

## CONSIDER THE IMPORTANCE

# *Rising Interest in Estate Planning*

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Essential estate planning items – Wills, Powers of Attorney, & Healthcare Directives – are generally agnostic to the ebbs and flows of the national economy. After all, these documents are put in place to ease the burdens of estate administration during periods of incapacity or after a death, and any latest news from the Fed is unlikely to have any meaningful impact on these documents and their execution.

In contrast, more sophisticated, proactive planning – likely to involve gifting, loans, and/or Trusts – can certainly be affected by economic factors. For example, as interest rates continue to rise in the face of inflation, some estate planning strategies will become less effective while other strategies (and the clients who implement them) will reap the benefits. Let's take a look!

### **RATE REVIEW**

To set the stage, we will first remind ourselves of some important figures issued by the IRS: the Applicable Federal Rates (AFRs) and the Section (§) 7520 rate. The AFRs – in short-, mid-, and long-term varieties – establish the minimum interest rates that the IRS will allow for private loans without having any unwanted tax implications. Issued monthly, the AFRs plummeted at the onset of the COVID-19 pandemic, but they have now surged back to exceed pre-pandemic levels.

The §7520 rate, which is calculated as 120% of the mid-term AFR rate, is used in a somewhat actuarial method as a means to determine the value of annuities, life estates, and remainder interests. Since it is based off of the mid-term AFR, the §7520 rate also fell sharply but has resurged in 2022, with the current rate of 5.2% being the highest we have seen since 2007.

### **WHERE WERE WE?**

In a low interest rate environment, especially like that of the recent pandemic years, a few strategies stood out as particularly advantageous. Grantor Retained Annuity Trusts (GRATs) and, for the charitably-inclined, Charitable Lead Annuity Trusts (CLATs) took advantage of a lower §7520 rate to optimize the transfer of assets to beneficiaries with little to no gift tax implications. And on the AFR side of things, intra-family loans and loans to Trusts could be established with some of the lowest minimum interest rates in recent memory.

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What all of these strategies have in common is that, with lower rates (AFR or §7520), it is easier/more likely for the assets involved to outperform the rates. That outperformance equates to more value ultimately passed to beneficiaries with less potential tax implications than if the rates were higher.

## INTEREST-ING DEVELOPMENTS

As we transition to a higher interest rate environment, however, a few strategies will see increased utility. For example, clients who have potential estate tax liabilities and want a significant personal residence to ultimately transfer to their beneficiaries can consider a Qualified Personal Residence Trust. A QPRT removes the residence (and the appreciation thereon) from the taxable estate, and a higher §7520 rate means a lower taxable gift required to transfer the property into Trust.

Another example of inverse proportions are charitable strategies. Just as a Charitable *Lead* Trust can be attractive with low interest rates, a Charitable *Remainder* Trust becomes more effective as rates rise. A higher §7520 rate means a higher valuation of the remainder, which makes for more impactful tax deductions and increases the likelihood that various requirements for passing IRS muster can be met.

## WHERE DO WE GO FROM HERE?

Certainly, it is important to remember that no matter which strategies are benefitting from the current state of interest rates, the best strategy is the one that works for the client and helps them to accomplish their goals and legacy objectives. That being said, for clients who could benefit from a QPRT, now could be a great time to broach the subject. For clients who are charitably inclined and have highly-appreciated assets, the opportunity presents itself to visit or revisit a Charitable Remainder and even a Wealth Replacement strategy. As we approach the 2025-2026 sunset of the estate and gift exemptions, interest in having these conversations with clients should also be on the rise!

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\*Not in the practice of law for Underwriters Brokerage Service

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