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In the Spotlight:

Citywealth Leaders distinguished **Gideon Rothschild** with a listing as one of North America's leading lawyers in private wealth management. Gideon was also listed in *Chambers USA* as one of the nation's leaders in Wealth Management. Gideon is "praised as 'the best asset protection attorney in the country'...and is considered to be particularly adept in work with an international dimension."

Daniel S. Rubin is quoted in the December-January 2010 edition of *Worth* magazine. In the article, "Year in Review: 10 Steps to Financial Recovery," he comments on protecting assets from creditors and protecting heirs from themselves. In addition, Daniel was elected as a Fellow of the American College of Trust and Estate Counsel ("ACTEC"). Fellows are selected on the basis of professional reputation and ability in the fields of trusts and estates and on the basis of having made substantial contributions to these fields through lecturing, writing, teaching and bar activities.

Irving Sitnick, Gideon Rothschild, and **Daniel S. Rubin** are honored with a listing in *New York Super Lawyers*®. Both **Gideon** and **Daniel** are listed in *Best Lawyers*® for their work with private clients.

New "HIRE" Act Impacts Foreign Reporting

On March 18, 2010, President Obama signed into law the Hiring Incentives to Restore Employment Act (the "HIRE" Act) intending to boost private sector hiring in 2010, principally through payroll forgiveness for Social Security taxes paid on certain new hires and a tax credit for retaining such new hires for at least one year thereafter.

While providing incentives for new hiring, the estimated \$18 billion cost of the HIRE Act is by no means insubstantial. Offset, in part, through increased information reporting and enforcement in the area of offshore accounts and foreign grantor trusts, the impact of the HIRE Act is sure to impact many taxpayers.

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Please join us on April 28, 2010 for a webinar on "New Developments in Foreign Trusts and Foreign Account Reporting." Click [here](#) to register.

Grantor Retained Annuity Trusts: Here Today, Gone Tomorrow?

On March 24, the House of Representatives passed the "Small Business and Infrastructure Jobs Tax Act of 2010." The Act, if passed by the Senate and signed by the President, would significantly limit the future utility of grantor retained annuity trusts by requiring (i) that the annuity payments to the grantor continue for a term of at least ten years, and (ii) that the remainder interest have a value "greater than zero". The effective date of these provisions relating to grantor retained annuity trusts would be the date of enactment of the Act.

By way of brief background, a grantor retained annuity trust or "GRAT" is a statutorily sanctioned trust whereby the grantor transfers property in trust and retains the right to receive a series of payments for a predetermined period of years. Most commonly, the payments are structured such that, after accounting for a federally mandated rate of return on the property transferred into the

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GRAT (called the "\$7520 Rate"), the present value of the payments will equal the value of the property transferred into the GRAT. When the annuity payments are structured in this manner, the GRAT is often referred to as being "zeroed-out" because the remainder interest is valued at zero for gift tax purposes; thus, no gift tax is payable and no gift tax exemption is used in connection with the funding of the GRAT. To the extent that the investment return within the GRAT exceeds the \$7520 Rate, however, value will remain in the GRAT after all annuity payments are made, thereby effecting a tax free gift of the excess return. The annuity payment period of a GRAT will often be fairly short; for example, two or three years. A short annuity payment period is considered advantageous primarily because the grantor's death during the annuity payment period will cause all of the GRAT property to be included in the grantor's estate for tax purposes – a shorter payment period reduces the risk of death during that period. In addition, potential significant appreciation within the shorter term will not be cancelled out by virtue of a longer term normalization or reduction in values.

By requiring a remainder interest with a value greater than zero, the Act would require that the grantor pay gift tax, or at least use some portion of the grantor's \$1,000,000 gift tax exemption, when establishing the GRAT. Since the GRAT may or may not actually realize an investment return sufficiently in excess of the \$7520 Rate so as to pass property to the GRAT remainder

beneficiaries, this can result in a waste of the grantor's gift tax exemption or the payment of gift tax without any purpose. Separately, by requiring that the annuity payments continue for a term of at least ten years, the Act would increase the tax risk to the use of GRATs by older individuals, and will inject increased mortality risk into GRAT planning even for younger individuals.

