Proskauer

Wealth Management Update

September 2019

September 2019 Interest Rates for GRATs, Sales to Defective Grantor Trusts, Intra-Family Loans and Split-Interest Charitable Trusts

The September Section 7520 rate for use with estate planning techniques such as CRTs, CLTs, QPRTs and GRATs is 2.2%, which is identical to the August rate. The September 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 to 9 years (the mid-term rate, compounded annually) is 1.78%, down slightly from 1.87% in August.

The low Section 7520 rate and AFRs continue to present potentially rewarding opportunities to fund GRATs in September with depressed assets that are expected to perform better in the coming years.

The AFRs (based on annual compounding) used in connection with intra-family loans are 1.85% for loans with a term of 3 years or less, 1.78% for loans with a term between 3 and 9 years and 2.21% for loans with a term of longer than 9 years. With the mid-term rate now *less than* the short-term rate, clients will likely prefer the mid-term rate in their estate planning transactions.

Thus, for example, if a 9-year loan is made to a child, and the child can invest the funds and obtain a return in excess of 1.78%, the child will be able to keep any returns over 1.78%. These same rates are used in connection with sales to defective grantor trusts.

Levitan v. Rosen, 95 Mass. App. Ct. 248 (May 6, 2019) – Massachusetts Appeals Court Continues to Make Its Own Rules of Trust Law

In May of 2019, the Massachusetts Appeals Court attracted national attention when it decided *Levitan v. Rosen*, a divorce proceeding in which the court was asked to decide whether the wife's beneficial interest in a spendthrift trust should be included in the marital estate.

Levitan reminded many estate planners of *Pfannenstiehl v. Pfannenstiehl*, a 2015 case in which the Massachusetts Appeals Court held that a spouse's beneficial interest in a spendthrift trust was part of the marital estate. That holding was overturned by the Massachusetts Supreme Judicial Court (the "SJC") shortly thereafter.

In *Levitan v. Rosen*, the irrevocable spendthrift trust at issue was a Florida trust, which contained an absolute discretion standard and had only one lifetime beneficiary (rather than eleven, as was the case in *Pfannenstiehl*). The trust gave the wife the right to annually withdraw five percent of the principal of her share.

The trial court held that: (i) the wife's withdrawal right was not subject to the trust's spendthrift provision; (ii) the withdrawal right was a marital asset subject to equitable distribution because it was more than a mere expectancy; and (iii) the remainder of the wife's interest in the trust was a mere expectancy and was therefore excluded from the marital estate. Upon review, the appellate court determined that the trial court erred with regard to issues (i) and (iii). The appellate court held that the wife's entire interest in the trust, including her right of withdrawal, was an asset subject to equitable distribution.

The court distinguished the case from *Pfannenstiehl*: "Here, by contrast, the wife's share of the trust is not susceptible to reduction (as she is the sole beneficiary of her share presently held in trust), the beneficiary class is closed, and the 'primary intent' of the trust is to provide for the wife rather than for subsequent generations. Accordingly, the wife's trust interest in this case is sufficiently distinguishable from those deemed mere expectancies in *Pfannenstiehl*."

Nonetheless, the appellate court concluded that because the wife's entire interest in the trust was subject to the trust's spendthrift provision, the entire interest must be distributed exclusively to her, without any equitable division. The case was remanded to the trial court to decide the equitable division of the remaining marital assets (i.e., the husband's retirement account). On June 27, 2019, the SJC denied appellate review.

Oregon Legislature Enacts Unique Purpose Trust Statute (H.B. 2598)

In June of 2019, the Oregon legislature enacted a standalone purpose trust statute, effective January 1, 2020. While some states permit the use of a purpose trust under Uniform Trust Code ("UTC") Section 409, Oregon's statute provides several unique features that are absent from the UTC statute:

(1) Under the Oregon statute, a purpose trust must have a "business purpose" (not defined by the statute) and may hold an ownership interest in any type of recognized entity. Most other states that have enacted purpose trust statutes do not specify such a purpose, except that it must be lawful, not wasteful, not against public policy and capable of attainment. Because of the undefined "business purpose" language, there remains a question as to whether such a trust can be established to maintain a family art collection, for example, or a family compound.

(2) Instead of being managed by trustees, the Oregon statute provides that the trust must be managed by a "stewardship committee" of at least three persons. The statute requires this committee to account to the trustee (and the trust enforcers) annually.

(3) The statute does not provide for the appointment of a trust protector, which is a customary position in purpose trusts. However, the statute does defer to the "terms of the trust" in most instances, so if a trust protector is desired, it would likely be accommodated.

Alberhasky v. Alberhasky, 2019 WL 2150810 (Iowa Ct. App. May 15, 2019) – Iowa Court Warns that a Trustee May Owe Heightened Fiduciary Duties when a 529 Account Is Held in Trust

The Iowa Court of Appeals held that a claim for breach of fiduciary duties was prematurely dismissed, signaling that when a trust owns a Section 529 account, such that the trustee acts as custodian, fiduciary obligations imposed by the trust may apply.

In 2000, Alois Alberhasky created and funded a revocable trust (the "Trust"). She named herself trustee and designated her son, Rod, and her daughter, JoEllen, as successor trustees, to act upon her incapacitation. In 2009, Rod and JoEllen assumed their roles as co-trustees of the Trust. In 2010, the Trust enrolled in a 529 plan with grandson Max as the named beneficiary, depositing $65,000 of trust assets into the account. The Trust also set up 529 plans with identical deposits for the benefit of Ms. Alberhasky's other three grandchildren. Ms. Alberhasky then died in 2011. In 2012, after Rod and Max had become estranged, Rod modified the 529 plan initially naming Max as the beneficiary to instead name Max's younger brother Grayson as beneficiary.

Max Alberhasky brought suit against his father alleging breach of fiduciary duties, seeking to void the transaction transferring the beneficiary designation. The district court dismissed the suit, holding that Max had no standing to challenge how the 529 account was controlled by its owner. Upon review, the appellate court reversed and remanded.

While the appellate court did not decide the issue of whether there had been a breach of fiduciary duties, the court did provide a reminder as to the differences in fiduciary obligations that apply when a trustee acts as custodian of a 529 account held in trust versus when an individual acts as custodian of a 529 account that is not held in trust.

A 529 account custodial relationship does not, by itself, create a fiduciary obligation upon the custodian to the beneficiary. However, when a trust owns the 529 account, such that the trustee acts as custodian, fiduciary obligations imposed by the trust may apply. And while a trust might be drafted to permit another beneficiary of the trust to be named as a beneficiary of the 529 account, here, the Trust provided no such language.

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