding taxes to enforce reporting requirements on certain foreign accounts owned by specified U.S. persons or U.S.-owned foreign entities. Generally, a tax equal to 30% must be withheld by a U.S. withholding agent on any withholdable payment made to a foreign financial institution (FFI) if the institution is not a "participating FFI." An FFI is a participating FFI if it has an agreement (an FFI Agreement) with the IRS under which the institution agrees to obtain certain information on each U.S. account holder and comply with various reporting and withholding requirements. The withholding of 30% is on a broader category of U.S. source income than is captured under the current withholding rules.

Although this regime was scheduled to go into effect on January 1, 2013, tax practitioners, foreign governments and FFIs expressed concerns about the ability of FFIs to become compliant so quickly. As a result, the IRS issued Notice 2011-53, which extends this deadline and phases in FATCA over time. Please contact us if you would like more detailed information.

In addition to the withholding regime described above, FATCA also requires new reporting for U.S. owners of specified foreign financial assets and enhanced reporting for U.S. shareholders of passive foreign investment companies. These reporting obligations have been suspended until the forms for reporting have been released in final. The Treasury Department has announced that it expects to issue further FATCA guidance by the end of this year. We hope that the withholding and reporting obligations of trusts will be clarified in the Treasury's guidance.

FBAR Forms

In February 2011, the Financial Crimes Enforcement Network (the FinCen) issued final regulations regarding the filing of Form TD 4 90-22.1 Foreign Bank Account Report (FBAR). Although the final regulations are very similar to the proposed regulations, there are several important differences with respect to trusts:

The final regulations clarify that a trust beneficiary will not be deemed to have a financial interest in the trust's foreign account merely by reason of being a discretionary beneficiary or a remainderman of such trust. However, if the beneficiary receives more than 50% of the trust's current income, he will be deemed to have a financial interest in the trust's foreign account.

A beneficiary of a trust with a present beneficial interest in more than 50% of the trust's assets or who receives more than 50% of the trust's current income will be deemed to have a financial interest in the foreign accounts of such trust.

The final regulations no longer provide, as did the proposed regulations, that a U.S. person who creates a foreign trust and appoints a trust Protector subject to the U.S. person's direct or indirect instruction will be considered to have a financial interest in the trust's foreign accounts.

Like the proposed regulations, the final regulations provide that a U.S. person who has an ownership interest in a trust for U.S. income tax purposes will be deemed to have a financial interest in the trust's foreign accounts. Similarly, the final regulations also contain the proposed rule that a trust beneficiary, who would otherwise be required to file, will not have to do so if the trust, a trustee of the trust or an agent of the trust is a U.S. person that files an FBAR disclosing the trust's foreign financial accounts.

Local Developments in 2011: State-Specific Considerations

California

Transfers Without Probate: Estate of Giraldin (Court of Appeal of California, Fourth Appellate District, Division Three, September 26, 2011).

In *Estate of Giraldin*, the settlor executed a revocable trust and appointed his son as trustee. Pursuant to the terms of the trust, the settlor was the sole beneficiary under the trust and the trustee was to distribute as much income and principal as the settlor directed. In making such determinations, the trustee was not to consider the rights of the remainder beneficiaries, who were the settlor's wife and other children. One month prior to executing this trust, the settlor invested $4 million—the majority of his estate—in his two sons' business, one of whom was the trustee. The funds to pay for the investment were taken from the settlor's separate account and the stock was issued in the settlor's name. After the investment was fully funded, the stock was transferred into the name of the trust.

The remainder beneficiaries filed a petition, seeking to remove the trustee, to compel an accounting and, in effect, to undo the investment. They claimed, amongst other arguments, that the trustee violated his fiduciary duties to diversify the investments of trust assets, to avoid conflicts of interests and to deal impartially with the beneficiaries. The petitioners further argued that the trustee had a legal obligation to dissuade the settlor from making unwise investments.

