Proskauer

Wealth Management Update

March 2023

March 2023 Interest Rates for GRATs, Sales to Defective Grantor Trusts, Intra-Family Loans and Split Interest Charitable Trusts

The March 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 3.70%, down from 3.82% in February 2023.

The March 2023 Section 7520 rate for use with estate planning techniques such as CRTs, CLTs, QPRTs and GRATs is 4.40%, down from 4.60% in February 2023.

The AFRs (based on annual compounding) used in connection with intra-family loans are 4.50% for loans with a term of 3 years or less, 3.70% for loans with a term between 3 and 9 years, and 3.74% 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 3.74%, the child will be able to keep any returns over 3.74%. These same rates are used in connection with sales to defective grantor trusts.

In re Pasquale Storto, Jr. Trust, No. 360134, Mich. App. Lexis 268 (Jan. 12, 2023)

A Michigan appellate court held that a document upon which a settlor hand-wrote instructions directing the distribution of cash and real property constituted a sufficient amendment to his trust.

Pasquale Storto, Jr., a resident of Michigan, executed a living trust on October 17, 2005. The trust provided that he may desire to prepare a written statement or list, either entirely in his handwriting or just signed by him, to dispose tangible personal property to certain persons in the future. It further provided that "if the list does not qualify as an amendment, I nevertheless hope those entitled to my estate will respect it."

The residue of the trust was to be distributed 50% to the settlor's sister, Linda Beaumont (also the successor trustee) and 50% equally between the settlor's ex-wife and grandchildren. Lastly, the trust provided that the settlor reserved the right to amend or revoke the trust by a writing signed by him or on his behalf and delivered to the trustee.

The settlor died in May 2020, upon which the settlor's longtime significant other, Priscilla Parness delivered his estate planning documents to Beaumont (the successor trustee). Among the estate planning documents was a memo entitled "Memorandum Regarding Distribution of Personal Property." The shell of the memo was a standard template for the transfer of personal property; however, the settlor wrote by hand (and signed on November 21, 2011), the following items to be distributed to Priscilla: (1) his personal vehicle, (2) his home at 4880 Westland and (3) $50,000 – Cash Minimum. The memo contained an additional handwritten entry distributing a time-share to Priscilla dated June 24, 2017.

A dispute arose between Priscilla and Beaumont as Beaumont claimed that the original signed memo could not be located (they only had a copy) whereas all the settlor's other estate planning documents were originals.

This ended up in litigation where there were two issues. First, Beaumont argued that since the original memo could not be found, Michigan has a rebuttable presumption in such cases that it was destroyed (and therefore revoked). The probate court and the appellate court rejected this argument as Priscilla had met the burden of proof that the original memo was not revoked.

The second issue is whether the memo qualifies as a valid trust amendment pursuant to Michigan law or should simply be deemed as an attempt to distribute personal property, in which case certain bequests to Priscilla would be invalidated.

Ultimately both courts determined the memo to be a valid trust amendment. The relevant statute provides that a settlor may revoke or amend a revocable trust by substantially complying with a method provided in the terms of the trust. The appellate court noted that the settlor (1) ensured that the memo would be delivered to the successor trustee upon his death as he kept it with his other estate planning documents and (2) fully complied with the terms of the trust as it was done in writing and signed and delivered to him as trustee.

In re Dissolution of Doehler Dry Ingredient Solutions, LLC, C.A. No. 2022-03540-LWW (Sept. 15, 2022)

Delaware's Court of Chancery denied a request for judicial dissolution of an LLC, since the LLC agreement contained a buyout provision in the event of a deadlock between members.

Doehler Dry Ingredient Solutions, LLC ("Doehler"), is a Delaware LLC in the dried foods industry based in Indiana. Doehler is governed by an Operating Agreement which provides for it to be managed by a board of four managers consisting of Russell Davis, Garry Beckett, Stuart McCarroll and J. Patrick O'Keefe.

Doehler's membership interest is owned 25% by Russell Davis (through a holding company); 25% by Garry Beckett; and 50% by Doehler North America, Inc.

By March 2022, various disputes arose between Russell Davis and the other members and managers resulting in his removal as a manager on March 24, 2022. This removal led to further disputes among Davis and the others.

