Proskauer

Wealth Management Update

September 2024

September 2024 AFRs and 7520 Rate

The September 2024 Section 7520 rate for use with estate planning techniques such as CRTs, CLTs, QPRTs and GRATs is 4.8%, a decrease from the August 2024 rate of 5.2%. The September 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 4.57%, down from 4.95% in August;
- 3 to 9 years (the mid-term rate, compounded annually) is 4.02%, down from 4.34% in August; and
- 9 years or more (the long-term rate, compounded annually) is 4.37%, down from 4.52% in August.

In the Matter of the Niki and Darren Irrevocable Trust and the N and D Delaware Irrevocable Trust, No. 2019-0302-SG (Del. Ch., July 24, 2024) – Delaware Court of Chancery Holds Trust Decanting Void Due to Noncompliance with Statutory Requirements

Facts: In 2012, a resident of El Salvador settled a California irrevocable trust of which she was the initial sole trustee (the "2012 Trust"). The 2012 Trust provided that the settlor would be the sole income beneficiary during her life but could not receive distributions of principal. Upon the settlor's death, the principal of the 2012 Trust was required to be divided into separate remainder trusts for the settlor's daughter (55%) and son-in-law (45%). Upon the subsequent deaths of the daughter and son-in-law, their respective remainder trusts would be divided into equal shares for their mutual children and held in separate continuing trusts.

In 2014, the settlor and her daughter and son-in-law wished to make various changes to the terms of the 2012 Trust, which they determined to accomplish by first changing the situs of the 2012 Trust to Delaware and appointing Comerica as the Delaware corporate co-trustee, and then decanting the 2012 Trust to a new Delaware trust with the desired terms (the "2014 Trust").

The substantive terms of the 2014 Trust—of which Comerica was the sole initial trustee—differed from the 2012 Trust in the following major respects: (1) the vesting of the son-in-law's remainder interest was accelerated to occur upon the earlier of the settlor's death or his divorce from the settlor's daughter (a significant consequence of this change was that if the daughter and son-in-law divorced, the settlor would no longer be entitled to receive income from the son-in-law's share of the principal, which would be split off into a separate trust for his benefit); (2) the daughter's and son-in-law's respective remainder interests in the principal were adjusted to provide for a 50/50 split; and (3) the class of ultimate remainder beneficiaries upon the deaths of the daughter and son-in-law was expanded to include *all* of their respective lineal descendants, including adopted ones, rather than just their mutual children. Although these changes in the 2014 Trust generally favored the son-in-law over the settlor and her daughter, each of them consented to the proposed decanting of the 2012 Trust, which the settlor and Comerica, as co-trustees, then purported to implement under the Delaware decanting statute. After the purported decanting, the 2014 Trust received subsequent additional contributions not derived from the 2012 Trust.

In 2018, the settlor's son-in-law and daughter obtained a divorce, which triggered the vesting of the son-in-law's 50% remainder interest under the terms of the 2014 Trust. This prompted the settlor and Comerica, as co-trustees of the 2012 Trust, to bring an action for declaratory relief in the Delaware Court of Chancery on the grounds that the decanting of the 2012 Trust assets to the 2014 Trust was invalid under the Delaware decanting statute and thus void *ab initio*. The Court denied this relief on the part of the settlor and Comerica pursuant to the "unclean hands" doctrine, given that they were the trustees of the 2012 Trust who originally attempted to implement the decanting. However, the settlor's daughter also joined this action to request similar declaratory relief as to the nullity of the decanting, which the Court was willing to entertain. Furthermore, although the son-in-law apparently conceded that the decanting was invalid under Delaware, he nevertheless contended that this rendered the decanting *voidable* (rather than *void*) and that the decanting should be upheld on various equitable grounds. The Court held a trial on these matters.

Holding: The purported decanting of the 2012 Trust principal to the 2014 Trust was a nullity under Delaware law, such that the assets subject to the purported decanting must be deemed to have remained in the 2012 Trust. Further litigation will be required in connection with the tracing of specific assets of the 2014 Trust (in light of the contributions thereto which were separate from the purported decanting) to determine how to appropriately restore the 2012 Trust to the position it should now occupy in the absence of the decanting.

