Wealth Management Update

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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.

This publication is a service to our clients and friends. It is designed only to give general information on the developments actually covered. It is not intended to be a comprehensive summary of recent developments in the law, treat exhaustively the subjects covered, provide legal advice, or render a legal opinion.

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January 2025 AFRs and 7520 Rate

The January 2025 Section 7520 rate for use with estate planning techniques such as CRTs, CLTs, QPRTs and GRATs is 5.2%, an increase from the December 2024 rate of 5.0%. The January applicable federal rate ("AFR") for use with a sale to a defective grantor trust or intra-family loan with a note having a duration of:

- 3 years or less (the short-term rate, compounded annually) is 4.33%, up from 4.30% in December;
- 3 to 9 years (the mid-term rate, compounded annually) is 4.24%, up from 4.18% in December; and
- 9 years or more (the long-term rate, compounded annually) is 4.53%, showing no change from the December rate.

In re Estate of Jesse L. Beck, 557 P.3d 1255 (Mont. Oct. 29, 2024) – Montana Supreme Court Holds That a Cell Phone Video Cannot Be Admitted to Probate

In 2022, the decedent, Jesse, crashed his motorcycle and was subsequently struck and killed by a police officer responding to the accident. He was survived by his daughter, Alexia. Four days prior to his death, Jesse sent his brother, Jason, a phone video recording of himself, in which Jesse stated that, in the event anything should happen to him, he gives all his possessions to Jason.

In October 2023, Jason filed a petition for formal proceedings to probate Jesse's video recording as an enforceable Will under Montana Code section 72-2-523.

Under section 72-2-523, if a "document or writing added upon a document" is not executed in compliance with the formal Will requirements, the document or writing will be treated as if it had been executed in compliance with the Will requirements if the proponent establishes, by clear and convincing evidence, that the decedent intended it to constitute his or her Will.

The question in this case was whether the video could be considered a "document" under the statute.

Jason argued that the phrase "document or writing" contrasted to the requirement that Wills be "in writing" under Montana's formal Will requirements, and that this established the legislature's intent to allow non-written documents to qualify as intended Wills. He further noted the statutory directive that the Uniform Probate Code ("UPC")[1] be "liberally construed and applied to promote its underlying purposes and policies," and argued that allowing video recordings as documents would further the purpose of honoring testamentary intent.

The court responded that though in recent years there have been efforts to bring estate planning into the "digital age," there has not been, in any state, legislative authorization of nonwritten, video Wills, nor approval of such a Will by any court.

In addition, the purpose of section 72-2-523 is to relax formal execution requirements for written documents that "harmlessly" fail to satisfy all the formal requirements. The court stated that there is no indication that this purpose was intended to authorize entirely new forms of testamentary disposition not previously contemplated by the UPC. Here, Jesse's video, while expressing testamentary intent, comported with none of the formal Will requirements, nor attempted to do so: it was not written, signed, or witnessed by anyone, nor accompanied by documentation attempting to do those things. Thus, to the extent that the video could be considered an attempted Will, the errors were not harmless or de minimis.

The Court also rejected Jason's argument that the Restatement (Second) of Property supports an expansive reading of "document" to account for changes in technology. A comment in the Restatement defines "donative document of transfer" as one that is "a writing, or the equivalent of a writing," which includes a "recording of spoken words" and extends to other technological developments "that in clear and convincing manner appropriately manifests the donor's intention to make a gift." However, there is no indication that section 72-2-523 was intended to incorporate that comment of the Restatement.

Ultimately, the court found that the language of section 72-2-523 requires a Will to be a "document," and there was no basis that would permit the term to extend to an entirely new form of intended Wills (here, a video recording lacking any form of statutory authentication).

Memorial Hermann Accountable Care Organization v. Commissioner, 120 F.4th 215 (5th Cir. Oct. 28, 2024) – Fifth Circuit Does Not Apply Treasury Regulation, Illustrating the Effects of the *Loper Bright*[2] Decision

Memorial Hermann Accountable Care Organization ("MHACO") is an "accountable care organization" ("ACO"). ACOs are groups of health care providers that manage and coordinate care for Medicare beneficiaries. MHACO claims that 65% of its revenue over the course of its life was generated by Medicare Share Savings Program ("MSSP") activities.

