Wealth Management Update

February 2025

Edited by Henry J. Leibowitz
Contributor: Farhaan K. Anjum

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.

February 2025 Interest Rates for GRATs, Sales to Defective Grantor Trusts, Intra-Family Loans and Split Interest Charitable Trusts

The February 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 4.52%, up from 4.24% in January 2025.

The February 2025 Section 7520 rate for use with estate planning techniques such as CRTs, CLTs, QPRTs and GRATs is 5.40%, up from the 5.20% Section 7520 rate in January 2025.

The AFRs (based on annual compounding) used in connection with intra-family loans are 4.34% for loans with a term of 3 years or less, 4.52% for loans with a term between 3 and 9 years, and 4.86% 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 4.86%, the child will be able to keep any returns over 4.86%. These same rates are used in connection with sales to defective grantor trusts.

Nosirrah Management, LLC v. AutoZone, Inc., (W.D. Tenn. November 15, 2024)

A United States District Court in Tennessee denied a motion to dismiss an action seeking to recover short-swing profits under Section 16(b) of the Securities Exchange Act of 1934 from the use of AutoZone stock to make annuity payments under a GRAT because of the substitution power within the GRAT.

Plaintiff filed a complaint seeking to recover short-swing profits under Section 16(b) of the Securities Exchange Act of 1934 alleging that William C. Rhodes III, AutoZone's Executive Chairman and former President and CEO, purchased AutoZone stock in March and April 2022, and sold it between December 16, 2021 and July 18, 2022 resulting in a profit of approximately $1,046,503.

Section 16(b) of the Securities Exchange Act has strict rules against what is known as short-swing trading by company insiders, including officers, directors or 10-percent stockholders from any purchase and sale or any sale and purchase of a security within a period of 6-months and that profits from such sale belong to the corporation.

Plaintiff and AutoZone communicated between September 2022 and January 2024 and on January 10, 2024, AutoZone confirmed it would not pursue recovering any such profits from Rhodes because the March 14 and April 7 purchases were from Rhodes' GRATs. Plaintiff, who also has similar active lawsuits to recover short-swing profits against two other companies, filed suit.

Rhodes filed a Motion to Dismiss arguing he was the settlor, trustee and sole lifetime beneficiary of the GRATs and argued that the March 14 and April 7 transactions were not purchases of AutoZone stock, but rather in-kind annuity payments made under the GRATs. As a result, Defendant argued that the GRAT annuities are exempt from Section 16(b) by operation of SEC Rule 16(a)-13 which exempts transactions from Section 16(b) where transactions effect only the form of the beneficial ownership without changing the person's pecuniary interest in the security.

The District Court refused to consider Rhodes' claims that he was the grantor, trustee and sole lifetime beneficiary because the District Court found no evidence in the Complaint or exhibits because the actual trust agreements for the GRATs were never submitted.

Rhodes also argued that the GRAT annuity payments were exempt from Section 16(b) by operation of SEC Rule 16a-13 because his acquisition of AutoZone stock from the GRATs changed the form of his beneficial ownership of the stock, from indirect to direct, without changing his pecuniary interest in the stock. Rhodes relied on a 1997 SEC No-Action Letter to Peter J. Kight as well as an independent reading of the SEC Act.

The District Court argued the Kight Letter was inapplicable because 1) No-action letters are not binding authority on the District Court; and 2) the Kight Letter was distinguishable from the facts at hand. In the Kight Letter, SEC determined the exception under Rule 16a-13 applied where the grantor of a GRAT would receive an annual payment in cash or in kind, given there was "no opportunity for any abuse of inside information." The District Court went on to note that in the present case, there was an opportunity for Rhodes to abuse inside information because the GRAT held a power of substitution and Rhodes could have had the opportunity to abuse inside information by swapping out the shares before they appreciated drastically.

As a result, the District Court finding that Rhodes could not sufficiently prove the 16a-13 exemption applies by failing to prove he was the beneficial owner of the stock, the District Court denied Rhodes' Motion to Dismiss.

In the Matter of the Petition of Richard S. Myers and Erin Langan (N.Y. Div. of Tax Appeals, ALJ)

An administrative law judge (ALJ) held that the Division of Taxation properly allocated a nonresident's 2020 wage income to New York.

Petitioners are a husband and wife who are longtime Pennsylvania residents who were never residents of New York. At all relevant times, the Petitioner was employed by Bank of Montreal ("BMO") and worked at its New York City office in Times Square from January 1, 2020 through March 13, 2020. During this time, the COVID-19 pandemic swept the nation, and a state of emergency was declared in New York. Governor Cuomo enacted the Pause Act to require non-essential businesses be restricted to work from home. Financial institutions, including BMO, were identified as essential businesses not subject to the restrictions imposed.

On March 16, 2020, BMO temporarily closed its New York office and required Petitioner to find alternative working arrangements. Petitioner worked at BMO's disaster recovery site in Jersey City on March 16, 2020 and March 17, 2020. From March 18, 2020 through December 31, 2020, Petitioner worked exclusively from his home in Pennsylvania.

For their 2020 tax return, Petitioners filed a New York State nonresident and part-year resident income tax return and claimed a substantial refund of $104,182 for an overpayment of New York State taxes. The Division of Taxation sent the Petitioners via direct deposit $30,156.40 and began an audit of the Petitioners' return.

Utilizing the convenience of the employer test, the Division claimed all workdays in 2020 were considered New York workdays and increased the total New York State taxes due from $19,347 to $93,372.60. This change reduced the overpayment by the Petitioners from $104,182 to $30,156.40 and the Division issued a notice of disallowance for the difference of $74,025.60.