Analysis: The Delaware decanting statute (12 Del. C. § 3528) only permits the decanting power to be exercised by the trustees of a trust if they otherwise have authority to invade the principal of the trust for the benefit of one or more beneficiaries. However, the 2012 Trust did not grant the trustees any power to invade principal during the Settlor's lifetime. Thus, the purported decanting of the 2012 Trust was clearly invalid under Delaware.

Notwithstanding that the purported decanting of the 2012 Trust was invalid, the settlor's son-in-law posited various equitable theories (e.g., unclean hands, laches, acquiescence on the part of the settlor and her daughter) to argue that the transfers of assets from the 2012 Trust to the 2014 Trust pursuant to the invalid decanting must nevertheless be upheld. However, the Court was not persuaded by the son-in-law's equitable theories because any such inequitable conduct by the settlor and/or her daughter lacked an "immediate and necessary" relation to the validity of the decanting at issue in the case.

Conn. Pub. Act No. 24-104 – Connecticut Uniform Trust Decanting Act

The Connecticut legislature recently enacted its own version of the Uniform Trust Decanting Act ("UTDA"), which will take effect as of January 1, 2025. Salient features of the Connecticut UTDA and significant differences from the Uniform Law Commission's model UDTA are outlined below:

- The decanting power granted under the CT UTDA does not affect the power to enter into a nonjudicial settlement agreement under CT law or any power to decant under the terms of the trust instrument. [Section 3]
- The decanting power granted under the CT UTDA may be exercised with respect to any trust with a CT governing law provision or situs of administration in CT (including a trust originally administered in or governed by the law of another jurisdiction if the situs/governing law is subsequently changed to CT) [Section 5]
- Except as noted below, an authorized trustee may exercise the decanting power without the consent of any person or prior court approval [Section 7(a)].
    - However, probate court approval is required to exercise the decanting power with respect to any testamentary trust [Section 9(c)]. *This exception is not included in the model UTDA.*
- To exercise the decanting power, an authorized trustee of the first trust must give 60-days written notice to (i) each living settlor of the first trust; (ii) each qualified beneficiary of the first trust; (iii) each person with a presently exercisable power over any part of the first trust; (iv) each person with the power to remove or replace the authorized trustee fiduciary; (v) each fiduciary of the first trust; (vi) each fiduciary of the second trust; (vii) the CT Attorney General, if the first trust includes a charitable interest; and (viii) the CT Attorney General and Department of Social Services, if the first trust is a special-needs trust [Section 7(b)].

    - The CT UTDA's various provisions regarding special-needs trusts are not included in the model UTDA.

- Virtual representation of individuals required to receive notice is permitted to the same extent as under the CT Uniform Trust Code [Section 8].
- Interested parties may petition the probate court for declaratory relief or other judicial review [Section 9].
- An exercise of the decanting power must be evidenced by a written instrument that identifies the first trust and the second trust, the property to be decanted and the property, if any, that will remain in the first trust [Section 10].
    - *This requirement to identify any property that will remain in the first trust is also included in the model UTDA.*

- If the first trust has a discretionary invasion standard, then the decanting power may not be used to add beneficiaries or omit/reduce any beneficiary's vested interest (e.g., any mandatory distribution or withdrawal right or presently exercisable power of appointment), but it may be used to omit/reduce the interest of any beneficiary (other than a vested interest) and add/omit/modify any power of appointment (other than to omit a presently exercisable GPOA) [Section 11].
- If the first trust has an ascertainable invasion standard, then the decanting power may not be used to add/omit any beneficiary, change the ascertainable distribution standard (except for the period by which any beneficial interest is extended in the second trust), change any power of appointment or omit/reduce any vested interest [Section 12].
- Special rules apply to the changes that can be made by exercise of decanting power with respect to special-needs trusts [Section 13], trusts with determinable charitable interest [Section 14] and honorary trusts for animals [Section 23].
- Regardless of the first trust's invasion standard, the decanting power may not be used to change any restriction on the exercise of decanting power in trust instrument, change any spendthrift provision, change any restriction on amendment or revocation, increase trustee compensation (unless the beneficiaries consent), reduce trustee liability, change trustee removal/replacement powers (unless existing powerholder consents) or jeopardize any tax benefit (e.g., QTIP status, GST-exempt status, etc.) [Sections 15-19].
- Regardless of the first trust's invasion standard, the decanting power may be used to divide and reallocate fiduciary powers among the fiduciaries, change the duration of the trust (subject to RAP) and change grantor trust status (provided, that if the first trust is a grantor trust, the grantor has power to block decanting by written objection within 60-day notice period) [Section 17, 19, 20].