MHACO filed an application with the IRS for recognition as an organization described in IRC section 501(c)(4). Section 501(c)(4) organizations are "operated exclusively for the promotion of social welfare." The IRS denied the tax exemption. The Tax Court upheld the denial, concluding that MHACO's "non-MSSP activities primarily benefit its commercial payor and healthcare provider participants, rather than the public, and therefore constitute a substantial non-exempt purpose."

MHACO appealed, arguing, in part, that the Tax Court applied the wrong legal standard.

In finding that MHACO did not qualify as a 501(c)(4) organization, the Tax Court applied the "substantial nonexempt purpose test." This test derives from *Better Business Bureau of Washington, D.C. v. United States*, 326 U.S. 279 (1945), and provides that a single non-exempt purpose, if substantial in nature, will destroy the exemption, regardless of the number or importance of truly exempt purposes. This is the standard that governs cases under IRC section 501(c)(3).

MHACO contended that this standard does not govern cases under section 501(c)(4). Rather, the proper test is laid out in 26 CFR 1.501(c)(4)-1(a)(2)(i). This regulation states that an organization is eligible for exemption under 501(c)(4) if it is "primarily engaged in promoting in some way the common good and general welfare of the people of the community" (the "primary purpose test").

Despite the Treasury Regulation, the Fifth Circuit found that the Tax Court correctly applied the substantial nonexempt purpose test. In its decision, the Fifth Circuit noted that they are no longer required to provide *Chevron* deference to the Treasury Regulations, and the court found it irrelevant that the

[1] Montana is a UPC jurisdiction.

[2] *Loper Bright Enters. v. Raimondo*, 144 S. Ct. 2244 (2024).

Internal Revenue Manual indicated that the IRS had previously applied the primary purpose test to section 501(c)(4) determinations. Rather, the Fifth Circuit decided that it made "little sense to treat the same phrase differently in two neighboring paragraphs of the same statute." And, the fact that the Treasury, as party to the case through the Commissioner, argued that the substantial nonexempt purpose and primary purpose tests are not meaningfully different, bolstered the court's reasoning. The court also cited cases from other circuits endorsing the substantial nonexempt purpose test in this context.

In re James A. Reed Trust, No. 366701 (Mich. Ct. App. Nov. 14, 2024) – Michigan Court of Appeals Reforms Trust to Comport With the Settlor's Intent

James Reed died in March 2020. He was survived by his children, Patricia, Gerald, Roger and David.

As relevant to the case, James' Revocable Trust (the "Trust") held real property in Michigan and Indiana and membership interests in the James A. Reed Farm Properties, LLC (the "LLC"). The Trust directed that the LLC membership interests be distributed to Patricia, the Indiana real property be distributed to James' grandson, and the remaining trust assets be distributed to Roger and Gerald.

James executed the LLC Operating Agreement on the same day he created the Trust. However, no Articles of Organization were filed for the LLC before James died. The initial capital contribution to the LLC consisted of the real property in Michigan (the "Michigan Properties"). Three days after creating the Trust and signing the Operating Agreement, James executed quitclaim deeds conveying the Michigan Properties to the Trust.

After James' death, Patricia, as Trustee, sought to file the LLC's Articles of Organization so that she could transfer the Michigan Properties from the trust to the LLC. In response, Roger and Gerald filed a petition asking the probate court to find that the Trust clearly and unambiguously provided for Roger and Gerald to inherit the Michigan Properties. Patricia then sought reformation of the Trust under MCL 700.7415, arguing that it was James' intent for Patricia to inherit the Michigan Properties. The probate court found that James had intended to bequeath the Michigan Properties to Patricia and that James had made a mistake of law by believing that the LLC Operating Agreement, alone, was sufficient to transfer the Michigan Properties to the LLC. Therefore, the probate court reformed the Trust and directed Patricia, as Trustee, to form the LLC, transfer the Michigan Properties to the LLC, and transfer the LLC membership units to herself.

The Michigan Court of Appeals affirmed the probate court's decision.

Under MCL 700.7415, a probate court may "reform the terms of a trust, even if unambiguous, to conform the terms to the settlor's intention if it is proved by clear and convincing evidence that both the settlor's intent and the terms of the trust were affected by a mistake of fact or law . . . ." The Michigan Court of Appeals found ample evidence that James intended for Patricia to inherit the Michigan Properties, including:

1. The estate planner's handwritten notes from her initial meeting with James, which included that James wanted the Michigan Properties to be left to Patricia, that he intended for there to be an unequal distribution amongst his children, and that Patricia was receiving more due to the assistance she provided to James;
2. The fact that James executed the Trust, which included the provision leaving the Trust's membership interest in the LLC to Patricia, on the same day he signed the LLC Operating Agreement, which provided that the initial capital contribution to the LLC was the Michigan Properties; and
3. Testimony from the estate planner and Patricia that James consistently stated his intent to leave the Michigan Properties to Patricia.

