Proskauer

Wealth Management Update

October 2022

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

The October 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 3.28%, up from 2.93% in September and up from 0.91% in October of 2021.

The October 2022 Section 7520 rate for use with estate planning techniques such as CRTs, CLTs, QPRTs and GRATs is 4.00%, up from 3.60% in September and up from 1.00% in October of 2021.

The AFRs (based on annual compounding) used in connection with intra-family loans are 3.40% for loans with a term of 3 years or less, 3.28% for loans with a term between 3 and 9 years, and 3.43% 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 3.43%, the child will be able to keep any returns over 3.43%. These same rates are used in connection with sales to defective grantor trusts.

Federal Estate, Gift and GST Tax Exemption to increase by $860,000 in 2023

On January 1 of each year, the federal estate, generation-skipping transfer (GST) and gift tax "basic exclusion amount," currently $12,060,000 per person, is adjusted for inflation. Due to recent inflation, the 2023 inflation adjustment is expected to be $860,000 per person, or $1,720,000 for a married couple. This will increase the exemption amount to a total of $12,920,000 per person or $25,840,000 for a married couple. The 2024 inflation adjustment, which will be based in part on inflation data from 2022, should also be considerable. High-net-worth individuals stand to benefit from these massive inflation adjustments. Those who have used up all or a substantial portion of their current gift tax exclusion amounts will be able to gift additional assets out of their estates ahead of the scheduled reduction in the exclusion amount on January 1, 2026. Individuals with a large amount of unused exclusion soon will have even more. For individuals with estates that are close to, or just above, the current exclusion level, these inflation adjustments may mean the difference between a significant estate tax liability and none at all. Please contact us to discuss ways to take advantage of these enhanced exclusion amounts.

Florida Legislation Update

The following changes to Florida's Trust Code are effective July 1, 2022:

- **Trustee Resignation (Fla. Stat. 736.0705(1))** - The legislation adds an additional method by which a trustee may resign, by both (i) using the procedure set forth in the trust instrument and (ii) giving notice to the co-trustees, or if none, to the successor trustee who has accepted his appointment, or if none, to the person who has the authority to appoint a successor trustee.
- **Rule Against Perpetuities (Fla. Stat. 689.225)** - The legislation extends the existing 360 year statutory rule against perpetuities period to 1,000 years for trusts created on or after July 1, 2022.
- **Noncharitable Trusts Without Ascertainable Beneficiary (Fla. Stat. 736.0409)** - Florida law allows for the creation of a noncharitable trust without a definite (or definitely ascertainable) beneficiary, or a noncharitable trust with an otherwise valid purpose to be selected by the trustee. New legislation extends the period such trusts may be enforced from 21 years to 1,000 years.
- **Direct Representation (Fla. Stat. 736.0303)** - The legislation expands the group of descendants whom a parent can represent and bind in trust matters, to the extent there is no conflict of interest and no guardian has been appointed, to include, in addition to the parent's unborn or minor child (i) the unborn descendants of the parent's unborn child, and (ii) the minor or unborn descendants of a parent's

minor child.

Donoghue v. Smith, 2022 U.S. Dist. LEXIS 76071

This is a shareholder derivative action in which shareholders of Sinclair Broadcast Corporation ("Sinclair") seek disgorgement of approximately $5.5 million in alleged short-swing profits realized by David D. Smith, a corporate insider- officer, director, and beneficial owner of more than 10% of the common stock of Sinclair- from the acquisition and subsequent sale of shares acquired by Smith from certain GRATs that he had established for the benefit of his children. Smith used his power of substitution under the GRATs to reacquire the Sinclair shares and, within six months, sold the shares on the open market, triggering liability under Section 16(b) of the Securities Exchange Act of 1934 (the "Exchange Act"). Section 16(b) "imposes strict liability on corporate insiders whose purchases and sales of securities result in short-swing profits" and "compels statutory insiders... to disgorge profits earned on any purchase or sale [of the corporation's securities] made within six months of each other." No showing of actual misuse of inside information or unlawful intent is necessary to state a claim under the statute, which is designed to "prevent the unfair use of information which may have been obtained by reason of the insider's relationship to the issuer." Smith moves to dismiss Plaintiffs' claims based on two main arguments: (1) under applicable regulations, his acquisitions of stock from the GRATs were exempt from Section 16(b) and (2) his acquisitions of stock do not constitute "purchases" within the meaning of Section 16(b).