Florida Bar Trust Law Committee – Legislative Proposal Re: Amendment to Decanting Statute

The Trust Law Committee of the Florida Bar's Real Property, Probate and Trust Law Section recently proposed the following amendments to the Florida decanting statute (F.S. § 736.04117):

- Power to decant by modification.
- Clarification that a trustee exercising the decanting power is not considered to be a settlor of the appointee trust, though the decanting trustee's intent—in addition to that of the settlor(s) of the invaded trust and appointee trust—may be considered in determining settlor intent with respect to the appointee trust.

Neal v. Lamb-Ferrara, 2024 Fla. App. LEXIS 4172 (Fla. Ct. App., 3d Dist., May 29, 2024) – Warning to Out of State Lawyers Who Advise Florida Residents on Trust/Estate Planning and Administration Matters

In this case, the Florida Court of Appeals held that an Illinois law firm was subject to personal jurisdiction in Florida state courts with respect to claims of legal malpractice and breaches of fiduciary duties arising from said Illinois firm's provision of trust/estate planning and administration services to Florida residents, even though the Illinois firm performed all its work outside of Florida and was aided by Florida co-counsel in the administration of client's Florida probate estate.

In holding that the Illinois firm was subject to personal jurisdiction in Florida, the Court analyzed the facts here to conclude that they satisfied both (1) the requirements of Florida's Long-Arm Statute and (2) constitutional due process limits, as discussed below:

- Long-Arm Statute – the statutory test was readily satisfied by virtue of prior Florida case law holding that the FL Long-Arm Statute "may extend to nonresident defendants that perform estate services for an estate probated in Florida." This conclusion was not changed by the fact that the Illinois firm did not maintain an office in Florida and never directly filed papers in the Florida court. The record showed that the Illinois firm was retained by the Florida clients as lead counsel in this matter and largely directed the activities of its Florida co-counsel. Furthermore, the Florida Supreme Court has held that engaging in even one single act for profit within the state may constitute a business venture that justifies the exercise of jurisdiction under the Long-Arm Statute.

- Due Process Limits – the due process test is a bit more stringent, as it requires that a defendant subjected to personal jurisdiction in a state's courts must (a) have sufficient minimum contacts with the state, and (b) such exercise of jurisdiction must be reasonable so as not to "offend traditional notions of fair play and substantial justice" (this requirement is commonly understood to mean that it must be reasonably foreseeable to the defendant that he or she might be haled into the state's courts for the conduct at issue).
    - The first prong of this test ("minimum contacts") was satisfied in this case based largely on the same facts and reasoning discussed above with respect to the Long-Arm Statute.
    - The second prong of this test (call it "reasonableness") was satisfied in this case because the Illinois firm "rendered estate planning services to [Florida client] with full awareness that he was domiciled in Florida and that his will would be probated in Florida."

It must be noted that the Court's opinion here is narrowly limited to the issue of personal jurisdiction over nonresident attorneys who represent Florida clients—it does not address the merits of the underlying malpractice claims. There is nothing in the Court's opinion to suggest that a nonresident attorney's mere provision of estate planning and administration services to Florida clients would in itself constitute malpractice.

