Estate Planning
Practical Solutions to Common Issues

It's 2024, What Planning Should I Think About Now?

By: Martin M. Shenkman and Joy Matak

Introduction

What should you be thinking about now? While that New Year's party may be more fun than thinking about estate planning, perhaps it is really time to get your planning in order. New Year's is commonly coupled with making resolutions. Just as we and our clients might commit to going to the gym regularly, giving up that daily Krispy Kreme donut, clients (and advisers!) should all address a range of planning considerations and make commitments to clean up their planning in 2024. Whatever the situation, there are likely important steps to take. This newsletter will focus on many of them. Please don't use the common excuse "nothing has changed." What in the world remains the same as only a few years ago?

Inflation Adjustments for 2024 Require Action

The amount that can be gifted changes every year for inflation. Inflation over the past few years has been significant, so there may have bandwidth now to top off trusts and other planning steps. If clients haven't reviewed and updated their plan in recent years, doing so is prudent before making new gifts.

The estate, gift and generation-skipping transfer (GST) tax basic exclusion has been increased to $13,610,000 per taxpayer (or $27.22 million per married couple), starting on January 1, 2024.[1] If the last time your client touched their plan was back in 2012 when the exemption was a mere $5 million, perhaps the client should make additional transfers now. Advisors should review the agreements and consider whether and how older trusts might need to be modernized before significant transfers are made.

Each year, U.S. taxpayers can make "de minimus" gifts that qualify for an annual exclusion. The freebie amount has increased steadily over years and, starting in 2024, the amount that a taxpayer might gift to each donee is $18,000.[2] However, given the high lifetime exemptions, unless a client has already used up their entire lifetime exemption or has a large family such that making annual

[1] IRC Sec. 2010.
[2] IRC Sec. 2503.

gifts is material, the annual exclusion often does not present a significant wealth transfer opportunity for many clients. Some clients might be inclined to skip annual exclusion gifting altogether or just use the exclusions to make smaller gifts outside of trusts. Advisors should likely direct such clients to consider making large one-time gifts to an insurance trust using lifetime exemptions so that they might skip the annual gifts and Crummey notices in the future.

Transfers between spouses who are both U.S. citizens are still eligible for the unlimited marital deduction. However, non-citizen spouses don't qualify. Starting in 2024, annual exclusion gifts in the amount of $185,000 may be made to non-citizen spouses. A regular plan of annual gifting to a non-citizen spouse over many years (and other planning too) may help such clients to accomplish wealth transfer goals.[3]

Consider The 65 Day Rule

A non-grantor trust is responsible for paying taxes on income generated by the assets it owns. In determining the trust's taxable income, the trust may be able to deduct income that was required to be distributed or was actually distributed to a beneficiary of the trust. To the extent the trust can reduce its gross income by current beneficiary distributions, such income will flow through to the beneficiary, who would likely have to report the income on their own income tax return.

Further, a non-grantor trust can distribute income to a beneficiary within 65-days of year end and treat the distribution as if made in the prior year.[4] This rule might afford a trustee with additional time to evaluate whether distributions are prudent and might facilitate income shifting to beneficiaries in lower tax brackets. Non-grantor trusts are taxed at the highest tax rates once the income reaches a threshold of $15,201 for 2024. This is an incredibly compressed tax rate considering that individual taxpayers do not reach the highest tax rates until their income exceeds $731,200, if married filing jointly. As a result, a non-grantor trust may have a 40.8% federal income tax on most of its income.

However, there may be work to be done prior to year-end in order to accomplish an income shift if that is what is desired. Accounting income for the purposes of determining what is distributable to a current beneficiary and taxable to the trust is a concept that is determined differently from "taxable income." Without delving too far into the complex concepts of fiduciary accounting, interest, dividends and distributions from partnerships are generally considered "accounting income" whereas capital gain income is often deemed to be "principal" and not typically distributable for accounting income purposes.

Partnership distributions are generally considered to be part of fiduciary accounting whereas partnership taxable income is not even though the partnership income is taxable to the owners, pro rata in accordance with their ownership in the entity. The effect of this is that if a partnership earns income but makes no distributions, the trust owning a partnership interest will have a tax liability but distributions to beneficiaries will not pass income out to the beneficiaries and the trust will not be eligible for an income distribution deduction.