The court held in favor of the trustee. It explained that the trustee's duty is solely to the settlor, who possessed the power to revoke. Moreover, the remainder beneficiaries have no right to determine how the trust assets are managed and have no rights to any trust property until the settlor dies, when the trust becomes irrevocable. The court went on to say that the settlor is entitled to do what he wants with trust assets, unless he is adjudicated legally incompetent, and the trustee has no duty or obligation to determine whether the settlor is competent and possesses capacity.

Change of Ownership Statement.

Effective January 1, 2012, S.B. 507 will take effect, under which the deadline to file a change of ownership statement with the local assessor will be extended from 45 days to 90 days. This bill applies to transferees of real property or manufactured homes; corporations, partnerships and other legal entitles that own real property; and legal entities that own real property for which ownership or control has been changed by more than 50%.

Additionally, this bill will increase the penalty cap for late filings from $2,500 to $5,000 for properties eligible for the homeowners' exemption, and increase the penalty cap to $20,000 for properties that are ineligible for the homeowners' exemption.

Effective January 1, 2012, the value of estate assets that can be transferred without probate administration will increase due to the passage of Chapter 117, Statues of 2011 (AB 1305-Huber).

The size of estate trust assets—excluding joint tenancy assets, which pass under beneficiary designation, such as life insurance or retirement accounts—that can be collected by affidavit will increase from $100,000 to $150,000 (Probate Code Section 13100). Additionally, the value of the decedent's salary or other compensation that is excluded from the value of the decedent's property in California will increase from $5,000 to $15,000 (Probate Code Section 13050). These statutory increases will assist in the collection of small value accounts, investments or automobiles that were inadvertently not transferred to a decedent's revocable living trust. In California, we recommend the use of such trusts for probate avoidance purposes.

Connecticut

In May 2011, the estate and gift tax applicable exclusion amounts were lowered to $2 million retroactive to January 1, 2011.

Florida

In June 2011, Florida adopted its version of the Uniform Power of Attorney Act (the Act) that was effective on October 1, 2011. The highlights are as follows:

- Existing powers of attorney executed prior to the effective date of the Act remain valid under the Act provided its execution complied with the law of Florida at the time of its execution. Existing durable or springing powers of attorney remain durable or springing under the new Act.
- Contingent or "springing" powers of attorney are no longer authorized unless they were in existence prior to the effective date.
- The Act permits the appointment of successor agents and co-agents and unless the power of attorney provides otherwise, each co-agent may act independently. This is a significant change from the prior law, which required a majority of named agents to concur unless otherwise provided in the document.
- New powers of attorney must be signed by the principal and two witnesses and be notarized.
- The principal may revoke a power of attorney by expressing that revocation in a subsequently executed power of attorney in any other writing signed by the principal. However, the mere execution of a new power of attorney does not revoke an existing power of attorney.
- An agent may only exercise authority that is specifically granted to the agent and any authority necessary to give effect to that express grant of specific authority.
- The Act allows a principal to grant authority to the agent to take significant actions that can impact the principal's estate plan or gifting program, but such power may be granted with additional formalities and is subject to restrictions.

Illinois

State Income Taxes.

Illinois lawmakers passed a significant income tax increase in 2011 to close a $13 billion budget deficit. Personal income tax rates were increased from 3% to 5%, a 67% increase. Trust income tax rates were subject to an identical increase, and trusts also pay a 1.5% "replacement tax." Corporate income tax rates were increased from 4.8% to 7%, a 46% increase. Corporations also pay a 2.5% replacement tax in Illinois. The income tax increases are supposedly temporary in nature, expiring after 2014, but many expect the increases to be extended indefinitely given Illinois' significant budget deficit. The new law does include a trigger that would cause a reversion to the old rates if spending increases at greater than 2% from year to year through 2014.

State Estate Taxes—Generally.

Illinois has again "decoupled" from the federal estate tax system. Effective for decedents dying after December 31, 2010, Illinois imposes an estate tax equal to the state death tax credit amount that used to be in effect under Section 2011 of the IRC assuming an applicable exclusion amount of $2 million. While the federal applicable exclusion amount was increased for 2011 and 2012 to $5 million, Illinois' applicable exclusion amount remains relatively low. Illinois, however, does not impose a gift tax. Therefore, significant planning opportunities exist under current law to reduce state estate taxes by making lifetime gifts.