ABA Formal Ethics Opinion 511R – Confidentiality Obligations of Lawyers Posting to Listservs

The American Bar Association has issued a formal ethics opinion to clarify attorneys' confidentiality obligations when posting to email listservs or otherwise participating in discussion groups with attorneys from different law firms. The upshot of this opinion is that attorneys participating in such groups must take care even when discussing abstract legal and factual issues so as to ensure that they do not say anything which might reasonably enable other members of the group to infer confidential client information.

Conley v. Conley (In re Conley Trust), No. 366180 (Mich. Ct. App., July 18, 2024) – Michigan Court Holds Beneficiaries Properly Issued K-1s in Connection with Transfer Made Pursuant to a Trust Settlement Agreement

Facts: This case involved a dispute regarding the enforcement of a settlement agreement entered into by the beneficiaries and trustee of the Raymond T. Conley Trust. After the death of the trust's settlor and his wife, their children Wallace and Kathleen (the appellants), who were beneficiaries of the Trust and siblings of the sole trustee, Maureen Conley (the appellee, who was also a beneficiary), accused Maureen of breaching her fiduciary duties. After extensive litigation, a settlement agreement was reached in 2021.

Under the settlement agreement, Wallace and Kathleen were entitled to receive significant cash distributions from the Trust in exchange for Maureen receiving the house owned by the Trust, free and clear of any claims by Wallace and Kathleen. To effectuate the transfer of the house, Wallace and Kathleen executed quitclaim deeds in Maureen's favor. Maureen thereafter issued K-1s to Wallace and Kathleen, as beneficiaries, reporting their shares of capital gains incurred in connection with the conveyance of the house to Maureen.

In 2022, Wallace and Kathleen sought to have the probate court enforce the settlement agreement, alleging that Maureen, as trustee, had breached its terms by issuing K-1s to them as described above. The probate court initially found that Maureen had breached the agreement but later reversed this decision, concluding that the terms of the agreement were unambiguous and that any tax consequences that Wallace and Kathleen faced were a natural outcome of the settlement. On appeal, Wallace and Kathleen argued that the probate court erred in its interpretation of the settlement agreement as unambiguous and its determination that no breach had occurred.

Holding: The Court of Appeals upheld the probate court's ruling, concluding that Maureen's issuance of K-1s to Wallace and Kathleen was consistent with the settlement terms, which the Court found were clear and unambiguous.

Analysis: The appellants' arguments revolved around the following two provisions of the settlement agreement:

> "10. The further administration of any of the activities of either trust, or the administration of any estate of either LOIS M. CONLEY or RAYMOND T. CONLEY will not involve Wallace or Kathleen. In other words, they will have no claims of interest, nor will they have any responsibility.

> 11. All parties will be responsible for their own attorney fees, costs or other obligations associated with the administration of the Trusts or the settlement of all matters."

First, the appellants argued that the foregoing Paragraphs 10 and 11 were in conflict and created an ambiguity that should have been resolved by a trier of fact in the probate court proceeding. However, given that the appellants did not raise this argument in the probate court, the Court found that it was unpreserved and subject to a deferential *plain error* standard of review on appeal. Applying this standard, the Court concluded that Paragraphs 10 and 11 were complementary, rather than ambiguous.

Second, the appellants argues that Maureen breached Paragraph 10 of the settlement agreement by issuing the K-1s to them. Their theory was that they completed their obligations under the settlement agreement by executing the quitclaim deeds to the house and thus had no further obligations with respect to any subsequent tax consequences. However, the Court reasoned that the related conveyance of the house from the Trust to Maureen (made in consideration of the cash distributions received by the appellants) was also an essential step to complete performance of the settlement agreement, such that the appellants were obligated under Paragraph 11 thereof to share in the capital gains taxes incurred by said conveyance. Thus, the Court concluded that Maureen's issuance of K-1s to the appellants for this purpose did not breach the settlement agreement.

