Wealth Management Update

July 2022

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As part of our ongoing efforts to keep wealth management professionals informed of recent developments related to our practice area, we have summarized below some items we think would be of interest. Please let us know if you have any questions.

July 2022 Interest Rates for GRATs, Sales to Defective Grantor Trusts, Intra-Family Loans and Split Interest Charitable Trusts AFRs

The July applicable federal rate ("AFR") for use with a sale to a defective grantor trust, self-canceling installment note ("SCIN") or intra-family loan with a note having a duration of 3-9 years (the mid-term rate, compounded annually) is 2.99%, up from 2.93% in June and up from 1.00% in July of 2021.

The July Section 7520 rate for use with estate planning techniques such as CRTs, CLTs, QPRTs and GRATs is 3.6%, which is equal to June's 7520 rate, but is significantly higher than the 7520 rate of 1.2% in July of 2021.

The AFRs (based on annual compounding) used in connection with intra-family loans are 2.37% for loans with a term of 3 years or less, 2.99% for loans with a term between 3 and 9 years, and 3.22% for loans with a term of longer than 9 years.

Thus, for example, if a 10-year loan is made to a child, and the child can invest the funds and obtain a return in excess of 3.22%, the child will be able to keep any returns over 3.22%. These same rates are used in connection with sales to defective grantor trusts.

Connecticut Gift and Estate Tax Exemption

Connecticut has a unified gift and estate tax exemption, which historically has been significantly lower than the federal gift/estate tax exemption. However, legislation was passed in Connecticut to increase the unified Connecticut exemption yearly until it matched the unified federal exemption in 2023. As a result of some ambiguities in Connecticut statutes, it was unclear whether the 2023 Connecticut gift/estate tax exemption would match the actual federal exemption in 2023 or the codified $5 million exemption, indexed for inflation (*i.e.*, the federal exemption prior to the 2018 Tax Cuts and Jobs Act). Connecticut Public Act No. 22-110 has clarified that the Connecticut gift/estate tax exemption will match the actual federal/gift tax exemption in 2023.

529 Plans

Starting in the 2024-2025 school year, 529 Plans established by anyone other than the parents of a student (*e.g.*, grandparents, aunts, family friends, etc.) will not affect financial aid decisions for the student.

Boyle v. Anderson, 871 S.E.2d 226 (April 14, 2022)

Mr. Anderson created an *inter vivos* trust for the benefit of his children and grandchildren. After Mr. Anderson died, his daughter, Sarah, became Trustee of the trust. Linda, the administrator of the estate of Mr. Anderson's predeceased son, filed a complaint against Sarah for breach of fiduciary duty.

The trust instrument contained a provision that stated that any dispute not amicably resolved, by mediation or otherwise, would be resolved by arbitration, so Sarah filed a motion to compel arbitration. Linda opposed the requirement of arbitration, arguing that she never agreed to resolve disputes by arbitration. The Circuit Court denied Sarah's motion, so she appealed, again claiming that her dispute with Linda should be resolved by arbitration.

The relevant provisions of the statutes referenced in Sarah's appeal are as follows:

Virginia Uniform Arbitration Act — Contract	Virginia Uniform Arbitration Act — Agreement	Federal Arbitration Act
A provision in a written **contract** to submit a controversy to arbitration	Written **agreement** to submit any existing controversy to arbitration	A **contract** relating to a transaction involving **commerce** that contains an **arbitration clause** that does not violate contract law

The Supreme Court of Virginia acknowledged that parties can waive their rights to a trial and freely engage in alternative dispute resolution, such as arbitration. However, the Court emphasized that an individual cannot be compelled to submit to arbitration unless such individual has agreed to resolution by arbitration.

In determining that the Virginia Uniform Arbitration Act did not apply to Linda's claim with respect to Mr. Anderson's trust instrument, the Court emphasized that a trust instrument is not an agreement or a contract because (i) an agreement is (A) a mutual understanding between two or more persons about their relative rights and duties regarding past or future performances or (B) a manifestation of mutual assent by two or more parties, and (ii) a contract is based on mutual assent, but a trust instrument is not based on a beneficiary's knowledge or acquiescence. The Court also emphasized that a trust beneficiary is not a party to a trust instrument, and, therefore, even if a trust instrument has an arbitration provision, the beneficiary has not agreed to it. The Court also distinguished the obligations of a trustee of a trust and the obligations of a party to a contract, pointing out that a trustee is held to a higher standard than a party to a contract, as a party to a contract can act freely for his or her own interests, but a trustee owes a duty of loyalty to a trust beneficiary.

In determining whether the Federal Arbitration Act applied to Linda's claim with respect to Mr. Anderson's trust instrument, the Court was required by precedent to interpret the plain meaning of the Act. That plain reading analysis resulted in the Court's determination that the Federal Arbitration Act could not compel Linda to submit to arbitration because a trust is not a contract, and the Federal Arbitration Act only applies to contracts.