It was recently reported that Illinois legislators have agreed in principle to increase the Illinois applicable exclusion amount to $3.5 million in 2012 and $5 million in 2013. These changes are to be included as part of the tax bills being considered to keep the CME Group, Inc. and Sears Holdings Corp. in the state. These proposed changes are interesting given that legislators needed to significantly increase income taxes, yet are finding room in the budget to decrease estate taxes. Also, under current federal law, the $5 million applicable exclusion amount is to revert to $1 million in 2013, but the proposed Illinois law would apparently provide a $5 million applicable exclusion amount in 2013.

It is also unclear whether any of the proposed changes to Illinois law would include making the Illinois estate tax applicable exclusion amount portable, like the federal applicable exclusion amount in 2011 and 2012. Also unclear is whether the proposed legislation would clarify the applicability of the Illinois estate tax marital deduction to partners of a civil union.

Illinois lawmakers failed to pass the proposed legislation prior to the end of its scheduled veto session on November 10. However, lawmakers are set to return to Springfield on November 21 to deal with these issues.

Deduction for State Estate Taxes.

Section 2058 of the IRC provides a deduction on the federal estate tax return for state estate taxes paid with respect to property included in the federal gross estate. Given the differing federal and state estate tax applicable exclusion amounts, one planning tool Illinois estate planners have been making use of involves establishing a state-only QTIP marital trust upon the death of the first spouse and funding the trust with an amount equal to the difference between the remaining federal and state applicable exclusion amounts. In short, this planning allows full use of both the federal and state applicable exclusion amounts without incurring a state estate tax upon the first spouse's death.

One technical issue that has arisen with this planning concerns payment of state estate taxes on the state-only QTIP marital trust upon the surviving spouse's death. If the state estate tax due is apportioned to the state-only QTIP marital trust, the Section 2058 deduction on the federal estate tax return may not be available because the tax would have been paid from assets not included in the federal gross estate. Accordingly, consideration should be given to revising estate tax apportionment clauses in estate planning documents to apportion the state estate tax due on a state-only QTIP marital trust to assets that are included in the federal gross estate.

Illinois Powers of Attorney.

New statutory property and health care powers of attorney became effective on July 1, 2011. The new power of attorney forms made a number of substantial improvements to the prior forms. While prior statutory forms remain valid, consideration should be given to executing the updated forms.

Following the enactment of the new statutory property and health powers of attorney, various technical changes have been made or proposed to the new power of attorney forms. For example, a bill was signed into law this summer amending the new health care power of attorney form to address issues relating to HIPAA. In addition, concerns have been raised regarding what existing property powers of attorney are revoked by the new property power of attorney form (e.g., powers of attorneys executed with investment firms may be revoked by the new property power of attorney form). The legislature passed a bill defining "excluded powers of attorney" which would not be revoked by execution of the new property power of attorney form. The governor, however, exercised his amendatory veto power to substantially change the bill. The Illinois House recently overrode the governor's veto and the expectation is that the Illinois Senate will take up the measure when it returns to Springfield on November 21.

New York

Although the 2011 New York legislative session did not produce as much law affecting estate and trust planning, administration and litigation as the 2010 session, there were still a number of significant changes in this field. Perhaps the most notable piece of legislation from the 2011 session came in the area of domestic relations, as New York enacted a law recognizing same-sex marriage. Other relevant pieces of legislation from this session concern formula clause constructions related to the reinstatement of the federal estate tax, changes to the laws authorizing a trustee to decant trusts, examination of individuals in connection with wills containing in *terrorem* clauses, and making of health care decisions related to hospice care.

Domestic Relations Law.

A new Section 10 has been added to the Domestic Relations Law (DRL) to recognize the validity of same-sex marriages, and to provide same-sex married couples with the same public marital rights and benefits as opposite-sex couples. Benevolent organizations and charitable corporations, however, shall not be required to provide accommodations, advantages, facilities or privileges related to the solemnization or celebration of marriage. This change was effective on July 24, 2011.

