A PLANDEMIC OF WEALTH TRANSFER OPPORTUNITIES

BY STEPHEN H. GARIEPY

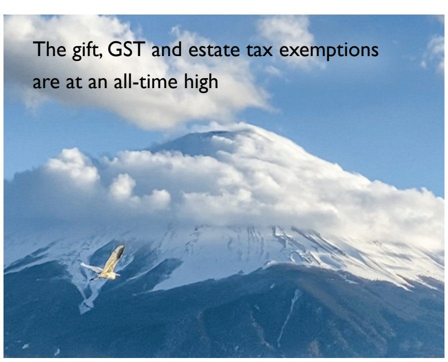
Visiting Japan has always been on my bucket list. That meant this March I couldn't let COVID-19 cancel my trip. As it turned out, the stars were aligned. Blue skies, a perfect view of Mt. Fuji's summit, cherry blossoms, no crowds and the restaurants were open.

Meanwhile, picking up the news from back home, the stay-in-place order came down. My firm required nearly everyone to work remotely. So I stayed, in place, working as remotely as possible — 6,500 miles social-distancing, 13 hours time-zone-distancing, two weeks as scheduled, returning client emails and phone calls, as always.

While there, I saw another set of stars aligning — seven estate planning stars — presenting an unprecedented opportunity for family wealth transfers. These seven stars are high exemptions, low valuations, low interest rates, powerful estate planning tools, ways to make gifts yet retain access, ways to wait and see and even unwind a gift, and motivated clients.

High exemptions

First, the gift, generation-skipping transfer and estate tax exemptions are at an all-time high of $11,580,000 per individual. For a married couple, that's a total of $23,160,000.



The gift, GST and estate tax exemptions are at an all-time high

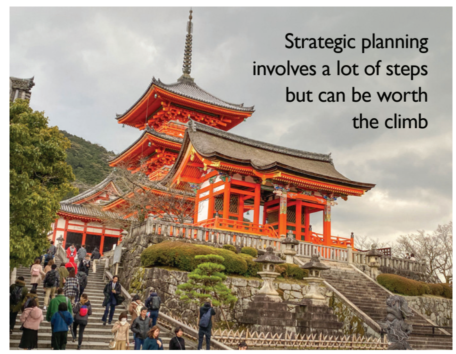
But these high exemptions sunset on December 31, 2025. On January 1, 2026 they revert to what's estimated, with an inflation adjustment, to be $6,560,000. However, if the November elections result in a change in control in the Senate and White House, these temporary exemptions could be reduced much sooner and lower.

The next Congress and administration will face tremendous pressure to raise revenue on account of the COVID-19 business slow-downs, the trillions of dollars in stimulus grants, and expanded social programs. High on the list of possible revenue raisers is an increase in estate taxes.

Senator Sanders' bill, "For the 99.8% Act," would reduce the gift exemption to $1 million, the GST and estate exemptions to $3.5 million, raise the estate tax rates to 45% – 77%, and eliminate the step-up in basis for inherited assets.

What the Biden-Sanders Unity Task Force proposes is a "return to the historical norm." Some interpret this to mean the same low exemptions proposed by Sanders but with a flat 45% rate, with the additional possibility of eliminating the basis step-up or even subjecting appreciated property to a capital gains tax at death.

If with a Democratic sweep the Biden-Sanders' plan were enacted mid-year 2021, it could be made retroactive to January 1, 2021. There is a Supreme Court precedent that this would not violate the Constitution. Moreover, it wouldn't take the usual 60 votes in the Senate to overcome a filibuster. Under the budget reconciliation process, it could be enacted by a majority vote of 51, or even a tie vote of 50/50 with a Democratic Vice President casting the deciding vote. That could reduce the gift exemption from the current $11,580,000 to $6,560,000 with an inflation adjustment, $3,500,000 or even as low as $1,000,000, effective January 1, 2021.



Strategic planning involves a lot of steps but can be worth the climb

A key distinction must be made between the bonus gift exemption and the base gift exemption. The bonus gift exemption is the difference between the current gift exemption of $11,580,000 and the base gift exemption which is whatever the new gift exemption turns out to be. For example, if the current gift exemption sunsets to $6,560,000 in 2026, the bonus gift exemption is now $5,020,000; or if the Sanders' proposal of a $1,000,000 gift exemption is enacted in 2021, the bonus gift exemption by hindsight will now have been $10,580,000. What's crucial is that in order to use any part of the bonus gift exemption, a client must first use all of the base gift exemption, and whether that turns out to be $5,650,000, $3,500,000, $1,000,000 or some other amount is yet to be seen. And to have the effect of increasing the estate exemption, the use of the gift exemption must exceed the estate exemption in effect at death, and whether that estate exemption turns out to be $5,650,000 with an inflation adjustment, $3,500,000 or some other amount is yet to be seen.

Nonetheless, gifts of $1 to 5 million that make use of only base exemption and no bonus exemption are still as effective as always since they can be leveraged by valuation discounts, appreciation, income, grantor trust tax status and GST exemption. In selecting assets for lifetime gifts, clients should take into consideration the loss of a step-up in basis in the estate, although there can be ways to reposition gifted assets for a step-up.