Although it is impossible to say whether the Act will actually become law, the current confluence of (i) low asset values, (ii) a \$7520 Rate near its all time low, and (iii) the real possibility that GRATs might not remain as viable an estate tax planning technique for much longer, suggests that now is the time to establish a GRAT.

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Foreign Account Reporting

Individuals with an interest in a "foreign financial asset" will be required to attach to their individual income tax return for tax years beginning in 2010 certain information about the foreign financial asset if the aggregate value of all such specified foreign financial assets equals at least \$50,000. A "foreign financial asset" includes (i) any financial accounts at foreign financial institutions; (ii) to the extent not held in an account at a financial institution, foreign issued stock or securities, interests in a foreign investment fund or derivatives with a foreign counterparty; and (iii) any interest in a foreign entity. The information that must be provided to the Internal Revenue Service includes (i) the name of the foreign financial institution

maintaining the account, (ii) the account number, and (iii) the maximum value of the account during the tax year. Failure to make the required disclosure will subject the account holder to a \$10,000 penalty. Moreover, a 40% penalty will apply to any actual underpayment attributable to an undisclosed foreign financial asset.

In addition, the statute of limitations period has been extended to six years for assessments relating to a "significant omission" of income from foreign assets. A significant omission is an omission that exceeds the lesser of 25% of the amount of gross income stated in the return, or \$5,000.

Foreign Trusts

A foreign trust created by a United States transferor for the benefit of one or more United States beneficiaries is treated as a grantor trust, and thus will be subject to taxation by the United States on the trust's worldwide income. The HIRE Act (i) clarifies, and possibly expands, the circumstances when a foreign trust will be treated as having one or more United States beneficiaries (for example, even when the interest of a United States person is contingent on a future event), (ii) provides a special rule requiring that discretionary distributions be limited to non-United States persons if the trust is to be treated as a foreign non-grantor trust, and (iii) presumes that a foreign trust has United States beneficiaries unless the United States transferor both submits as yet undetermined information to the Secretary of the Treasury, and demonstrates that the trust

has no United States beneficiaries.

In addition, the Act provides that, effective upon enactment, any uncompensated use of foreign trust property by a United States grantor, United States beneficiary or any United States person related to such grantor or beneficiary will be subject to tax as a distribution to such grantor or beneficiary for the fair market rental value of such property. This provision will result in many individuals having to file a Form 3520 to report such deemed distributions.

Passive Foreign Investment Companies

United States persons who are shareholders of a passive foreign investment company (commonly known as a "PFIC") will now have to file an annual report with the Internal Revenue Service containing such information as the Internal Revenue Service may require.

Finally, United States owners of foreign trusts will be subject to new reporting requirements and increased penalties for failing to properly report (now equal to the greater of \$10,000 and 35% of the value of the trust).

Financial Institution Reporting

Following on the heels of the UBS matter, the HIRE Act includes provisions intended to effectively end bank secrecy in foreign jurisdictions. Under the Act, United States "withholding agents" must withhold 30% of certain payments to foreign financial institutions unless the foreign financial institution has agreed to comply with onerous new reporting requirements relating to accounts held by or for

the benefit of United States persons.

Specifically, to avoid being subject to withholding, a foreign financial institution must agree, among other things (i) to comply with verification and due diligence procedures with respect to accounts held by United States persons or United States owned foreign entities, (ii) to itself withhold 30% on certain pass-through payments to certain account holders, and to either (iii) obtain waivers from its account holders of the protection of foreign secrecy laws or, absent receipt of a waiver within a reasonable time, close the account.