Gerald and Roger argued that James' actions were part of a ruse to trick Patricia into believing she would inherit the Michigan Properties so that she would continue to assist James. They pointed to the fact that LLC Articles of Organization were never filed as evidence that James never intended to form the LLC and never intended to leave Patricia anything. The Michigan Court of Appeals was not persuaded by this reasoning.

The Michigan Court of Appeals also found sufficient evidence supporting the conclusion that James made a mistake of law – James' estate planners testified that they believed the Michigan Properties could be transferred to the LLC after James' death, and the Operating Agreement erroneously claimed that the LLC was properly organized.

IQ Holdings, Inc. v. Commissioner, T.C. Memo. 2024-104 (Tax CT. Nov. 7, 2024) – Tax Court Disallows Charitable Deduction Due to Lack of Contemporaneous Written Acknowledgment

IQ Holdings, Inc. ("IQH") reported total charitable contributions of $2,932,168 on its 2014 tax return. The amount reflected donations of equipment, residential property, and cash to IQ Life Sciences Corp. ("IQLS"), a tax-exempt private foundation founded by IQH's owner.

On audit, IQH provided the IRS with a letter from IQLS to IQH confirming receipt of the charitable contributions, but the letter did not specify whether IQLS provided any goods or services in consideration for the donations.

The court upheld the IRS's denial of the charitable deduction due to IQH's failure to comply with the acknowledgment requirement under IRC section 170(f)(8)(B).

Under section 170(f)(8), the charitable deduction under section 170(a) is denied for any contribution of $250 or more unless the taxpayer receives a "contemporaneous written acknowledgment" of the contribution from the donee including the following information:

i. the amount of cash and a description (but not value) of any property other than cash contributed;

ii. whether the donee organization provided any goods or services in consideration, in whole or in part, for any property described in clause (i); and

iii. a description and good faith estimate of the value of any goods or services referred to in clause (ii).

While the letter from IQLS confirmed receipt of the donated items, it did not explicitly indicate whether IQLS "provided any goods or services in consideration" for the donations. The court noted that an acknowledgment must explicitly state whether consideration is provided for the contributed property even if the donor did not receive any consideration, and no deduction will be allowed if the acknowledgment does not include this mandatory statement. The court found it was not sufficient that IQLS's letter used the word "donation" (and thus, according to IQH, implied that there was no consideration).

The court rejected IQH's argument that the omission in the letter should be excused by the doctrine of substantial compliance, noting that the doctrine of substantial compliance does not apply to the acknowledgment requirement since this requirement "goes to the heart of the statutory purpose" – to assist taxpayers in determining the deductible amounts of their charitable contributions and to assist the IRS in processing returns on which charitable deductions are claimed.

In re Estate of William F. McLoughlin, 104 Mass. App. Ct. 752 (App. Ct. Sept. 30, 2024) – Massachusetts Appeals Court Finds That Providing an Affidavit in Support of an Action Contesting a Will Did Not Violate the Will's *in Terrorem* Clause

The decedent, William F. McLoughlin, Sr., died on October 30, 2020. He was survived by his six children. His Will, dated September 25, 2020, devised assets to all his children except William Jr.

> The decedent's Will contained the following *in terrorem* (or "no contest") clause:
>
> If any beneficiary hereunder shall contest the probate or validity of this will or of any of the beneficiary designations in place in connection with any of my qualified plans, IRAs, life insurance policies or any other asset of mine passing outside of this, my last will, or any provisions thereof, or shall institute or join in (except as a party defendant) any proceeding to contest the validity of this will or any provisions I have made during my lifetime for the distribution of my assets, whether probate or non-probate in nature, or to prevent any provision thereof from being carried out in accordance with its terms, then all benefits provided for such beneficiary are revoked, and such revoked benefits shall pass to the residuary beneficiaries of this will (other than such beneficiary).

