
Has COVID-19 (Unfortunately) Made This a Good Time for Estate Planning?

Many families and businesses have been devastated by physical and financial losses as a result of the coronavirus pandemic, and our hearts and prayers go out to those families. Even though the timing may not seem right based on the current problems, this might be the time to engage in additional estate planning for you and your family.

Current Gifting of Assets

In light of the extremely high federal estate tax exemption, many wealthy families have felt it unnecessary to do any estate planning to avoid estate taxes. The estate/gift tax exemption for 2020 is \$11,580,000 per person. Thus, a married couple can leave their family \$23,160,000 without any liability for federal estate tax, assuming that they have not made taxable gifts utilizing part of the exemption amount. Under current law, this exemption will drop at least in half in 2026, when the exemption will be \$5 million as adjusted for inflation. In light of the major budget deficits currently being incurred as a result of funding for the effects of the coronavirus, many commentators believe that it is likely that the estate tax exemption will be reduced prior to 2026 since Congress will be looking for ways to close the budget gap. Thus, it may be advisable for a family with substantial assets to make large gifts during 2020 to protect against the estate tax exemption being reduced in 2021 or later. Last year, the IRS issued final regulations which provide that utilizing the higher exemption will not result in additional tax if the exemption gets reduced as of the date of the individual's death. There will be no "clawback" of the estate exemption. Therefore, in light of the fact that your assets may have declined in value, but will eventually regain their value, it may be advisable now to make a gift, either outright or in trust, in order to take advantage of the lower asset values. Of course, assuming that the individual is willing to forgo the income on assets gifted, 2020 may be the time to make a substantial gift, as this will protect against the reduction in the estate tax exemption in later years.

Intra-Family Loans

The Internal Revenue Service publishes minimum interest rates to be used for certain transactions. These interest rates are known as the Applicable Federal Rates. These rates provide a minimum rate of interest to be charged for both demand and term loans. For loans which are made in May 2020, the rate varies from 0.25% per annum to 1.15% per annum, depending upon the length of the term of the loan. For example, if a grandparent is willing to make a loan to a grandchild to assist the grandchild in purchasing a home, the loan could provide for an annual interest rate of 1.15% for a loan which is longer than nine years. This is much lower than the interest rate that the grandchild will be able to obtain with a third-party mortgage. Thus, the grandchild would save a substantial amount of money over the length of that loan. The loan can be structured as a formal mortgage with the grandparent taking back a mortgage on the property. There are a number of other situations in which an intra-family loan can be very advantageous.

Grantor Retained Annuity Trust

As a result of the current low interest rates, another alternative would be to create a Grantor Retained Annuity Trust or GRAT. In a GRAT, the donor transfers assets to an irrevocable trust and receives payments back each year from the trust. The IRS issues a rate that must be used in determining the value of any gift made in connection with the creation of the GRAT. This rate is known as the Section 7520 rate. The Section 7520 rate for May 2020 is 0.8% per annum. In a GRAT, the assets would be invested by the trustee and income earned by the trust. If the trust earns more than the amount distributed to the donor each year, that excess passes to the beneficiaries of the trust without any additional gift taxes. The GRAT can be structured so that there is either no gift or a minor gift upon the creation. The value of the gift is the amount under the IRS tables that would be left after payment of the annuity to the donor. For example, if someone were to put \$5 million into a GRAT that has a term of 5 years, with annual payments to the grantor of \$1,000,000 per year, and assuming that the GRAT earned 3% in income each year and had an annual growth in principal of 5%, the donor would receive back the \$5 million over the term of the GRAT, but would also be making an initial gift of \$117,800 to the beneficiaries. The gift amount is the amount determined by the IRS as the amount that will be left in the GRAT upon termination of the GRAT, assuming that the GRAT earned 0.8% per year. In fact, based on the higher earnings of the GRAT, there would be \$1,496,804 available to the beneficiaries after the term of the GRAT. Thus, the donor will have made a tax-free gift of \$1,379,004 (the \$1,496,804 remaining less the initial gift of

\$117,800 already reported). These numbers, of course, would change depending upon the amount earned by the trust and also the length of the trust itself. However, for certain clients or under certain circumstances, this strategy can be a very efficient way to make gifts without any major gift tax liability.

While it may seem strange to be making gifting plans in light of the pandemic, for certain clients, this may be the opportune time to do so. If you are interested, or would like further information, please contact your Maddin Hauser attorney or one of our estate planning attorneys listed below.

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