A. Smith's acquisitions of stock from the GRATs are exempt under SEC Rule 16a-13

Smith argues that his acquisitions of stock from the GRATs are exempt from Section 16(b) under SEC Rule 16a-13, which exempts, in relevant part, "transactions that effect only a change in the form of beneficial ownership without changing a person's pecuniary interest in the subject equity securities" which typically includes changes from indirect to direct ownership or vice versa. The Court denies Smith's argument that his acquisitions of Sinclair stock merely changed the form of his beneficial ownership from indirect to direct because he failed to establish that he maintained beneficial ownership after the shares were transferred to the GRATs. Smith fails to prove that he had "investment control" over the securities held by the trusts in order to maintain the relevant indirect pecuniary interest necessary to be considered a beneficial owner of securities held by a trust. The GRATs explicitly give the Trustees, not the Settlor, the authority to "sell or otherwise dispose of any or all property comprising the Trust Estate" and to otherwise manage, sell, convey, or dispose of any property freely at any time. The GRATs further provide that the Settlor can in no event serve as Trustee. Thus, it is the Trustees who have "investment control" and not Smith. The Court concludes that Smith fails to demonstrate that the Rule 16a-13 exemption applies to the transactions at issue here.

Smith further argues that in the Statements of Changes in Beneficial Ownership of Securities (the "Forms 4") that he filed with the SEC, he "admitted" in these filings that he "remained the beneficial owner of the Sinclair stocks after it was contributed to the GRATs." However, the Court may not rely on Smith's statements in the Forms 4 for their truth, and can only examine the documents to determine what the documents stated, not to prove the truth of their contents.

SEC Rule 16a-1 defines beneficial owner as "any person who, directly or indirectly… has or shares a direct or indirect pecuniary interest in the equity securities." Pecuniary interest is defined as "the opportunity, directly or indirectly, to profit or share in any profit derived from a transaction in the subject securities." An indirect pecuniary interest includes "a person's interest in securities held by a trust." SEC Rule 16a-8(b) provides that with respect to settlors, "if the settlor does not exercise or share investment control over the issuer's securities held by the trust, the trust holdings and transactions shall be attributed to the trust instead of the settlor."

B. Smith's acquisitions of stock from the GRATs were not "purchases"

Under the Exchange Act, purchases "includes any contract to buy, purchase, or otherwise acquire" securities, which covers many transactions not ordinarily deemed a sale or purchase. The Court holds that Smith's alleged exchanges of property of an equivalent value for the shares held by the trust falls within the statutory definition of "purchase," given that the value of the property substituted by Smith matched the range of prices at which the Sinclair Class A common stock traded on the open market. The transactions each involved an agreement to exchange property, equal to the current market value of the securities, for those securities. The Court concludes that Smith's acquisitions of stock from the GRATs were "purchases" for purposes of Section 16(b).

Finally, Smith argues that "treating an insider's re-acquisition of shares from a GRAT is highly unlikely to serve the purpose of Section 16 because the insider makes all of the investment decisions for the GRAT, and therefore the insider enjoys no informational advantage over the GRAT." The Court is not convinced, stating that there is nothing in the pleadings to support the assertion that Smith made all of the investment decisions for the GRATs. To the contrary, it is the Trustees who have the authority to exercise investment control over the shares, and as such there is no basis to conclude that Smith and the GRATs were equally informed parties with respect to the acquisitions on the dates alleged in the Complaint, and the Court therefore denies Smith's motion to dismiss.

Yost v. Carroll, DC IL, 130 AFTR 2d ¶2022-5086

This case involves Plaintiff, Mr. Yost's ("Yost") attempt to collect on two promissory notes (the "Notes") totaling $8,261,333.79, plus interest, costs, and attorneys' fees that were signed by his daughter, Anne, and her then husband, the defendant, Mr. Carroll ("Carroll"), which Yost alleged were signed in connection with "loans" from Yost totaling approximately $7,000,000 for the purchase of homes by the married couple. No payments were made on either Note and until recently, none were due. In June 2020, after Anne and Carroll began divorce proceedings, Yost demanded payment of over $8,000,000 from Carroll on the Notes, which included claimed interest. Yost did not demand payment from his daughter, though she was a co-signer on the Notes. In Carroll's Affirmative Defenses he argued that the large transfers of money purporting to be promissory notes were in fact gifts, and that Yost had "orchestrated a scheme to evade the payment of gift taxes to the United States on large transfers of money to his daughter and her then husband, Mr. Carroll." The Amended Pleading suggests that Yost expressed the view that the Notes were a necessary tool to enable him to make gifts that appear to be loans so that gift taxes would not have to be paid, and to serve as a device to keep track of the money given to his daughters. The Amended Pleading states that Yost promised never to enforce the Notes, and they would be forgiven at his death.