[3] Rev Proc 2023-34.
[4] IRC Sec. 663(b).

This becomes particularly problematic when clients do not present the concern until tax returns are being prepared during the spring of the following year. By then, it's usually too late to fix the issue because distributions from the partnership only count if they were made by year end.

So, monitor trusts (and plan new trusts) to be able to shift income to human beneficiaries who may pay lower tax. Distributions may also avoid the 3.8% net investment income tax (NIIT). Consider the non-tax goals of the trust and beneficiaries. While you don't want to distribute out trust cash (which may flow the taxable income to the recipient) if the beneficiary is in the midst of a problem, many are not, and the tax savings can be substantial. This should be a standard post-New Year's step.

Income tax mitigation aside, trustees owe a fiduciary obligation to the beneficiaries and unless the trust requires that the trustee make distributions, the trustee should consider the purpose of the trust before making distributions. Even if a distribution reduces the overall tax liability of the family unit, it might not be in the best interests of the family for a distribution to be made. A trustee should really consider all of the surrounding circumstances before making the decision to distribute, hopefully in consultation with qualified advisors.

Trust Makes Charitable Gifts

A non-grantor trust might get a better tax deduction for charity than if you made the donation personally because non-grantor trusts can deduct 100% of a charitable contribution against income earned. However, the trust agreement must specifically allow for donations to be made from the income earned by the trust.[5] Otherwise, the trust will not be permitted to take the charitable contribution deduction.

Plan for Retirement

Advisors should connect with clients to confirm that clients have realistic budgets with up-to-date financial forecasts, particularly for those clients nearing retirement. Even wealthy families need to ensure that their spending is in sync with their cash flow.

Working collaboratively as an advisory team, advisors can have difficult conversations with clients about whether their lifestyle choices are conducive given their projected resources in the future. Longevity is a significant factor for many clients who must determine whether their current resources will, to a comfortable percentage of likelihood, be sufficient to support their lifestyles.

Even for wealthy clients, their spending has to be in sync with their cash flow. When did the client last update their plan? Have they factored in what their lifestyle might be in the future? Some planners assume less expenditures in later decades, but some clients may opt to kick it up a notch with a luxurious 3-year cruise. What are the assumptions in the client's plan, and do they work for them? Has the client considered longevity? If the client dodges accidents and key health issues how long might they realistically live? Consider that there is a correlation with wealth and longevity, so using standard tables may significantly understate how long the client will live. Have they insisted that their financial adviser discuss all this with their estate planner so that the clients

[5] IRC Sec. 642(c).

estate plan realistically factors in their likely future finances? Many have not and that could really torpedo their planning.

Plan for Loss of Capacity

Not something anyone wants to think about, but a reality with potential health issues and aging most of us will face the reality of waning capacity. Professionals should discuss with their clients steps to address this eventuality. Consolidate accounts, communicate key information, organize all records, have current estate planning documents that name appropriate people to step in to help.

Who Are Your "Descendants"

Most trusts and estate plans have language defining descendants, if any, based on the laws of long ago, or default to state law definitions. The world has changed. Concepts like assisted reproductive technology (ART), post-humous conception, etc. did not exist. Societal norms have changed and will continue to. Whatever your wishes and values, be sure to revisit every will and trust and be certain that they comport with your wishes and address the new realities. Some state laws provide that the definitions when the will/trust was created must be used. Determine whether and how clients might modify the language to reflect what they now want.

Review Old Documents

Clients should revisit old trusts and consider the many ways that might be available to update and improve them (non-judicial modification, decanting, trust protector action, etc.).

How old is the client's will and other documents? When were those last revisited?

Power of attorney – document to appoint an agent to handle legal, tax and financial matters.

Living will – statement of health care wishes. This gives guidance to the agent appointed under the clients health proxy. It is also a good place to document religious or other personal wishes.

Health Proxy – designate an agent to make health care decisions if the client cannot.

HIPAA Release – designate an agent to interact with medical professionals and have access to the clients medical records (but not to make medical decisions which is in the health proxy).

