

Client Alert

May 2020

COVID-19 Estate Planning Strategies

COVID-19, and the immediate and prolonged response to it, has disrupted the economy in countless ways, many of them negative. However, here are some personal financial planning opportunities which may be attractive under the COVID-19 cloud. This alert will review four strategies to take advantage of the following factors:

- (i) many investments across all asset classes have lost market value, thus making the value of the transfer much lower;
- (ii) the federal estate and gift tax exemption is at an all-time high of \$11.58 million per individual taxpayer for 2020 (or \$23.16 million for married couples) due to the changes made by Congress by the Tax Cuts and Jobs Act of 2017. However, this exemption amount automatically reverts to the previous \$5.0 million per individual level on January 1, 2026 (and may drop before 2026 if the financial devastation continues or if the presidential election augurs in changes to the federal tax code); and
- (iii) the midterm applicable federal rate is at a historically low rate for May at 0.8%.

A. Gifts

1. Gifts of marketable securities

Individuals may gift marketable securities as part of an overall estate and business planning strategy. As market values have plunged, one may leverage the lifetime federal gift tax exemption and annual exclusion amounts. By gifting these assets now, the donor would use less of their exemption amounts and be able to utilize the balance in the future. When the asset values recover the appreciation inures to the donee's benefit outside of the donor's taxable estate.

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2. Gifts of real estate and closely held business interests

These assets are also be available for gifting. Through gifts of interests in family limited partnerships, limited liability companies and other closely held businesses, a patriarch or matriarch may utilize these vehicles to transfer the economic value of the real estate or closely held business interests to younger generations while addressing voting control and management functions.

By transferring such assets donors could take advantage of lower asset values for federal estate and gift tax purposes while also removing the future appreciation from the donor's estate. When utilizing these structures, various discounts may be available such as lack of control or minority interest, and lack of marketability. The depressed values taken as a whole with available discounts to lower further the value of such a gift would yield optimum leveraging of the applicable exemption amounts.

B. Sale to Intentionally Defective Grantor Trusts (“IDGT”)

An IDGT is probably the most valuable estate planning tool available today. An IDGT is typically established for the benefit of the Grantor's spouse and/or descendants and is not includible in the Grantor's estate. However, for income tax purposes, the Grantor is treated as the owner of the trust and pays the income taxes which further reduces the assets of the Grantor's estate. By structuring the trust this way, a sale to the trust also does not incur any tax liability to the Grantor. Generally, the Grantor sells assets to the IDGT in exchange for a promissory note. The promissory note bears interest at market rate (the current Applicable Federal Rate, or AFR) and a balloon payment of principal at the end of the note. It is recommended that the Grantor funds the Trust with at least 10% of the value of the installment sale to provide the Trust with enough liquidity to be considered a bona fide purchaser (this gift can utilize the Grantor's \$11.58 million gift tax exemption).

This is the perfect time for a sale to an IDGT. First, the value of many assets are depressed, and an appraisal of the fair market value of such assets is likely to be extremely low (in addition there may be additional discounts for lack of marketability and control). This will result in a lower sale price and the amount owed on a promissory note for the transaction will be for a lower amount. Second, the historically low AFR means that the interest rate on the promissory note will be minimal. This means less money will return to the Grantor which is great for estate tax purposes. The transferred assets will be frozen at today's values and the appreciation will grow outside of the Grantor's estate. Another benefit of a sale to IDGT is if the grantor should die during the term of the note, the trust's underlying assets and appreciation remain excluded from the grantor's estate; only the note will be includible in the Grantor's estate.

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C. Grantor Retained Annuity Trust (“GRAT”)

This strategy requires a grantor to establish an irrevocable trust that provides for the payment of an annual annuity back to the grantor for a specific term of years. The amount of the gift is equal to the amount contributed to the trust less the value of the retained interest. Therefore, if the grantor retains the right to receive an annuity that is equal to the amount given to the trust plus an interest factor equal to the current AFR rate, the grantor will not be making a gift for gift tax purposes. However, if the assets in the trust appreciate at a rate in excess of the current AFR rate, the amount of such excess will be transferred to the beneficiaries of the trust without any gift tax liability to the grantor. For example, if a grantor transfers a \$1 million to a trust and retains the right to receive \$108,000 a year for 10 years, the value of the gift would be zero. However, if the assets of the trust appreciated by 5% a year, the value of the trust at the end of the ten years would be \$371,000, which would be then transferred to the grantor’s heirs free of any gift tax. This is an extremely attractive option at the present: stocks and other assets are generally at historic lows, and if history is any indicator, most stock holdings will appreciate by more than the 0.8% AFR (hurdle rate) over the course of the trust term.

D. Charitable Lead Annuity Trust (“CLAT”)

Charitably inclined donors might consider a CLAT. Similar to a GRAT, the grantor creates an irrevocable trust and contributes assets to the trust which pays a fixed annuity to charity over a specified term. As in the case of the GRAT if the assets in the trust appreciate beyond the current AFR rate of 0.8%, such appreciation will be distributed to the beneficiaries gift tax free at the end of the trust term. The donor will receive an income tax deduction for the present value of the annuity using the current AFR rate. In addition, the CARES Act eliminated the cap on the amount of the deduction for an individual’s charitable contributions but only if made through a grantor trust. Like the GRAT, low asset values and a low assumed growth factor may make this an attractive option.

Conclusion

For individuals able to weather the economic storm caused by COVID-19, the present time may be attractive to engage in careful estate planning. The options discussed above are just some alternatives that may be beneficial under the current economic circumstances. Individuals should review their current wills, healthcare powers and durable powers of attorney to make sure they reflect current wishes and to consider all options that best reflect their economic situations.

Olshan lawyers from multiple practice groups are working together with clients to address COVID-19-related matters, including the CARES Act

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stimulus programs (i.e., the Paycheck Protection Program and EIDL) and other corporate matters, including contractual analysis and financing, tax, restructuring, employee benefits and employment practices, insurance coverage and litigation. Click [here](#) to access additional materials addressing issues raised by COVID-19.

Please contact the Olshan attorney with whom you regularly work or one of the attorneys listed below if you would like to discuss this client alert or have questions about its content.

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