Low valuations

The second star is suppressed asset valuations. The values of many businesses and other holdings have been impacted by COVID-19. Lower valuations allow the gift and GST exemptions to cover larger transfers. Also, business appraisers tell us greater volatility in the economy makes for higher discounts for lack of marketability and lack of control, further reducing valuations. However, the Sanders' proposals would eliminate valuation discounts for family-owned entities.

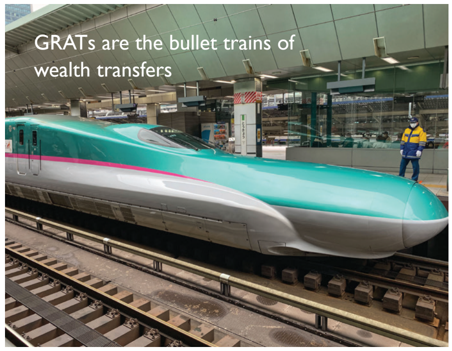
Low Interest Rates

The third star is historically low IRS interest rates. For November 2020, the Section 7520 rate is 0.4% and the Applicable Federal Rates range from 0.13 to 1.17%. These low rates enhance the outcome of many of our favorite wealth-transfer transactions, such as Grantor Retained Annuity Trusts and Charitable Lead Annuity Trusts. These rates also present an ideal opportunity for intra-family loans, such as loans to children or grandchildren for their purchase or refinancing of a home, starting a business or making investments, or loans to gift trusts.

Estate planning tools

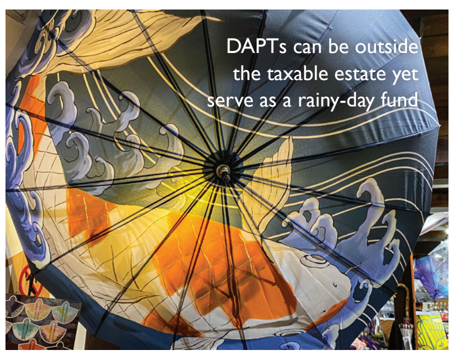
The fourth star is the continued availability of a wide selection of powerful estate planning tools. However, there are proposals to curtail many of these tools. These proposals, which could be made effective as early as January 1, 2021, include the following:

- Grantor Trusts would be included in the gross estate. These include our most effective tax strategies, such as gifts and sales to Intentionally Defective Grantor Trusts, Spousal Lifetime Access Trusts, Domestic Asset Protection Trusts and many Irrevocable Life Insurance Trusts.
- Grantor Retained Annuity Trusts (GRATs) are the bullet trains of wealth transfers. In Japan they travel up to 200 miles per hour. Here, GRATs are statutory and use virtually zero gift exemption. Currently, they can transfer all future appreciation exceeding 0.4% per year free of gift tax. But GRATs would be derailed with an imposed minimum term of ten years and a minimum taxable gift of 25%.



GRATs are the bullet trains of wealth transfers

- Dynasty Trusts would be curbed by limiting the benefit of the generation-skipping tax exemption to 50 years. That wouldn't cover the lifespan of even one generation.
- Not even annual gift tax exclusions would escape unscathed. Annual exclusion gifts to Crummey Trusts and gifts of business interests would be curtailed.



DAPTs can be outside the taxable estate yet serve as a rainy-day fund

- Can you imagine an estate planning world without a menu of such a wide variety of trusts? Where I was, all I could think, it would be like Japan without sushi.

Accessibility

The fifth star is that there are ways to make a gift and still be able to access it after giving it away. A client can create a Spousal Lifetime Access Trust, naming the spouse as a beneficiary, and the client too can benefit, albeit indirectly, by virtue of sharing life with the spouse. A client can also create a Domestic Asset Protection Trust (DAPT), naming oneself as a discretionary beneficiary. In this way, DAPTs can be outside the taxable estate yet serve as a rainy-day fund. Additional strategies returning assets to a client include GRATs, loans, sales and private annuities.

Flexibility

The sixth star, flexibility, can be of benefit to individuals who may not be ready to commit to making a large, irrevocable gift not knowing how the tax laws or economy may play out. There are several techniques allowing an individual to make a transfer, while providing the flexibility, later, to reverse it or complete the gift. These include disclaimers within nine months, QTIP elections by the date of the gift tax return, loans that can be returned or converted into gifts, and revocable trusts that can be converted into irrevocable trusts.

Motivated Clients

The seventh star is that clients are motivated. For many, the pandemic has brought into nearer focus the fact of our mortality. Face the facts — we're all wearing masks. Moreover, clients' calendars are cleared, they have more time to discuss and think through estate planning options and they're getting good, as we all are, at doing so on Zoom. There is also a sense of urgency on account of the possibility of changing tax laws and the ups and downs in the economy.

No alignment lasts forever, and this one might not outlast the end of the year. It's the convergence of these seven stars which present what might be a once-in-a-lifetime opportunity for strategic wealth-transfer planning.

We can't cure the virus, but perhaps we can solve a client's estate tax problem. The clock is ticking.

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