Unique Estate Planning Opportunities Amid COVID-19 Due to Depressed Markets and Historically Low Interest Rates

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The historically low interest rates recently announced by the Internal Revenue Service ("IRS") and the depressed value of certain assets offer opportunities for estate planning techniques that can reduce the cost of transferring wealth to younger generations.

The federal estate and gift tax exemption for 2020 is $11,580,000 per person ($23,160,000 for a married couple). The exemptions will revert to approximately $6,000,000 per person ($12,000,000 for a married couple) effective January 1, 2026; however, Congress can reduce the exemption at any time.

The rest of this article discusses various techniques that you could consider adding to your estate plan given the current environment.

Grantor Retained Annuity Trust. A grantor retained annuity trust ("GRAT") can be used to transfer income/appreciation in assets to younger generations at a low gift tax cost. A GRAT has the following characteristics: (1) a stated term of years (2-5 years); (2) a specified annual amount (the "retained annuity") which usually has a present value approximately equal to the value of the assets originally contributed by the grantor; (3) at the end of the GRAT term, any property remaining in the GRAT is distributed to the younger generation (outright or in trust) free of any gift or estate tax; and (4) if the grantor dies before the end of the GRAT term, the remaining property in the GRAT would be included in the grantor's estate for estate tax purposes, so nothing passes to the younger generation. Very low interest rates and depressed asset values make a GRAT very attractive.

The purpose of a GRAT is to allow the younger generation to receive, on a virtually tax-free basis, the investment returns on property in excess of a stated IRS interest rate (0.6% for June 2020). If the assets in the GRAT generate a total return in excess of the IRS rate, the younger generation receives that excess return tax-free; in addition, the grantor pays all income taxes out of his or her other property not out of the GRAT assets. The lower the IRS interest rate, the more likely the GRAT will be successful in transferring wealth to the younger generation on a tax-free basis. If, on the other hand, the assets do not generate a return of at least the stated IRS rate over the term of the GRAT, all of the trust assets will ultimately be repaid to the grantor, and the younger generation would receive nothing from the GRAT, but they would not have suffered any loss either (other than the costs associated with establishing the GRAT). In this regard, the GRAT is essentially a risk-free technique.

Intra-Family Loans. An intra-family loan can also be a simple and effective way to transfer wealth to younger generations. For June 2020, the short-term (three years or less) IRS interest rate is 0.18%, the mid-term (nine years or less) IRS interest rate is 0.43%, and the long-term (over nine years) IRS interest rate is 1.01%. An intra-family loan provides greater flexibility than typical commercial

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loans because an intra-family loan can be structured based on the individual needs of the younger generation (e.g., interest only note with a single balloon principal payment). An intra-family loan can provide significant tax benefits; the difference between the low interest rate on the loan and the rate of the return on the assets purchased with the loan will pass to the younger generation receiving the loan with no transfer tax liability. Moreover, if the intra-family loan is made to an intentionally defective grantor trust (discussed in more detail below), the tax benefits can be even greater. In addition, now is an ideal time to consider refinancing existing intra-family loans.

Intentionally Defective Grantor Trusts. Gifts and/or sales to a trust for descendants (often called an Intentionally Defective Grantor Trust ("IDGT")) are used to "freeze" the value of the assets transferred to the IDGT and transfer any future appreciation out of the grantor's estate. The income earned by the IDGT will be taxed to the grantor directly, so the grantor pays the income tax out of his or her estate while the younger generation receives the gross income. In effect, the younger generation receives a tax-free gift of the amount of income taxes that would otherwise be payable on trust income.

If the growth and appreciation of the assets held in the IDGT exceed the IRS interest rate (0.43% for a mid-term note), the excess is transferred to the younger generation free of gift or estate tax, and the assets in the IDGT are not included in the grantor's estate. Similar to the GRAT, the lower the IRS interest rate, the more likely the growth and appreciation of the assets held in the IDGT will exceed such interest rate.

Wealth Management Trusts. As an alternative to an IDGT, some clients prefer to establish a Wealth Management Trust ("WMT"). A WMT is a trust that is established by the beneficiary's parent or sibling for the benefit of the beneficiary but is designed to be treated as "owned" by the beneficiary for income tax purposes. As a result, the income earned by the WMT will be taxed to the beneficiary. Like the IDGT, if the growth and appreciation of the assets held in the WMT exceed the IRS interest rate (0.43% for a mid-term note), the excess is transferred to the younger generation free of gift or estate tax, and the assets in the WMT are not included in the beneficiary's estate.

Charitable Lead Trust. If an individual has charitable interests, now is an ideal time to consider establishing a charitable lead annuity trust ("CLAT"). The structure of a CLAT is similar to the structure of a GRAT (discussed above), except the annuity is payable to one or more charitable organization(s) rather than the grantor. At the end of the term of the CLAT (e.g., 5 years, 10 years, 15 years), the assets remaining in the CLAT after the annuity payments are made, pass to the younger generation at reduced (possibly zero) tax liability.

If you want more information on any of these techniques, you should consult your tax advisor.

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