FedEx Corp. v. United States, W.D. Tenn., No. 2:20-cv-02794 – District Court Requests Supplemental Briefing on Impact of *Loper Bright* Doctrine in a Federal Tax Case; Taxpayer and Government Unsurprisingly Disagree

A U.S. District Court has asked litigants in a longstanding federal tax controversy to provide supplemental briefing with respect to the impact on their legal positions of the U.S. Supreme Court's recent landmark decision abolishing *Chevron* deference in *Loper Bright Enters. v. Raimondo*, 603 U.S. ___ (2024).

In *Loper Bright*, the Supreme Court overruled the *Chevron* doctrine, holding that the Administrative Procedure Act requires courts to exercise their independent judgment in deciding whether an agency has acted within its statutory authority, and courts may not defer to an agency's interpretation of the law merely because a statute is ambiguous. However, the *Loper Bright* majority made clear that courts may still take account of an agency's considered views in such cases, giving non-binding weight to the agency's interpretation to the extent "it rests on factual premises within [the agency's] expertise" (so-called *Skidmore* deference).

When the *Loper Bright* was decided earlier this year, it was widely predicted by legal commentators that the decision would lead to a flurry of new litigation challenging administrative agencies' interpretations of federal statutes. The supplemental briefing requested by the District Court in *FedEx v. U.S.* appears to be the first application of the *Loper Bright* doctrine in a case involving administrative interpretations of federal tax law. This recent development also serves to demonstrate that *Loper Bright* may have significant consequences even for ongoing litigations that were initiated years before the *Loper Bright* decision.

Unsurprisingly, the litigants in *FedEx v. U.S.*—a case involving disputes over foreign tax credits—have taken diametrically opposed positions in their supplemental briefs concerning the impact of *Loper Bright*. The government's brief argues that the Treasury Department's interpretation of the international tax statutes at issue is entitled to deference in light of Congress's delegation of regulatory authority to the Treasury under IRC Section 965(o) and the Treasury's subject matter expertise in this highly complex, technical area of the law. In contrast, FedEx's brief argues that the Treasury's interpretations of the relevant statutes have been "consistently inconsistent" and are not entitled to judicial deference. These dueling arguments based on *Loper Bright* seem to validate the concerns expressed by many legal commentators that overturning *Chevron* would only serve to muddy the waters of administrative law and may lead to unpredictable and inconsistent results as federal courts across the nation grapple with the myriad implications of this doctrinal sea change.

IRS Promulgates Final Regulations and Additional Proposed Regulations with Respect to Required Minimum Distributions from Qualified Retirement Accounts

In the July 19, 2024, issue of the *Federal Register*, the Treasury Department promulgated lengthy final and proposed regulations to clarify numerous technical rules governing required minimum distributions ("RMDs") from qualified retirement accounts, including those related to the proper application of the "at least as rapidly" ("ALAR") principle.

The Treasury Department's **final** regulations under RIN 1545-BP82 introduce several key provisions:

1. **Updated RMD Rules**: Reflecting the SECURE 2.0 Act, these regulations clarify required minimum distributions from various retirement accounts, including 401(k), 403(b), and IRAs.
2. **Trusts as Beneficiaries**: The rules specify how trusts are treated when designated as beneficiaries, ensuring they meet specific criteria to qualify for favorable tax treatment.
3. **Eligible Rollover Distributions**: The regulations update guidelines for eligible rollover distributions, including changes that have occurred since the last major update in 1995.

These provisions aim to align tax regulations with recent legislative changes and provide clearer guidance for retirement account holders and their beneficiaries.

The Treasury Department's **proposed** regulations under RIN 1545-BQ66 aim to update the RMD rules as outlined by the SECURE 2.0 Act. Key provisions include:

1. **Adjustments to RMD Timing**: The regulations propose changes to the timing and calculation of RMDs, specifically accommodating the later required beginning dates for distributions.
2. **Spousal Beneficiary Provisions**: Special rules for surviving spouses who elect to treat a decedent's account as their own are clarified.
3. **Compliance with Updated Legislation**: The regulations ensure alignment with recent legislative changes, enhancing consistency in how retirement accounts are managed under these new laws.

These proposed updates are intended to streamline and clarify RMD obligations following legislative shifts in retirement savings regulations.

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