In response, Petitioners challenged this finding and asserted the original reporting of the New York State amount was understated because it did not properly reflect a deferred bonus received by the Petitioners in the amount of $442,191 for work performed in New York prior and during 2020. The Petitioners then claimed this increased their total New York State taxes due and after a recalculation the overpayment should have been reported as $80,385 rather than $104,182.

New York law imposes a tax on nonresident individuals on income from New York sources equal to the tax imposed on a New York Resident for the full year, reduced by certain credits and multiplied by the New York source fraction. The New York source fraction is equal to the individual's New York source income divided by the individual's New York adjusted gross income from all sources for the entire year. A nonresident individual's New York source income consists of the sum of the items of income, gain, loss and deduction derived from or connected with New York sources.

When a nonresident individual works partly within and without New York, income is apportioned accordingly, however, any allowance for days worked outside of New York must be based on the performance of services out of necessity and not convenience.

The Division asserted that because BMO was exempt from the Pause Act as an essential business, the Petitioner could have performed his job in New York if such accommodation had been made available. The fact that BMO closed its New York office and required the Petitioner to find alternative arrangements was irrelevant as it was not a necessity on BMO's part. The ALJ agreed with the Division with respect to its assertion that the Petitioner did not prove his wages were improperly allocated to New York pursuant to the convenience of the employer test.

Udell v. Udell (Fla. 4th DCA 2024)

The Fourth District Court of Appeal reversed a trial court order denying the reopening of an estate for fraud based on a waiver signed by the surviving spouse.

The decedent's estate pursued a wrongful death action after the decedent was tragically murdered by a deliveryman. Under Fla. Stat. § 768.20, claims of wrongful death must be brought by the personal representative of an estate on behalf of the survivors. Accordingly, one of the decedent's two sons, as personal representative, pursued claims of loss of consortium on behalf of the decedent's spouse ("Appellant"), among other damages. The personal representative settled the action completely on the loss of consortium claim and distributed the proceeds according to the decedent's estate plan.

The decedent's will divided her estate into a marital and non-marital portion. The marital portion was required to be distributed outright to the Appellant, and the non-marital portion was required to be held in trust for the Appellant's benefit; upon his death, the remainder was required to be distributed to the two sons and their children. Under the trust, income and principal could be paid to the Appellant at the discretion of the trustees, who were the two sons. The personal representative distributed the settlement proceeds to the trust, and the estate was closed.

Thereafter, the Appellant and the two sons had a disagreement over the disposition of the settlement proceeds due to the Appellant's desire to donate the proceeds to a library in the name of the decedent. After retaining counsel, the Appellant and the sons agreed to increase the Appellant's monthly distributions in exchange for the Appellant waiving his rights to any other distributions from the trust (the "Agreement").

Several months later, the Appellant petitioned to reopen the estate, claiming that the personal representative committed fraud or bad faith in connection with the settlement by withholding material information about the Appellant's rights as the surviving spouse in violation of the personal representative's duties. Specifically, the Appellant argued that the personal representative had a duty to disclose that the Appellant, as the surviving spouse, was entitled to receive 100% of the settlement proceeds, and that the personal representative acquired an advantage by transferring the proceeds to the trust instead. The Appellant moved to rescind the transfer of the settlement to the trust and pursue recovery of his claims as surviving spouse.

The personal representative responded with the affirmative defense that the Appellant waived his rights to reopen the estate through waivers signed during the probate administration and through the Agreement, which he argued "waived any right to any further distribution under the trust by plain and unambiguous language." The Appellant contended he had no actual or constructive knowledge of his 100% entitlement to the settlement and the Agreement contained no waiver for fraud.

The trial court granted the personal representative's motion for summary judgment, finding the Appellant waived any right to further distribution from the trust due to the Agreement and that the estate could thus not be reopened for fraud.

On appeal, the court recognized that Florida law allows for an estate to be re-opened in instances of fraud or bad faith, which extends to situations where a fiduciary violates an obligation to make a full disclosure to a beneficiary of all material facts. The court found that, although the loss of consortium claim was pursued by the estate as required by Florida law, it was not a claim of the estate, but rather a claim of the Appellant's as surviving spouse. Thus, any recovery based on the claim was not truly as estate asset that could be distributed to the trust, but rather the Appellant's asset that he allowed the personal representatives to distribute to the trust.

Under this rationale, the court reasoned that the Agreement did not control the claim and bar re-opening because the Agreement only waived the Appellant's right to recover further distributions *from the trust*, and the Appellant instead sought to rescind the original distribution *to the trust*. Further, the court noted that, even if the Agreement was relevant, it did not expressly or impliedly waive any claims for fraud. The court reversed the trial court's grant of summary judgment.

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:

BOCA RATON

Joshua B. Glaser
+1.561.995.4743 — jglaser@proskauer.com

Albert W. Gortz
+1.561.995.4700 — agortz@proskauer.com

David Pratt
+1.561.995.4777 — dpratt@proskauer.com

LOS ANGELES

Mitchell M. Gaswirth
+1.310.284.5693 — mgaswirth@proskauer.com

Andrew M. Katzenstein
+1.310.284.4553 — akatzenstein@proskauer.com

Caroline Q. Robbins
+1.310.284.4546 — crobbins@proskauer.com

NEW YORK

Nathaniel W. Birdsall
+1.212.969.3616 — nbirdsall@proskauer.com

Stephanie E. Heilborn
+1.212.969.3679 — sheilborn@proskauer.com

Christiana Lazo
+1.212.969.3605 — clazo@proskauer.com

Henry J. Leibowitz
+1.212.969.3602 — hleibowitz@proskauer.com

Jay D. Waxenberg
+1.212.969.3606 — jwaxenberg@proskauer.com