In considering Yost's Motion to Dismiss the Amended Pleading, the Court recognizes the common law defense of in pari delicto, that is, a plaintiff is precluded from prevailing in a suit against a defendant when they share equal or mutual fault in the very transaction at issue. Carroll alleged that Yost expressly stated that the Notes were essential to avoiding tax liability and were never intended by either party to be promissory notes at all. Thus, by executing the Notes, Carroll and Anne became part of the alleged scheme and have implicated the doctrine of in pari delicto. Carroll also argued that because Yost was not only an "eager participant" in the tax evasion scheme, he devised it, he "should not benefit from it."

The central question in this case rests on whether Yost made the statements and promises that are alleged in the Amended Pleading, not on the legal accuracy of his conclusion that the Notes were necessary to avoid gift taxes. The Court concludes that Carroll's Amended Pleading stated a viable defense or claim and therefore, denies the Motion to Dismiss.

In re Marriage of Rene Simon Cruz and Rena Dillon Cruz (Cal. Sup. Ct. 2022)

I. Background

1. H and W were married from 1992 until 2019. They have two adult children.
2. W inherited mineral rights from her mother.
3. In 2012, W's brother advised her to move the mineral rights into trusts before the possible reduction of the gift tax exemption amount on January 1, 2013.
    a. First, H and W created an LLC called Cruz Mineral Investments, LLC ("CMI"), which was community property because it was formed during marriage.
    b. H and W then signed a transmutation agreement transmuting a portion of CMI from community property to each of their separate property.
    c. Next, W deeded the mineral rights to CMI and then H and W executed a second transmutation agreement confirming that the CMI membership interests were in fact separate property.
    d. H transferred a portion of his separate property CMI membership interests (39% of the interests in CMI) to the "2012 Rene Delaware Trust" – a trust for the benefit of W and the children.
    e. W transferred a portion of her separate property CMI membership interests (39% of the interests in CMI) to the "2012 Rena Delaware Trust" – a trust for the sole benefit of the children.
4. In 2014, H and W engaged a second estate planning attorney to engage in additional estate tax planning.
    a. At the attorney's recommendation, W settled the "2014 Rena Delaware Trust" for the benefit of H and the children, gifted her remaining 11% of CMI to the new trust, and then the 2012 Rena Delaware Trust sold its interests in CMI to the new trust.
    b. H assigned his remaining 11% of CMI to the 2012 Rene Delaware Trust.
    c. At this point, a SLAT for H and children owned 50% of CMI and a SLAT for the benefit of W and children owned the other 50%.
5. W claimed to have basically no knowledge of any of the estate planning transactions that she was involved in, though she signed the documents in front of notaries and was present for all meetings and phone calls.
6. W claims that H tricked her into giving up her mineral rights.

II. Court's Analysis

1. The first question was whether the mineral rights were part of the marital estate at the time of the trial. Answer: No.
    a. Because of the transactions described above, the LLC interests holding the mineral rights had been transferred to irrevocable trusts and were no longer part of the marital estate.

2. The second question was whether the transmutation agreements were valid. Answer: Yes.
    a. The Court notes that the transmutation agreements acknowledge possible conflicts of interest and each spouse's right to independent counsel, and describe the assets being transmuted with sufficient particularity.

3. Finally, the Court asked whether H exerted undue influence on W in order to "trick" her into transmuting the mineral rights. Answer: No.
    a. There's a rebuttable presumption of undue influence for transactions between spouses when such undue influence is alleged.

    b. The Court looked first at whether W was "disadvantaged" by the estate planning transactions. The Court noted that neither H nor W was very familiar with estate planning, but W was more familiar because she had acted as Trustee of trusts for the benefit of her parents and herself prior to 2012.

    c. The Court looked at whether W was under any sort of physical or mental disability or weakness; she was not.

    d. The Court asked whether there was unequal bargaining power between H and W; the Court found that, if anything, it was unequal in favor of W, who came from a wealthy family.

    e. The Court found W's testimony to be completely unreliable.

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