Foreign financial institutions agreeing to the new rules will be required to report the name, address and taxpayer identification number of each United States account holder, as well as the account number, account balance, and gross receipts and withdrawals or payments from the account. In the case of any United States owned foreign entity, the institution will also be required to report the name, address and taxpayer identification number of each substantial (generally 10% or greater) United States owner.

As a result of the foregoing, United States taxpayers will no longer be able to hide behind bank secrecy laws in most foreign jurisdictions. Therefore, taxpayers who have not yet come forward under the voluntary compliance initiative should give serious consideration to doing so now lest the Internal Revenue Service find them first. If you wish to explore this issue further, please contact Gideon Rothschild who heads up

our voluntary compliance representation before the Internal Revenue Service.

A Cautionary Tale Regarding Will Executions

On April 27, 2009, the New York County Surrogate's Court, in the case of *In re Estate of Wu*, ruled that the beneficiary of certain life insurance policies, who coincidentally served as an attesting witness to the decedent's will, was liable for a proportionate share of the federal and state estate tax due by reason of the decedent's death notwithstanding a provision in the decedent's will that exonerated the life insurance from liability for the estate tax it generated.

Harry Wu served as one of two attesting witnesses to his sister's will. Although Harry was not named as a beneficiary under the will itself, he was named as the beneficiary of two life insurance policies on his sister's life with a total death benefit of \$3,314,215. The will contained a commonly used tax provision that stipulated that all estate taxes, including those generated by assets passing outside of the will (like the life insurance payable to Harry), were to be paid out of the residuary estate under the will rather than apportioned among those receiving property by reason of the decedent's death.

Notwithstanding the tax provision of the decedent's will, however, the executor sought an order directing Harry to pay a proportionate share of the estate tax because § 3-3.2 of the New York State Estates, Powers and Trust Law provides that a

witness to a will whose testimony is necessary to probate the will cannot benefit from a disposition in the will. The dispute between Harry and the executor was whether the exoneration from liability for the estate tax pursuant to the tax clause under the will was a "disposition of property" within the purview of the statute.

The Surrogate's Court found Harry's testimony as an attesting witness to be necessary to probate the will and, therefore, declared the tax provision ineffective to exonerate the life insurance received by Harry from payment of a proportionate share of the estate tax. Specifically, the Court reasoned that the tax provision was tantamount to a beneficial disposition of property because the payment of taxes from the residue of the estate would have relieved Harry of what would otherwise have been his obligation.

According to the Court, "[t]he policy animating the invalidation of a legacy to a person whose testimony is required for probate is equally applicable to a benefit conferred by a tax clause."

The fact that Harry was unaware that he was named as a beneficiary under his sister's life insurance policies at the time that he witnessed her will did not matter.

Now you know why your lawyer insists that you come to his or her office to execute your will.

Pushing Back On Child Support and Maintenance Obligations

In recent months, courts throughout New York state have been inundated with applications for the downward modification of child support and/or maintenance (also known as spousal support), as a direct result of the troubled economy. The outcomes in these cases illustrate that in practice, most petitioners will find themselves stuck with the terms of their original bargain. In general, this speaks to the importance of having a flexible separation agreement that anticipates the potential for a change in financial circumstances. However, a successful modification remains possible if the petition is timed properly, well drafted, highly detailed and replete with persuasive documentary proofs.

Specifically, the challenge faced by a petitioner depends upon how the child support and/or maintenance obligation arose. There are three possibilities:

- The petitioner may have never agreed to the child support or maintenance obligation; instead, it may have been imposed upon him by court order. In such a situation, the petitioner will be required to prove only that a substantial change in circumstances has occurred since the order was issued.
- The petitioner may have voluntarily entered into an agreement with respect to child support. In such a situation, the petitioner will be required to prove that unanticipated

changes in circumstances have occurred.

- The petitioner may have entered into an agreement with respect to maintenance. In such a situation, the petitioner will be required to prove extreme hardship in continuing payment of the existing maintenance.