William Jr. filed a motion to allow him to file an objection to the Will late (in July 2021), asserting that he was unaware of the "new" 2020 Will, he did not understand that it was the 2020 Will that had been admitted to probate, and the 2020 Will was invalid based on the decedent's mental state at the time of its writing. Sean, one of the decedent's other sons, ultimately submitted an affidavit in support of William Jr's motion in which he corroborated allegations made by William Jr. and contradicted some of the affidavit that the decedent's personal representative (one of the other children) had filed in response to William Jr.'s motion. In the affidavit, Sean stated that the decedent had suffered from Alzheimer's and that the decedent's mental state had significantly deteriorated by 2020. Sean also alleged that the other siblings had kept the decedent isolated and controlled and manipulated the decedent into executing the 2020 Will excluding William Jr.

The lower court found that Sean's affidavit triggered the *in terrorem* clause in the decedent's Will, and that Sean thus forfeited his inheritance. On appeal, the Massachusetts Appeals Court reversed.

Though *in terrorem* clauses are valid and enforceable in Massachusetts, they are construed narrowly.

Per its terms, the two triggers to the Will's *in terrorem* clause are: 1) if a beneficiary "shall contest the probate or validity of [the] will"; and 2) if a beneficiary "shall institute or join in . . . any proceeding to contest the validity of [the] will."

Reading the clause narrowly, the court found that Sean did not "contest the probate or validity" of the Will. A "contest" is a judicial proceeding to determine the validity of a Will, and Sean's filing of the affidavit did not meet this definition.

As to the second trigger, the court found that Sean did not "institute or join in" his brother's proceeding. Sean was only involved as a witness, and this was not sufficient to trigger the clause. The court noted that the only Massachusetts cases that have found a violation of a Will's *in terrorem* clause are those in which the individual is a party to the action. The fact that Sean voluntarily submitted the affidavit (rather than being subpoenaed) and that his affidavit went further than it needed to go to respond to the personal representative's statements did not change the analysis. The court further noted that if Sean had been subpoenaed to testify, he would not have been found in violation of the clause, and the outcome should not depend on whether a witness is sophisticated enough to insist on a subpoena.

Finally, the court opined that interested parties should have a full opportunity to test the validity of a Will in order to protect what may have been devised to them and to preserve the testator's wishes. Therefore, once a legal process is initiated (as it was here), witnesses should be permitted to testify.

Godoy v. Linzner, 106 Cal.App.5th 765 (CT. App. Nov. 13, 2024) – California Court of Appeal Invalidates Amendment to Trust as a Restraint on Alienation

In 2005, Silvia Villarreal executed her Revocable Trust. In 2018, with the assistance of an attorney, she amended and restated the Trust (the "2018 Restatement"). Silvia then amended the Trust again in 2019, without the assistance of an attorney (the "2019 Amendment"). As pertinent to the case, the trust assets included her long-term home (the "Property").

In the 2018 Restatement, Silvia provided that the Trustee was to distribute the Property to her three children, Arturo, Sonia and Leticia. Each child was to receive an undivided one-third interest, as tenants in common. Silvia requested that "the children retain this real property for a minimum of five years after the date of [her] death," and suggested that, if they wanted to sell the property, they could consider selling it to their siblings or one of the grandchildren. The 2018 Restatement emphasized that these requests and suggestions were "precatory and not mandatory," and that the vesting of the interests in the Property was as of the date of Silvia's death.

In the 2019 Amendment, Silvia added to her Trust that her wish was to keep the house as a place for her children to "enjoy, live and prosper and not to be sold or given outside of [the] family." She then included language that: 1) if any of her children wanted to sell their portion of the property, they must offer it for $100,000 to each other; and 2) the children must be flexible in receiving the purchase price if it takes one to ten years.

Two of the siblings, Arturo and Sonia, then filed a petition seeking a determination of whether Silvia's wishes in the 2019 Amendment were precatory or mandatory. If the wishes were mandatory, Arturo and Sonia asked the probate court to strike the 2019 Amendment because its language imposed an unreasonable restraint on alienation under California Civil Code section 711. Leticia, who was the Trustee, objected. The probate court found that the wishes in the 2019 Amendment were mandatory and imposed an unreasonable restraint on alienation. On appeal, the California Court of Appeal affirmed.

First, the court rejected Leticia's argument that section 711 does not apply when fee simple property interests are passed by a testamentary instrument. Leticia contended that testamentary instruments are outside the reach of the statute because testators should be permitted to impose whatever restrictions they want on the property they gift. But, the court concluded that the prohibition of restraints on alienation "applies regardless of the method in which a fee simple interest is conveyed, because a restraining condition is antithetical to the created fee simple interest and its inherent right of free alienation," and there is no exception to this rule even where the purpose of the restraint is to keep the property within the family.

