WINSTEAD

COVID-19 Preparedness: Wealth Preservation

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Winstead's Wealth Preservation Team is fully operational and working remotely to assist clients with estate planning needs. We are also available to discuss unique planning issues due to COVID-19, either over the phone or by video conference through Zoom, Facetime, etc.

To that end, we wanted to share what we have been seeing over the last few weeks. Our general comments on estate planning issues and opportunities in today's world follow:

Core Estate Planning Documents

We are hearing from clients who want to modify their estate plans by amending their Wills and revocable trusts. We are also hearing from clients who have an added sense of urgency to update their financial and medical powers of attorney. We are working with our clients to review and update their core estate planning documents as needed, and to address unique challenges posed by signing legal documents in the presence of a notary and/or witnesses under current shelter-in-place orders. We have been able to find creative solutions for many clients.

Funding Revocable (Living) Trusts

Most of our clients have created revocable (living) trusts as part of their core estate plan. Many clients, however, have not funded their revocable trusts. With court closures and delays increasingly common, if there is a death it is unclear whether a court will be available to rapidly facilitate the probate process and make funds available to a surviving spouse or other beneficiaries. Now may be an opportune time to fully fund a revocable trust in an effort to avoid the probate process altogether, or to partially fund a revocable trust with liquid assets to make funds readily available in the case of incapacity or death. It is also a good time to review beneficiary designations on non-probate assets, such as retirement plans and life insurance, to ensure that their passage is consistent with the overall estate plan.

Wealth Shifting Considerations

The goal for many of our affluent clients is to shift wealth to friends and family members at the lowest possible tax cost. Lifetime gifting tends to be more efficient when asset values are depressed and interest rates are low. Given the recent volatility of financial markets, now may be a favorable time to transfer wealth at a reduced transfer tax cost. Below is a brief summary of selected wealth shifting strategies that are especially attractive in today's environment:

Intra-Family Transactions

With today's historically low interest rates, intra-family transactions, where senior family members lend or sell assets to junior family members, have a greater chance of shifting wealth free of transfer taxes. Wealth will be effectively shifted to junior family members or trusts for their benefit if the transferred assets appreciate at a rate greater than the interest rate charged.

The interest rates used for most intra-family transactions—the Applicable Federal Rates ("AFRs")—continue to plummet. In April 2020, the short-term AFR (for loans less than 3 years) is just 0.91%, the mid-term AFR (for loans between 3 and 9 years) is 0.99%, and the long-term AFR (for loans more than 9 years) is only 1.44%. The historically low AFRs not only benefit new transactions, but present an opportunity to enhance existing transactions by renegotiating lower interest rates for existing promissory notes, thereby reducing the hurdle rate and increasing the potential wealth shift.

GRATs

A Grantor Retained Annuity Trust, or GRAT, is an irrevocable trust funded with a single contribution of assets, which pays the initial contribution back to the grantor (the annuity) over a minimum term of two years. At the end of the GRAT's initial term, any remaining assets are distributed free of transfer taxes to the grantor's friends or family members, or often to a trust for their benefit.

The objective of a GRAT is to shift future appreciation on assets to beneficiaries at a minimal gift tax cost. A GRAT is often structured so that the present value of the annuity is nearly equal to the value of the initial contribution. This results in a taxable gift of a negligible amount at the GRAT's funding, and is often referred to as a "zeroed-out" GRAT. For the

GRAT strategy to be successful, the assets transferred to the GRAT must appreciate at a rate greater than the IRS assumed rate of return, which is set by the "7520 rate." Thus, the lower 7520 rate, the lower the hurdle rate for the GRAT to be successful. In April 2020, the 7520 rate is just 1.2%.

Funding a GRAT with stocks that have significantly dropped in value as a result of a market downturn increases the chance that the actual rate of return exceeds the 7520 rate. For many clients, it may make sense to establish GRATs now, when the equity markets are depressed. It may also present an opportunity for clients with existing GRATs to recover the assets and place them into new GRATs with a greater chance of successfully shifting wealth, given depressed asset values and a lower 7520 rate. We are available to assist, and would be pleased to provide you with a more personalized summary of how a GRAT may operate in your particular case.

Charitable Planning

We have seen a number of clients make significant gifts to charities in an effort to address the negative impact of COVID-19. We are working with our clients to structure their charitable gifts, form new charitable organizations, and administer existing charitable organizations. Certain techniques, such as Charitable Lead Annuity Trusts, or CLATs, also benefit from depressed asset values and low interest rates. We welcome the opportunity to engage in a more meaningful discussion to help achieve your charitable goals in a tax-efficient manner.

Income Tax Changes and Filing Extensions

On March 27, 2020, the President signed into law the Coronavirus, Aid, Relief and Economic Security Act (CARES Act) providing a $2 trillion relief package for the US economy. Some notable provisions from the CARES Act, along with relevant announcements from the Treasury Department, are summarized below:

- Charitable Deduction Limits. In 2020, an individual can deduct charitable contributions of cash up to 100% of his or her adjusted gross income (AGI), rather than the normal 60%. While this more generous limit does not apply to gifts to donor advised funds or private foundations, any charitable gifts in excess of the 100% AGI limit can be carried forward for five years.
- Required Minimum Distributions Suspended for 2020. Required minimum distributions (RMDs) for certain retirement plans, including 401(k)s and IRAs, have been suspended for 2020. Many clients will stop taking distributions from their retirement plans for 2020, with the hope that these assets will recover from their 2020 losses.
- Income Tax Filing Extension. The IRS has announced that individuals and corporations now have until July 15th to file their income tax returns and to pay taxes. The time for making first-quarter estimates has been similarly extended. These rules apply to income tax returns for trusts and estates as well.
- Gift Tax Filing Extension. Similarly, the IRS announced that taxpayers have until July 15th to file their gift tax returns and to pay gift tax.

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