It is important to note that this case was limited to the applicability of the State and federal statutes discussed above; importantly, the Court did not hold that an arbitration clause in a trust agreement is inherently unenforceable.

In RE: Omega, 2022 WL 1498499 (May 12, 2022)

On December 30, 2005, Mark Frank Douglas established a Revocable Trust that he called the Omega Trust. He subsequently amended the trust twice in 2015. In July 2016, Mr. Douglas informed the Trust Protector of the Omega Trust that he was in poor health and that he needed assistance with preparing a Third Amendment to the Omega Trust. In that same month, Mr. Douglas told the Trust Protector about the specific changes that he wanted to make to the Omega Trust, and the Trust Protector assisted the Settlor in drafting an email to his attorney to that effect. Shortly thereafter, Mr. Douglas informed the Trustee of the Omega Trust that he was going to make changes to the trust and that he would work with his estate planning attorney to do so.

In August of 2016, Mr. Douglas emailed his attorney about updating several of his estate planning documents, including the Omega Trust. In that email, Mr. Douglas set forth the specific changes that he wanted, namely the addition of beneficiaries and the designation of different successor fiduciaries. Mr. Douglas informed his attorney in that email that he had "significant health issues." Shortly thereafter, the estate planning attorney emailed Mr. Douglas with some questions about the desired changes listed in his prior email. Four days later, the attorney emailed Mr. Douglas a summary of the revisions to be made with respect to various estate planning documents, including the Omega Trust. He informed the Settlor that drafts, including the Third Amendment to the Omega Trust, were in progress. That same day, Mr. Douglas responded to his attorney's email with a few more changes, and the attorney replied that he would incorporate said changes into the documents. Two days later, on August 18, 2016, the Settlor died.

The Omega Trust contained a provision regarding amendments to the trust, which read as follows: "The Grantor reserves the right at any time or from time without the consent of any person and without notice to any person other than the Trustee to revoke or modify the trust hereby created, in whole or in part, to change the beneficiaries thereof, or to withdraw the whole or any part of the trust estate by filing notice of such revocation, modification, change or withdrawal with the Trustee." In a separate provision, the Omega Trust provided that any amendments to the Trust Agreement would be effective when signed by the Settlor.

A petition was brought in the Circuit Court seeking a declaration that the email correspondence between Mr. Anderson and his attorney (summarized above) constituted a valid Third Amendment to the Omega Trust. The Special Trustee of the Omega Trust, appointed by the Court, filed a motion to dismiss. The Circuit Court dismissed the petition because (i) Mr. Anderson did not take the steps set forth in the amendment provisions of the Omega Trust to amend the trust, and (ii) there was no clear and convincing evidence that the Settlor intended to amend the Omega Trust.

On appeal, the Supreme Court of New Hampshire analyzed New Hampshire's version of the Uniform Trust Code, which states, in part, that a Settlor can revoke a trust by any method manifesting clear and convincing intent of such revocation, as long as the governing trust instrument does not prohibit revocation by methods other than those set forth in the such trust instrument.

The Court denied the Special Trustee's motion to dismiss because, while the revocation provision in the Trust Agreement provided a method by which the Omega Trust could be revoked, it did not specify that that was the only method by which the Omega Trust could be revoked. The Court found that the email exchanges between the Settlor and his attorney were capable of evidencing the Settlor's intent to amend the Omega Trust. The case was therefore remanded to the lower court for trial on the merits.

Wallace v. Torres-Rodriguez, 2022 WL 1481782 (May 11, 2022)

After Milton Wallace, a high net worth Floridian, was diagnosed with a neurological condition, he and his wife, Patricia Rodriguez, established an irrevocable trust that was designed to hold jointly held assets for Patricia's benefit after Milton's death. In connection with the creation of the trust, they signed a postnuptial agreement that required the survivor to contribute all jointly held assets to the trust shortly after the death of the first of them to die.

Patricia died first, and, shortly after her death, her son, acting in his capacity as Personal Representative of Patricia's Estate, discovered that Milton had gifted assets from the joint accounts to Yanelin Torres-Rodriguez, a young woman with whom he was engaged in a romantic relationship for over a decade. Both Milton and Yanelin claimed that Patricia knew about the gifts, but the Personal Representative believed otherwise and sued Yanelin. At the time of the lawsuit, Yanelin owned three condominiums, a large amount of cash and a stock portfolio, all thanks to Milton.

The trial court found that Yanelin was unjustly enriched because she failed to prove that Milton gave her the gifts with Patricia's consent. However, the trial court also found that Yanelin was entitled to keep some of the gifted assets due to a "change of position" – *i.e.*, Yanelin detrimentally relied on Milton's generosity by choosing not to seek employment or attend college. As a result, the trial court permitted Yanelin to retain two of the condos and a brokerage account.

On appeal, the District Court of Appeal of Florida, Third District, ordered Yanelin to return all of the property resulting from Milton's gifts because (i) a change of position is a defense to unjust enrichment that must be affirmatively raised by a defendant and not the Court, and (ii) a change of position defense requires ignorance on the part of the recipient of the property, which, here, was not the case, as Yanelin knew that she was receiving jointly held property and never consulted with Patricia to verify that she consented to Milton's gifts to Yanelin.

