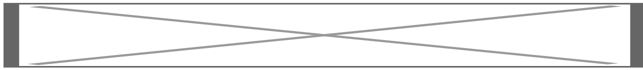

Insights

Estate Planning During the Time of COVID-19

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COVID-19 is creating a number of unique estate planning and legal challenges, from actual execution of documents to the volatility of the financial markets. However, it also has created some unique opportunities in wealth transfer planning.

A. Core Estate Planning and Remote Witnessing/Notarizing

Now, more than ever, individuals should focus on the health and safety of themselves and their families. However, while staying at home and spending time with family, it might also be a good time to review your current estate planning documents to ensure you have your core estate planning documents in order (i.e. Last Wills and Testaments ("Will"), Revocable Trusts, Powers of Attorney, Living Wills, and beneficiary designations) and that such documents reflect your current wishes. If it is necessary to execute documents during the COVID-19 pandemic, the Indiana Supreme Court, through Order 20S-MS-237, recently authorized estate planning documents to be executed remotely through Zoom, Apple FaceTime, or other forms of audio-video communication technology.

In addition to remote witnessing in Wills, notaries will be able to remotely notarize estate planning documents in the near future. In addition to remote notarization, some documents, such as revocable trusts, do not require witnessing or notarization and can be executed or updated at any time. Another, limited instance, is that the requirement that the appointment of a Standby Guardian for a minor child be notarized is suspended for now and, instead, the appointment may be witnessed by a single person.

B. Wealth Transfer Planning

In addition to considering your basic estate planning documents, COVID-19 has also created unique wealth transfer opportunities for many high-net-worth individuals and business owners. Prior to the COVID-19 pandemic, there were several conditions in place that encouraged high-net-worth individuals and business owners to consider wealth transfer strategies in 2020. These factors, which are still present, include (1) higher annual federal estate and gift tax exclusion amounts that were enacted through the 2017 Tax Cuts and Jobs Act but are set to expire on January 1, 2026; and (2) the potential for a change in the administration and the makeup of Congress in the November 2020 elections, which could lead to an acceleration of the sunset or other tax law changes. With COVID-19, the volatility of the financial markets, depressed asset values, and historically low interest rates have created an environment that is an opportune time to transfer wealth to family members or charities.

1. Intra-Family Transactions.

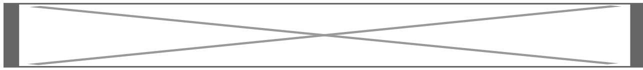
In a low interest environment, planning techniques involving intra-family transactions where a senior family member (grandfather, father, grandmother, mother) might lend or sell assets to a junior family member (son, grandson, daughter, granddaughter) are effective because the loaned or sold assets only need to appreciate at a rate greater than the interest rate charged. Currently, the mid-term adjusted applicable federal rate ("AFR") for April 2020 is .99% compared to 1.75% in February 2020 and 2.55% in April 2019. In such cases, the appreciation above the interest rate charged can pass to junior family members or trusts for their benefit, gift and estate tax free. Furthermore, the value of the assets remaining in a senior family member's estate will be frozen at the loan/purchase price or removed altogether through the transfer. The value of the loaned or sold assets will be based on the fair market value of the assets, which may include discounts for certain factors (such as lack of control of a business interest). Given the market conditions, it is anticipated that the fair market value of many assets will be extremely depressed and discounted. Should you implement an intra-family planning strategy, when asset values rebound, all of the appreciation in those assets will be outside of your taxable estate and will be held by or for the benefit of your intended beneficiaries, gift and estate tax free.

2. Grantor Retained Annuity Trusts.

A grantor retained annuity trust ("GRAT") allows you, the grantor, to contribute assets into a GRAT while retaining a right to receive, over a term of years, an annuity stream from the GRAT. When the term of years expires, the balance of the assets held in the GRAT passes to your intended beneficiaries. The Internal Revenue Service ("IRS") values the transfer of assets to your intended beneficiaries based on the value of the annuity stream you retain and an assumed rate of return on such assets. That assumed rate of return is issued by the IRS (commonly known as the 7520 rate). The current 7520 rate is 1.2%. As such, if you retain the right to receive an annuity stream from the GRAT equal to the value of the assets contributed, any assets remaining in the GRAT at the end of the term will pass to your intended beneficiaries, gift and estate tax free (known as a "zeroed-out GRAT"). As long as the assets transferred to the GRAT outperform the 1.2% assumed rate of return, there will be some remaining value in the GRAT to pass to the beneficiaries free from gift and estate tax. Once again, given the low hurdle rate and depressed asset values, GRATs should be strongly considered by anyone looking for an effective way to transfer wealth to younger generations.

3. Charitable Lead Annuity Trusts.

If you are charitably inclined, you may want to consider a charitable lead annuity trust ("CLAT") in your wealth transfer planning. Similar to a GRAT, you, the grantor, contribute assets to a CLAT, in which a charity is designated to receive an annuity stream for a term of years. At the end of the term of years, the balance of the assets remaining in the CLAT pass to your intended beneficiaries. As with a GRAT, it is possible to structure a CLAT such that the balance of the Trust assets passes to your intended beneficiaries, gift and estate tax free. The value of the assets ultimately passing to your intended beneficiaries (i.e. the value of the "gift") is determined by subtracting the value of the annuity stream the charity receives from the value of the assets at the time the CLAT is funded. The value of the annuity stream passing to the charity is also affected by the 7520 rate, so the lower the 7520 rate, the higher the present value of the annuity passing to the charity. As with all previous discussed strategies, low hurdle rates and depressed asset values result in more wealth being transferred to younger generations, gift and estate tax free.



4. Hypothetical Calculation for Tax Savings

To illustrate the value of a GRAT or CLAT, take a hypothetical situation where a client wishes to make a $3,000,000 gift to a CLAT, with the current 7520 rate of 1.2%. Also assume the client wants to create a “zeroed-out” CLAT and wants the CLAT to last for a period of ten (10) years. There is no gift for gift and estate tax purposes as long as the annual annuity stream to the charity was at least 10.672% of the initial assets contributed to the CLAT. If we assume the financial markets return to their pre-2020 levels and then continues in subsequent years at the same rate of return (as the previous years, an average of 6-8%), the CLAT is required to pay 10.672% each year of the initial $3,000,000 (roughly $320,000 each year for 10 years, or $3,200,000 to charity over the life of the CLAT); the market would “rebound” in 2020 back to the pre-2020 levels (say the DOW Index is at 29,000) before the first CLAT payment is required (from the low point to the past high, the DOW Index would be about a 1.5x increase) so the $3,000,000 in the CLAT would be worth $4,500,000 before the first payment to the charity is even made, and then the CLAT assets would then grow by 6-8% each year while paying out $320,000 to the charity, at 8% per year growth after the initial rebound, this would leave roughly $1,800,000 in the CLAT to be distributed to your intended beneficiaries at the end of the CLAT term, all passing gift and estate tax free while, at the same time, providing a $3,200,000 million benefit to charity).

While many assumptions must be made in the above calculation, you can see the potential “home-run” tax benefits for implementing these types of wealth transfer strategies now, rather than later.

If you are interested in updating or creating your core estate planning documents or implementing the wealth transfer strategies discussed above, please contact our estate planning attorneys, **Micah J. Nichols** or **Rodney S. Retzner**.