Is loss of employment, or a significant drop in income or property values, sufficient to obtain relief? Fairness would seem to require that this question be answered in the affirmative, but the law in this regard unfortunately does not speak in terms of fairness. In fact, quite to the contrary there is a substantial reluctance on the part of the judiciary to disturb established child support and maintenance obligations even in light of the harsh effects of the recession.

For example, in April of last year, a Long Island father sought to reduce his child support payments on the grounds that he lost his job due to downsizing, his new wife also lost her job, and his house was in foreclosure. Although the court recognized the involuntary nature of the job losses and that such changes were unanticipated, it refused to modify the child support. The court held that since the applicant's income had significantly increased over the years since the child support agreement was entered into, and he was the recipient of a severance package, he had failed to demonstrate an "unreasonable" change in circumstances.

A newly unemployed Westchester father fared no better in seeking to modify his child support

obligations. In that case, the court held that he failed to provide sufficient proof that he had used his best efforts to obtain employment commensurate with his qualifications and experience after losing his existing employment.

Specifically, courts have emphasized that they will look not only at the petitioner's income at the time modification is sought, but also at petitioner's overall financial circumstances, including potential earning capacity and the ability to maintain his or her own lifestyle.

The best strategy for a parent or ex-spouse struggling with child support or maintenance obligations as a result of the recession or other changed circumstances is to allow sufficient time to lapse between the changed circumstances and the filing of the petition of modification. This will enable the requisite proofs (e.g., a substantial job search) to be collated into a carefully framed petition.

Looking forward, however, separating or divorcing parties should include provisions in the separation or divorce agreement setting forth standards for triggering an automatic change in child support and/or maintenance obligations. Those provisions will be recognized and enforced by the courts (subject only to the best interests of a child to receive adequate support).

Before You Send Your Child to College

When children get ready to leave for college, their parents are often

involved in helping them prepare for the transition in almost every way imaginable. It is curious then that this preparation rarely includes ensuring that the child has executed the most basic estate planning documents; documents that may prove critically important while the child is away and on his or her own.

Health Care Proxy

For a child going away to college, a health care proxy in favor of mom and dad should be a prerequisite. It is not uncommon for a college student away from home for four (or even more) years to face medical issues during that time. An appropriately drafted health care proxy ensures that, if the need arises, the child's privacy rights under HIPAA (which are rights to which the child has only recently become entitled to as an adult), will not stand in the way of his or her parents accessing medical information and making appropriate health care decisions for the child. If a child attends an out of state college, it might even be advisable to have a health care proxy drawn in the child's home state, as well as in the state in which the child attends school, so as to ensure the health care proxy's ready enforceability. In all events, the child should provide a copy of his or her health care proxy to the campus health center to ensure that the parents have an easier time navigating the system if the need arises.

Power of Attorney

As with the health care proxy, a child headed off to college might also want to consider executing a power of attorney in favor of his or her parents. In general, a power of attorney allows an

individual (referred to as the "principal") to designate a representative (referred to as the "attorney-in-fact") to handle his or her financial affairs. In the case of a child headed off to college, the appointment of a parent as an attorney-in-fact can be extremely useful if the parent, for example, needs to execute banking transactions on behalf of the child while the child is away at school. A child who is less than eager to relinquish control over his or her financial affairs may be comforted in knowing that the grant of such power can be temporary (i.e., only while the child is away) and may be revoked at any time.

Last Will and Testament

In addition, for those children whose parents have, through successful estate planning of their own, already passed significant assets to the child, a last will and testament is also important. A will permits the child to dispose of his or her assets the child sees fit in the unlikely event of death. In particular, it is important to avoid a situation where the child dies without a will because in such a situation the child's assets would revert to the parents under the laws of intestacy. A reversion to the parents would, of course, have the effect of undoing their estate planning; instead, it might have been better for such assets to pass laterally to siblings.

Continued Thanks for Your Referrals

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