Emergency Child Medical Form – Consider discussing with the client the need to designate a person to make medical decisions for the minor children and give them critical information to do so.

Will – distributes assets and appoints guardians for minors and names a personal administrator to manage the clients estate.

Revocable Trust – bridges gaps in a will and power of attorney by designating successor trustees to manage trust assets and help the client especially if they are aging or disabled. On death it may minimize probate and publicity.

Beneficiary Designations – indicates where retirement, insurance and other assets will pass on death.

Deeds, and Other Title Documents – a deed is a formal legal document confirming ownership of real estate. If the client's house is owned by them and another person as joint tenants that means they each own an interest in the property and on death it passes to the survivor. Bank accounts and other assets can be listed as "Pay on Death to" or "Transfer on Death to" and in similar ways that those ownership documents also govern who can access the assets and who inherits.

Discuss with clients the need to do an inventory of all their documents and review them to see if they are current. If they are more than 3-5 years old or if the client has had major life changes since they were done (divorced, married, new kids, significant health issues, etc.) the client should consider reviewing them to be sure they still meet your needs. If a client is using low cost or online resources discuss with the client to confirm what, if any, special documents they may need because if the client does not fit into the typical mold, many of the lower cost options and online solutions will not work. For example, for clients who are on in years and are trying to protect assets from Medicaid, or those that have a family business or professional practice and need to address succession planning, or have a net worth that is substantial (yes, vague intentionally because it "depends"), the client really need to be careful using low-cost, online solutions or anything "standard."

Talk to Heirs

Has the client discussed with heirs and others who they might rely on the roles they have given them in their estate plan (trustees, trust protector, etc.)? How will they know what to do? Have they spoken to heirs even in broad general terms about your dispositive plan? Beginning to address these matters, as appropriate to those involved, might reduce future discord. Have clients written letters of instruction guiding fiduciaries as to what they should do? And letters to heirs about what their hopes and wishes are?

Divorce is Real

Divorce is a real issue that is rarely addressed when couples engage in estate planning. After all the assumption is that the couple will remain married. But the divorce rate for first marriages could be 40-50%. About 35% of those getting divorced were aged 55+. The divorce rate for those 50+ is double the rate of 20 years ago. Some predict gray divorces will triple by 2030. Considering these statistics, those with or contemplating estate plans to use exemption before 2026 when it will be halved should consider the implication of divorce. Many do not. Revisit those plans now and address this tough topic when planning. The differences in trusts and the implication of retitling assets can have a substantial impact if there is a later divorce.

Residency

Does the client have homes in multiple states and split their time? Where is the client a resident for tax purposes? Just because the client's friends say they're residents of a no tax state despite owning their historic family home in their old high tax state, doesn't mean they'll succeed on audit. See Matter of Obus et al., v New York State Tax Appeals Tribunal. Has the client really documented and understood the steps to take? Income and estate tax rules on residency/domicile can differ. Have they parsed those? Have they tracked days in each state using the rules each state has? Many states require you to prove you terminated your tax residency by clear and convincing evidence. Getting a new driver's license in the low tax state and spending more time there may not suffice. That is a tough standard. About 17 states have an estate tax and the rate in many hits 16%, some higher. Suggest to clients they revisit these issues with their tax team.

Asset Protection

To protect assets from suits and claims clients need to evaluate each asset on their balance sheet and consider how that particular asset might be protected. They also need to identify and then analyze every significant risk that each item on their balance sheet might generate. They also have to identify and consider any activities they are involved in that don't appear on the balance sheet and determine how to insulate their assets from those claims. Planning to protect assets is a key step for everyone (although admittedly more important for some, but no one should ignore liability risks). Having a detailed balance sheet is a great starting point for this analysis.