Section 13 of the DRL has been amended to provide that no application for a New York marriage license shall be denied on the grounds that the parties are of the same or a different sex. This change was effective on July 24, 2011.

Formula Clauses.

Section 2-1.13 of the Estates, Powers and Trusts Law (EPTL) has been amended, in light of the reenactment of the federal estate tax, to clarify certain formula clauses in wills and trusts as they relate to the federal estate tax and tax applicable to estates of decedents dying in 2010. On August 13, 2010, the New York Legislature added Section 2-1.13 to address the repeal of the federal estate tax and GST tax for 2010. In light of the federal opt-out regime, Section 2-1.13 has been amended to provide that, where a beneficiary designation, will or trust of a decedent who dies after December 31, 2009 and before January 1, 2011 is made with reference to applicable exclusion amounts available under the federal estate tax or federal GST tax, such dispositions shall be deemed to refer to the federal estate tax or federal GST tax in effect in 2010, regardless of whether an election is made not to have the federal estate tax apply to the estate. The above construction shall not apply where the will or trust manifests an intention that it be otherwise construed.

New Decanting Statute.

Substantial changes have been made to Section 10-6.6 of the EPTL relating to the exercise of a power of appointment and an authorized trustee's authority to invade trust principal (i.e. decanting). The new statute permits an authorized trustee with unlimited discretion to appoint principal to another trust for the benefit of one or more of the current beneficiaries, and to grant a power of appointment to trust beneficiaries if such beneficiaries would have received principal outright under the invaded trust.

The new trust may have a term longer than the term of the invaded trust, as long as it does not violate the applicable rule against perpetuities.

The exercise of the power of appointment shall be evidenced by a written instrument effective 30 days after service upon persons entitled to notice (unless they consent to a shorter period). The authorized trustee may exercise the power without consent of the creator or the persons interested in the invaded trust and without court approval, though the authorized trustee may seek court approval. A person interested in the trust may object by serving notice prior to the effective date.

Public Health Law.

On March 16, 2010, Chapter 8 of the Laws of 2010 amended the Public Health Law (PHL) by creating new Article 29-CC (Family Health Care Decision Act) and 29-CCC (Nonhospital Orders Not to Resuscitate) to establish procedures for making medical treatment decisions on behalf of persons who lack the capacity to decide about treatment for themselves and who have not designated a health care agent. The PHL has now been amended to add decisions related to hospice care to the Family Health Care Decisions Act. This change was effective on September 18, 2011.

Surrogate's Court Procedure Act.

Section 1404(4) of the Surrogate's Court Procedure Act (SCPA) has been amended to allow—in probate proceedings where the will contains an in *terrorem* clause—the examination, in addition to the nominated executors and the proponents, of persons who, after application to the surrogate court based on "special circumstances," the Surrogate determines may provide information related to the validity of the will that would be of substantial importance or relevance in informing a party's decision to object to the will. This change is effective immediately and applies only to estates of decedents dying on or after August 3, 2011. These changes are intended to address the Court of Appeal's decision in *Matter of Singer*, 13 NY3d 447 (2009). Similarly, EPTL Section 3-3.5 was amended to make it clear that none of those examinations will trigger the in *terrorem* clause.

North Carolina

North Carolina Estate Tax.

North Carolina estate tax will apply to decedents dying in 2011 and 2012 with an applicable exclusion amount tied to federal law. (Session Law 2011-5 (House Bill 124) redefined "Code" as the Internal Revenue Code as enacted as of January 1, 2011, for North Carolina tax purposes.) The North Carolina Department of Revenue has confirmed that North Carolina law conforms to the federal law for those decedents who died in 2010, and estates that elected to pay federal estate tax and receive a stepped-up basis will also receive a stepped-up basis for North Carolina purposes.

529 Plans.

S.L. 2011-106 cancelled scheduled adjusted gross income limitations for state income tax deductions for contributions to a North Carolina 529 Plan. The income tax deductions for 529 Plan contributions were to become available only to individuals whose adjusted gross income was not greater than $60,000, or $100,000 for married couples filing jointly. This law cancelled the income limitations, which were scheduled to begin in 2012.

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