Matter of Neva M. Strom Irrevocable Trust III, 203 A.D.3d 1255 (March 3, 2022)

Neva Strom established an irrevocable trust for the benefit of her daughters and funded it with her residence in New Jersey. The trust had an *in terrorem* clause that would treat any beneficiary as predeceased if such beneficiary directly or indirectly commenced or took part in any proceeding or action to impair, set aside or invalidate any terms of the Trust Agreement. The *in terrorem* clause did, however, specifically state that the clause would not be triggered if a beneficiary engaged in discovery referenced in New York EPTL § 3-3.5 or New York SCPA §1404, which permits preliminary examination of the drafter of a document and the nominated fiduciaries, among others.

The New Jersey home was eventually sold, and one of the beneficiaries was displeased. That beneficiary, Ms. Strom's daughter, filed affidavits in which she questioned the legality of the transfer of the home to the trust and arranged for the deposition of many of the professionals involved in the sale of the residence.

The Trustee of the trust filed an order to show cause in Surrogate's Court seeking a determination that the daughter violated the *in terrorem* clause. On appeal, the New York Appellate Division held that Ms. Strom's daughter did, in fact, violate the clause by deposing and compelling discovery from individuals unrelated to the trust.

In its opinion, the Supreme Court, Appellate Division, Third Department, New York emphasized New York's general dislike of *in terrorem* clauses and resulting insistence on strict construction of all *in terrorem* clauses, with paramount consideration given to the intent of the Settlor of a trust or testator of a Will.

Case of the Month

From Proskauer's Fiduciary Litigation Group

Surrogate's Court Dismisses Petition Seeking to Challenge the 2020 Amendment to a 2018 Trust on Standing Grounds. *Matter of van der Becq*, File No. 2021-39/C (Surr. Ct. Columbia Cnty Apr. 6, 2022)

Petitioners, who are the decedent's paternal cousins, filed a petition to challenge the validity of both decedents' October 31, 2018 trust (the "2018 Trust") ***and*** a November 15, 2020 amendment thereto (the "2020 Amendment"). The decedent, who contracted cancer, specifically disinherited her father's entire family under the 2018 Trust "for hiding the fact that [her father's] family carried the BRACA gene, which failure to disclose has led to [decedent's] early death," and continued that disinheritance under the 2020 Amendment, executed a couple of days prior to the decedent's death.

Respondent moved to dismiss, on standing grounds, that portion of Petitioner's petition to challenge the 2020 Amendment because: (a) if the 2018 Trust is valid, the 2020 Amendment fails as a matter of law, and (b) if the 2018 Trust is valid, there is no reason to analyze the 2020 Amendment because invalidating the 2020 Amendment will have no impact whatsoever on Petitioners, who are not beneficiaries of either the 2018 Trust or the 2020 Amendment.

Despite the lack of any pecuniary interest in a challenge to the 2020 Amendment, Petitioners continued to press their challenge to this amendment, which they dubbed the "deathbed amendment," because they apparently believed that including a challenge to the 2020 Amendment would necessarily strengthen their case to invalidate the 2018 Trust.

Refusing to be sidetracked by Petitioners' arguments about the purported defects of the 2020 Amendment, alleged conflicts of interest arising from its execution, and other "suspicious activity" asserted by Petitioners, Surrogate Richard M. Koweek granted Respondent's motion, holding that Petitioners lacked standing to challenge the 2020 Amendment, thereby leaving Petitioners exclusively with a challenge to the 2018 Trust executed two years prior to decedent's death.

***Takeaway*:** When the validity of a trust and the amendments thereto are being challenged, lawyers should consider whether the petitioner actually has any economic interest in the outcome of a challenge to one or more of the trust amendments. If not, a well-timed motion to dismiss may be able to significantly narrow the parameters of the case, which, in turn can save significant expense in terms of unnecessary discovery into capacity, undue influence and other factual issues not relevant to petitioner's claims and which may simply create distractions in the case, including at an ultimate trial.

Proskauer's Fiduciary Litigation Group handles complex fiduciary litigation on behalf of nationally recognized institutions and individuals. We draw on our century-old trusts and estates practice and the extensive trial experience of our litigators to help institutional and individual fiduciaries carry out their responsibilities in a manner that allows them to avoid litigation. We also represent beneficiaries who seek to challenge the actions of individuals who serve as their trustees or executors, or to enforce the terms of wills and trusts if they are not being administered correctly. Our lawyers have significant experience representing clients on both sides of contested accounting, asset valuation and conservatorship matters.

The Private Client Services Department at Proskauer is one of the largest private wealth management teams in the country and works with high-net-worth individuals and families to design customized estate and wealth transfer plans, and with individuals and institutions to assist in the administration of trusts and estates.

If you have any questions regarding the matters discussed in this newsletter, please contact any of the lawyers listed below:

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