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COMMENTARY

Current Issues for Estate Planners: The CTA, Rising Interest Rates and More

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Trusts and Estates

By Rebecca Rosenberger Smolen and Amy Neifeld Shkedy | February 27, 2024 at 12:19 PM

There are a number of prominent issues on the horizon for estate planners this year. In this article, we provide a brief overview of some of those issues, including the Corporate Transparency Act, rising interest rates, Pennsylvania recognition of irrevocable grantor trusts, pandemic-related probate delays and upcoming scheduled sunset of the historically large federal gift and estate tax exemption.

The Corporate Transparency Act (CTA) creates reporting requirements that must be fulfilled this year for the first time ever. It's not clear who will be taking the lead on satisfying the requirements, but, estate planners need to be mindful of them where their clients are business owners or have created business entities (other than a general partnership) to own investments such as real estate or securities. The purpose of this new registration program is to address financial abuses, such as money laundering, which have been attributed, in many instances, to the anonymity of owners of business entities.

Under the CTA, registration of "beneficial owners" who have "substantial control" (ownership/control of at least 25%) of business entities with the Financial Crimes Enforcement Network (FinCEN) is required, with financial penalties applying for those who don't comply. Beneficial owners of entities in existence before 2024 have until the end of this year to register, whereas beneficial owners of entities created this year must register within 90 days of creation. Starting in 2025, the registration must take place within 30 days of creation.

When a trust is a beneficial owner, the trustee generally must register, and in some circumstances, one or more current beneficiaries of the trust must register. It appears that remainder beneficiaries of a trust would not need to register. For individuals who are beneficial owners of multiple business entities (including trustees), there is a way to separately register with FinCEN rather than provide the identifying information separately for each entity.

Another current issue for estate planners relates to the rising interest rate environment, for the first time in more than 10 years. Not only does this create potential revenue to be mindful of for idle cash reserves in trusts and estates, but, it also changes the dynamics to make some classic estate planning transactions more attractive and some less attractive. Qualified personal residence trusts which were popular in the '90s and early to mid 2000s are worth considering again, as are charitable remainder trusts (CRTs). By the same token, grantor retained annuity trusts and charitable lead trusts have lower chances of "success" than they did in the lower interest rate environment.

CRTs are particularly worth considering for clients with highly appreciated stock portfolios that they would like to diversify as they are approaching retirement. They can also add value for an estate plan where an IRA or qualified retirement benefit (like a 401-K) will pass to children or grandchildren now that the stretch-out for an inherited IRA will be limited to 10 years under the Secure Act for most of those beneficiaries. With a CRT, only 10% of the trust assets must go to charity at the end of the trust term (based on the present value when the trust is created), so, while some charitable objective should be present, it does not need to be a paramount goal of the client for the CRT to be considered. In many cases, the tax benefits derived from the CRT will create more benefits for the non-charitable beneficiary than the loss of the funds going to the charity, so, it can be a "win win" vehicle.

In simple terms, a CRT is a trust structure where the taxpayer retains the right to an annuity or unitrust interest for life or a term of years from the trust assets, and then at the end of the payout period, the remaining assets pass to charity. The undistributed trust assets remain in a "tax sheltered" environment until distribution to charity, sort of like an IRA, but with some beneficial differences. The taxpayer is entitled to an income tax deduction for the present value of the future projected distribution to charity when the trust is created.

Another new issue for Pennsylvania residents is that starting in tax years beginning on or after Jan. 1, 2025, irrevocable grantor trusts will be recognized for state income tax purposes, as is currently the case for residents of every other state in the country. This will simplify income tax reporting for these trusts in the future by harmonizing the state income tax treatment with the Federal income tax treatment for Pennsylvania residents.

Coming out of the pandemic, many planners and clients are seeking more immediate control over assets at death for beneficiaries due to the widespread delays that many families experienced during that period. While it appears reasonable to expect things to get back to normal with turnaround time for the probate process (and sometimes better than normal with the advent of virtual probates becoming a more accepted practice), it is possible to take measures to plan ahead on this front. The ideal way to do so would be to title some assets in a revocable trust structure which is properly integrated with a client's estate plan. The other approaches, which are often suggested by bankers and financial institutions as "do it yourself" methods, such as employing TOD or joint accounts, may work in some instances, but can also wreak havoc with the dispositive provisions of a client's estate plan (and consequently create unexpected financial and emotional costs for families) in other instances, whereas a revocable trust avoids such potential hazards.

A final issue that remains of interest to many clients is the currently scheduled reduction in the federal gift and estate tax exemption at the end of next year, when it is set to be reduced to 50% of next year's exemption level. For 2025, the exemption is at $13.61 million. It is impossible to predict whether or not Congress will allow this sunset to go through, no matter what the outcome of the presidential election in the fall. If the past is any indication of the future, if it's not clear that the law will change by the middle of next year, estate planners will be clobbered in the second half of 2025 with estate planning transactions for clients trying to benefit from the historically high exemptions before they are potentially reduced. For anyone considering such efforts, it is highly advisable to get started much sooner than that to avoid the unpleasant stress of decision making on long term issues under time pressure. In many cases, whether or not the exemption is reduced, it may still be beneficial to take action to shift ownership of taxable wealth sooner rather than later.

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