Review Insurance

There is a myriad of types of insurance. Clients probably shouldn't buy every type of coverage imaginable as they may not need everything, and few clients can afford everything. But it is pretty common for clients to have big and dangerous gaps in their insurance plan. They need to be certain that they have reasonable coverage for risks that might affect themselves or their loved ones. Clients can often modify deductibles and other details to tailor coverage to suit both their needs and budgets. Commonly overlooked coverage includes personal excess liability or umbrella coverage. That is a policy that covers claims on suits beyond the limits on auto and homeowners policies. That can be vital to protecting wealth as many typical homeowners and auto policies have more modest limits on liability coverage, e.g., $500,000. If the clients estate is a large multiple of that, they pretty likely may want more coverage. If a client has a house they are renting it probably has to be insured as a rental not as a residence if they are not using it as such. If they lack sufficient property, casualty and liability coverage a calamity could wipe them out financially. It might no longer matter how great the clients planning is if they do not have enough assets to make any significant bequests. It may not matter what retirement plans the client has as a loss of unprotected assets (e.g., pension funds might be protected from claims) could derail the best laid retirement plans.

Many clients have insufficient disability and long-term care insurance. If they become incapacitated that coverage may be critical to assure adequate resources to survive.

Entities

Most limited liability companies (LLCs), corporations and other entities were created, at least in part, to protect assets from liability claims. But if clients ignore entity formalities (signing documents in appropriately, not having properly transferred assets to the entity), or commingled funds (e.g., paying personal expenses like their 1040 or estate planning fees from an entity), they might taint the protection that was fundamental to why they created the entity. Client should review with their advisers entity operations and what can be done to shore up the formalities.

Corporate Transparency Act Reporting

For the Corporate Transparency Act ("CTA"), do it yourself (DIY) may be an option for most clients involved in simple entities. Many entity filings may be simple. Example, the client owns a simple LLC 50/50 with their brother that owns a rental property. Either member can file on behalf of the entity and disclose the relevant information. However, if a client has a complex entity (officers, key employees with control and profits interests), or a complex trust owning entities (investment trustees, powerholders, loan director, etc.) they probably should have professional help. Discuss with clients that much of the complexity and cost professionals will charge is figuring out who has to report as a beneficial owner. Many situations won't be that easy or simple.

Clients should be informed not assume that any particular adviser is handling their filings if they do not have that commitment in writing. A major mistake clients will make is assuming the corporate attorney who created an entity, the estate planner who transferred the entity to a trust, or the CPA filing entity tax returns, is handling the filing for that entity. Few if any advisers will be able to do that or will want to. In the end the penalties and potential jail time will be on the client, so they should be certain every entity they are involved with has a person handling the filing for the entity and its beneficial owners or that they have hired a professional in a written agreement confirming who will file. Clients may need more than one professional involved in their filings.

CTA filings in some cases will get nasty and combative. Inform clients to expect it, start preparing now, and be ready to make costly changes. This new law will be a huge and costly mess for many clients. Here's an example that might become all too common. The client established non-reciprocal spousal lifetime access trusts ("SLATs") in 2012 to use exemption. Likely millions of taxpayers did this. They named their college roommate as the trust protector but the client never told her then nor since as nothing has come up requiring the trust protector's involvement. What if the trust protector under the clients trust is deemed a beneficial owner under the CTA rules? What if the client has not spoken to the roommate in many years? The client will have to now call her up: "Jane long time no speak. I listed you as the trust protector of my trust in 2012 and now I need your home address, Social Security Number and a copy of your driver's license so a company the trust you never heard about owns can file under the CTA. And the law isn't really clear but if you willfully don't cooperate you might face a $500/day penalty and jail time." How well is this going to go? Consider if at this point the client determines to call their estate planner and have Jane and others named in the trust changed. Then the clients lawyer might say "Your trust is more than a decade old and we really should review the whole thing to see if it is still what you want (it won't be) and still reflects state of the art provisions (it won't)". So, the lawyer recommends that the better way to address changing so many people you named and fixing up the old trust is to

decant (merge) the old trust into a new trust changing the name of the trust protector and many other positions. That might be $10,000++ of work to create a new trust, decanting documents and more. How will the client react to this?

The CTA is complicated: 312 pages of regulations and preamble, FAQs, small business guide and more. That volume of information barely clarifies most of the questions professionals have about various trust positions, etc. Consider the time to review an 85 page trust and 40 page operating agreement and other documents. This work will be significant in time and cost in many instances. There may be no escaping this work as entity document and trusts probably should be modified to address the CTA.