The court then concluded that the restraint on alienation in the 2019 Amendment was unreasonable (as is required for section 711 to invalidate the restraint). The court first noted that a restraint on alienation encumbering a fee simple interest is typically unreasonable because it defeats the purpose of the fee simple interest. The court then explained that, given the heavy burden of the restraint, Sylvia's justification for the

restraint (that the property stay in the family) did not overcome the heavy presumption in favor of alienability. The property was worth over $1 Million at the time of Silvia's death, and, thus, the children stood to lose hundreds of thousands of dollars if required to sell a one-third interest for only $100,000 (and to only a family member at that).

Will of Richard Feigen, No. 2021-1075 (N.Y. Sur. Ct. Westchester Cnty. Nov. 29, 2024) – Westchester County Surrogate's Court disqualifies attorney and law firm under the Advocate-Witness Rule

The decedent, Richard Feigen, died on January 29. 2021. He was survived by this third wife, Isabelle, and the children from his first marriage, Philippa and Richard. After disposing of jewelry, clothing and other tangibles, the propounded instrument, dated July 16, 2018, poured over the remaining assets to a revocable trust (the "Trust"). The Trust provided $5 Million to each of Philippa and Richard, $50,000 to each of Isabelle's three children, and the residuary to Isabelle outright. This disposition differed from the decedent's prior estate plan, which gave Isabelle 50% of the residuary and Philippa and Richard the other 50%. Philippa and Richard filed objections to the propounded instrument, alleging, as relevant here, that it was procured by undue influence of Isabelle and others and that it was procured by fraud practiced upon the decedent by Isabelle and others.

William Zabel and Schulte Roth & Zabel LLP ("SRZ") were the attorneys for Isabelle and the other nominated executors (the "proponents"). Philippa and Richard filed a motion to disqualify Mr. Zabel and SRZ under the "Advocate-Witness Rule" (as hereinafter described). Mr. Zabel had been significantly involved with the decedent's estate planning and in matters relevant to the proceeding. For example, when drafting the decedent's estate plan, Mr. Zabel had been in direct communication with Isabelle, as well as had continued to communicate with Isabelle after the execution of the propounded instrument about the decedent's affairs and her fears of a probate contest. Mr. Zabel had also made changes to a neurologist's letter regarding the decedent's testamentary capacity.

The court granted the motion and disqualified Mr. Zabel and SRZ.

Rule 3.7 of New York's Rules of Professional Conduct (the "Advocate-Witness Rule") provides, in relevant part:

a. "A lawyer shall not act as advocate before a tribunal in a matter in which the lawyer is likely to be a witness on a significant issue of fact unless:
    1. the testimony relates solely to an uncontested issue;
    2. the testimony relates solely to the nature and value of legal services rendered in the matter;
    3. disqualification of the lawyer would work substantial hardship on the client;
    4. the testimony will relate solely to a matter of formality, and there is no reason to believe that substantial evidence will be offered in opposition to the testimony; or
    5. the testimony is authorized by the tribunal.

b. A lawyer may not act as advocate before a tribunal in a matter if:
    1. another lawyer in the lawyer's firm is likely to be called as a witness on a significant issue other than on behalf of the client, and it is apparent that the testimony may be prejudicial to the client."

The Advocate-Witness Rule is not controlling statutory or decisional law, and disqualification under the rule rests within the discretion of the court. To disqualify an attorney under the rule, the party moving for disqualification (in this case, Richard and Philippa) must show that (1) the attorney's testimony is necessary to the moving party's case and 2) that such testimony would be prejudicial to the opposing party (in this case, the proponents).

The court first noted that the finding of undue influence hinges on circumstantial evidence and on the credibility of the witnesses. Thus, Mr. Zabel's testimony and the testimony of other SRZ trusts and estates attorneys involved in the decedent's estate planning would be necessary to support Richard and Philippa's claim of undue influence. For instance, Isabelle's direct involvement with SRZ attorneys in the decedent's estate planning may serve as circumstantial evidence. Further, the testimony might prove prejudicial to the proponents since there were several facts uncovered in discovery that may call into question the attorneys' credibility. For example, the fact that Mr. Zabel made changes to the neurologist's letter to delete the doctor's references to Isabelle's presence during the examination may prove prejudicial.

However, while the court immediately disqualified Mr. Zabel, they only disqualified SRZ effective at the time of trial, since to disqualify the whole of SRZ at the current state of the proceeding would be unnecessary and potentially cause undue hardship.

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