Doehler's Operating Agreement had a "shotgun" Buy-Sell Option under which any member can deliver written notice to the other members proposing a purchase price for each of Doehler's units. After receipt of such notice, the other member/s are required to either (1) purchase all the first member's units at the proposed price or (2) sell all their units to the first member at the proposed price. Accordingly, the other members sought to purchase the shares from Davis for $44,486.

The next day, Davis filed a petition in the Delaware Court of Chancery seeking judicial dissolution of Doehler due to irreconcilable differences among the members and managers.

The Court noted that judicial dissolution of an entity is a limited remedy granted sparingly and its availability is limited to situations where "the management has become so dysfunctional or its business purpose so thwarted that it is no longer practicable to operate the business."

Davis argues that such a standard is reached since he, as a member, in the future, will decline to approve various actions critical to Doehler, all of which require unanimous consent under the Operating Agreement.

Ultimately, the Court rejected this argument as it failed to identify any existing deadlock, rather a potential deadlock in the future. Additionally, the Court noted that even if an existing deadlock was alleged, it can be remedied through a legal mechanism within the Operating Agreement (the Buy-Sell Provision).

In re Estate of Raymond Joseph Frisbie, unpublished per curiam Mich. App. opinion 357831 (Nov. 17, 2022)

A Michigan Appellate court denied a petition for surcharge against a trustee and held that a trustee may not be liable for mere mistakes or errors in judgment when they have acted in good faith.

Raymond and Carol Frisbie had six children – Regina, Kristy, Kevin, Joyce, Patrick and Teresa. On July 5, 2014, Raymond appointed Joyce as his attorney-in-fact. At her parent's direction, Joyce created a joint living trust for Raymond and Carol using an online program, which was executed on July 18, 2014.

The trust designated Joyce as the sole trustee and sole beneficiary, with Regina named as successor trustee and contingent beneficiary. If both Joyce and Regina predeceased the surviving grantor, the trust's assets were to be divided equally among the other four children. Although Joyce was the sole beneficiary, Raymond and Carol instructed Joyce that trust funds were to be used to support Teresa.

In February 2016, Raymond loaned funds to Joyce from his personal account to purchase a home and allegedly informed her that such loan would be forgiven upon his death, as Joyce was the sole beneficiary of the trust. A family meeting took place in April 2016 during which Raymond and Carol informed all six children of the trust and their wish for Joyce to be named as sole trustee and beneficiary to handle everything privately after their deaths.

Carol died on May 28, 2016, and Raymond died shortly after on June 13, 2016. After Raymond's death, Joyce transferred $345,113 to Patrick at the insistence of the siblings. However, Regina thereafter challenged the validity of the trust. Regina's challenge was settled with the entry of a Court Order dated September 21, 2017 which provided that the estate be administered as though the trust was invalid, and appointed Guy Conti as an independent personal representative of Raymond's estate.

Upon investigation, Conti brought numerous actions against Joyce, Patrick, Teresa and Kevin. Conti reached settlements with Patrick, Teresa and Kevin, however, no settlement was reached with Joyce. Conti subsequently filed a petition to surcharge Joyce in the amount of $490,113, claiming that since the trust was invalid, she improperly (1) used Raymond's assets to purchase her home, (2) transferred the home to herself, and (3) transferred funds to Patrick.

Joyce alleges that such transactions were not improper as the trust was not invalidated at the time the transfers were made and the transfer was made to Patrick at the insistence of all siblings.

The probate court initially found that Joyce did not breach her fiduciary duty (while the trust was still valid) and determine that Joyce had attempted to follow her parents' wishes.

The Appellate Court further noted that although Joyce had misgivings regarding the transfer of funds to Patrick and she admittedly acted against her better judgment, the court found that she only did so as a compromise and at the insistence of her siblings and therefore did not act in bad faith. Specifically, the court noted that (1) bad faith has been defined by the Supreme Court as arbitrary, reckless, indifferent or intentional disregard of the interests of the person owed a duty; (2) bad faith claims cannot be based upon negligence or bad judgment, so long as the actions were made honestly and without concealment; and (3) bad faith can exist when the actor is motivated by selfish purpose or by desire to protect its own interests at the expense of those to who he or she owes a fiduciary duty.

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