Whittier Trust

WEALTH PLANNING

in Down Markets and Low Interest Rates

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The down market and low interest rates present significant estate planning opportunities – making this a very favorable time to consider wealth planning strategies for your family.

In the past decade, we have seen an unprecedented era of low market volatility and positive returns. However, in a matter of just a few weeks, the stock market has plunged from record highs back to levels from 2017. This downturn is coupled with a move to record low interest rates. While in the short-term it is unsettling, current market conditions create opportunities for long-term family enrichment. In 2020, an individual can transfer up to $11.58 million ($23.16 million per married couple) during lifetime or at death, free of federal gift and estate tax to children, grandchildren and future generations. Additional amounts transferred are subject to a federal tax at 40%. After December 31, 2025, exemption amounts are set to return to roughly half of that, meaning that any estate valued at over roughly $5.75 million in current dollars ($11.58 million per married couple) may be subject to that 40% tax in future years. For those seeking to transfer wealth over several generations, there is a similar amount available as an exemption from the generation skipping transfer tax ("GST tax"). (It should be noted that these taxes may be seen as convenient sources of tax revenue, resulting in an acceleration in the timing of the return to lower levels, or in a significant reduction in the exemptions to even lower levels, or an increase in rates if Congress and the President choose to do so. Thus, it is appropriate to consider making current use of these exemptions.)

Here are some planning opportunities to consider:

1. Make Intra-Family Loans

It is now possible to loan money at a nominal interest rate to a family member without being deemed to have made a gift. The IRS requires that the interest rate on loans between family members not be lower than the Applicable Federal Rate (or "AFR"). This rate changes monthly, but can be

fixed for the life of the loan. In fact, the rate has fallen dramatically and may continue to decline. By way of example, for April 2020, the "mid-term" AFR (for loans of 3 to 9 years) is 0.99% - declining from 1.53% in March 2020. The loan can be structured as "interest only" with a balloon payment due at maturity.

2. Make an Installment Sale to an Intentionally Defective Grantor Trust

An Intentionally Defective Grantor Trust ("IDGT") is an irrevocable trust that is designed to make the grantor responsible for the trust's income taxes including capital gain taxes (with this tax payment not being deemed a gift). An installment sale to an IDGT is another way to freeze the value of assets in the grantor's estate, with appreciation above the IRS required rate of interest going to the trust beneficiaries. This appreciation is further enhanced due to the "defective" feature of these trusts which requires the grantor/lender to pay taxes – thus allowing assets in the trust to grow income-tax free.

3. Create a Grantor Retained Annuity Trust or Charitable Lead Annuity Trust

A Grantor Retained Annuity Trust ("GRAT") is an irrevocable trust that pays back to the grantor a percentage of the value of the assets contributed for a period of two or more years, and at the end of the term, the assets remaining either distribute to the remainder beneficiaries (i.e. the beneficiaries other than the grantor) or remain in trust for their benefit. With careful planning, a GRAT strategy can work to shift this future appreciation at little or no gift tax cost. For a GRAT to be successful, the appreciation must exceed the IRS's assumed rate which is based upon (but is slightly higher than) the AFR rate described above. Creating a GRAT and funding it with stocks that have dropped significantly due to the present downturn can be a great way of increasing the potential for a significant transfer of wealth — again, at little or no gift tax cost.

A Charitable Lead Annuity Trust is similar to a GRAT, with the payments over the initial term of years being made to charity (which can include a donor-advised fund created by the grantor) instead of the grantor. Depending on how the CLT is structured, the grantor may receive a current income tax deduction. And like a GRAT, the value of the trust at the end of the initial term of years passes free of gift tax to the remainder beneficiaries. For individuals with philanthropic inclinations, a CLT in the current environment presents an excellent opportunity to benefit both charity and their family.

4. Gift Interests in Family Businesses

Giving interests in family businesses, including investment vehicles such as family limited partnerships, is another excellent planning tool during times of market volatility. The business itself may be facing issues which have decreased its overall value significantly. And similarly, the value of the underlying assets owned by the business, whether publicly-traded securities, real estate or an operating business, may have been impacted by market swings or other economic factors. Making a gift when the asset has dipped in value can maximize the assets passed to future generations. And if you transfer a partial interest in the business, discount opportunities (sometimes as much as 30% or more) off the pro rata share of the business's value remain possible under current IRS rules due to the lack of control and lack of marketability associated with the partial interest. An appraisal will be needed to support the valuation.

5. Establish a Multigenerational Nevada Irrevocable Trust

Now also may be an excellent time to gift securities or interests in a family business through the use of a multigenerational Nevada irrevocable trust. Gifts for the benefit of your family can be made to long-term trusts using your exemption from GST tax (currently $11.58 million per individual). A Nevada irrevocable trust can exist for 365 years, allowing families to pass wealth into the future through many generations, without incurring federal transfer taxes. In addition, Nevada does not impose income tax on individuals or trusts, so income can accumulate and grow over time, free of state income tax – thus further enhancing overall growth over the life of the trust.

6. Convert a Traditional IRA to a Roth IRA

An individual with a Traditional IRA should consider converting it to a Roth IRA. A Roth IRA is a retirement account that grows income tax free, allows contributions to be made at any age (subject to limitations), generally provides for tax-free withdrawals after age 59 1/2, and has no required minimum distributions (RMDs) – and importantly, future distributions will be income tax free. The cost of Roth conversions amounts to income tax (which can be paid from non-IRA assets) due on the conversion amount. With IRAs at lower values due to the market downturn, the tax bill on Roth conversions will be significantly less than would have been the case just weeks ago and the appreciation in the account following recovery will be tax free.

7. Substitute Assets in Existing Trusts

If you have previously created an irrevocable grantor trust, such as an intentionally defective grantor trust which permits a substitution of assets, swapping assets with better potential for growth can optimize the ultimate benefit of the trust. This may be an excellent time to review the tax basis and fair market value of the assets currently in a trust and identify those that have low basis and high value – while also reviewing your balance sheet and identifying assets with high basis and low value that will likely appreciate over time. You can then develop and execute a plan to substitute assets with your trustee and tax advisors.

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