



## Wealth transfer planning – how volatility creates opportunity

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With everyday life so unsettled and markets and interest rates so volatile, wealth transfer planning is probably not top of mind these days, even to high net worth individuals. However, the very conditions that are causing such uncertainty today have created the opportunity to transfer wealth to the next generations at historically low tax cost.

Among the factors creating this opportunity are depressed asset values that reduce the gift tax cost of transferring them, bottoming of the interest rates variously associated with valuing a gift or setting the bar for appreciation needed to make the transfer successful, the continuing availability of popular planning techniques, valuation discounts and other tools that can reduce the gift tax cost of wealth transfer. Finally, although today's high estate, gift and generation-skipping transfer ("GST") tax exemptions are not scheduled to sunset until 2026, the upcoming election could accelerate that sunset and, with it, the elimination of some of those popular wealth transfer planning techniques.

Here are some of the planning techniques that benefit today from one or more of the factors we noted earlier. RSM tax professionals can describe and illustrate these techniques, showing you how they can be tailored according to your own objectives and circumstances and what types of assets tend to work best in the respective techniques. Of course, no individual, even a very wealthy individual, should consider giving away significant amounts of principal or income unless he or she is both philosophically and empirically confident that they won't miss the money. Discretion is the better part of regret.

**Gifts.** Remove all future appreciation in an asset's value from your taxable estate from the date of the transfer. An asset with a currently depressed value but an impressive future is a good candidate for a gift. However, the donee of the gift takes your income tax basis in the asset, as opposed to the stepped-up basis currently available for an asset inherited from a decedent. For that reason alone, you might keep the asset and pass it at death.

**Make that gift to an IDGT.** An "IDGT" or "intentionally defective grantor trust" is an irrevocable trust designed so assets transferred to it are completed gifts that remove appreciation from your estate but any income or capital gains tax incurred by the IDGT are payable by you, the grantor. Along with removing appreciation from your estate, a principal benefit of the IDGT is that your payment of the IDGT's income tax is not a taxable gift. Therefore, the IDGT's assets can grow faster and the tax payments can "defund" your estate with no gift tax cost.

**Make a loan to an IDGT.** Once the IDGT is established, you can make a loan to the IDGT at the applicable federal rate (the "AFR") for the month the loan is made. The April AFR for a long-term loan, meaning longer than nine years, is only 1.44 percent. The IRS announces the changes in AFRs for the upcoming month early enough for you to determine if you should make the loan in the current month or hold off until the next month. Properly structured, the transaction has no income tax implications and, aside from the small seed gift made to give the IDGT some commercial viability as a borrower, there are no gift or GST tax implications. At the end of the day, the IDGT's investment return above the interest rate on the note is excluded from your estate. The intra-family loan can be an appropriate wealth transfer technique if you do not want to make an outright transfer of property, want to retain some income and would just as soon keep things relatively simple.

**Renegotiate intra-family loans.** If you made an intra-family loan some years ago when the AFRs were higher than they are today, you might ask your advisors if the loan documentation would allow for a renegotiation of the terms of the note, with an eye towards reducing the interest rate.

**Lend money to irrevocable life insurance trusts "ILITs" or renegotiate existing loans.** If you are making large taxable gifts to an ILIT, you might consider lending the funds instead. If properly structured and at the appropriate AFR, there would be no gift or GST tax implications to the loan. What's more, so long as the ILIT is a grantor trust, there would be no income tax implications because the income tax is paid by the grantor. Meanwhile, if you previously implemented one of these loan arrangements with your ILIT at a higher interest rate, you may want to consider renegotiating the terms of those loans.

**Grantor Retained Annuity Trust "GRAT".** GRATs can appeal to individuals who want to do wealth transfer, retain income and take a measured approach to tax risk. You can transfer an asset to an irrevocable trust, reserving the right to receive a payment from the trust (the annuity) for a term of years. If you survive the term, assets remaining in the GRAT at the end of the term pass to your children and will not be included in your estate for estate tax purposes. If you do not survive the term, the assets in the GRAT will be included in your estate. GRATs are typically designed to virtually eliminate any taxable gift when the GRAT is funded, something that is a lot easier to do when asset values are depressed and the interest rate the IRS uses to determine the value of the annuity is low. For April 2020, that rate is only 1.2 percent but, as noted, you should wait to see the rate for May to decide when to fund the GRAT. If the GRAT succeeds, any appreciation above the returned annuity passes to the remainderman, gift and estate tax free.

**Sale to an IDGT.** You create an IDGT and "seed" it with a taxable gift. You then sell an asset to the IDGT for an installment note bearing interest at the AFR for the month in which the transaction occurs. The transaction freezes the value in your estate by converting an appreciating asset into a fixed income instrument. Appreciation above the interest rate on the note remains in the trust, excluded from your estate. Properly structured, meaning among other things that the sale and note are respected as such by the IRS, there is no capital gain triggered on the sale, the interest payments are not taxable to you or deductible by the trust and your payment of the IDGT's income tax is not a gift. Only the unpaid balance of the note is included in your estate, which contrasts favorably with the GRAT and its mortality risk. Here again, you should wait to do the transaction until you see the AFRs for the following month. Of course, if you implemented this transaction when interest rates were higher, you might consider renegotiating the interest rate.

**Exercise “swap” powers in an IDGT.** Many IDGTs used in the above-described transaction provide that the grantor can exchange or “swap” assets of equal value with the IDGT without income tax implications. In many of those transactions, the asset sold to the IDGT was highly appreciated at the time but had a low basis. Today, the asset may have lost value but still has the same basis. You, the grantor, can now use the power to bring that low basis asset back into your estate so that it will get a step-up in basis when you die. What’s more, such a swap may enable you to exchange a poorly performing asset inside the IDGT for one with a more promising future.

**Charitable lead annuity trust “CLAT”.** This is a vehicle for charitably inclined individuals to make transfers to children at a reduced gift tax value. CLATs work well when interest rates are low. You can transfer property to a trust that will pay an income stream to a charity for a specified number of years or for your lifetime, or both. At the end of the trust term, the assets in the CLAT pass to your children or a trust for their benefit. A properly designed CLAT will have minimal gift tax implications and, if funded with a discounted asset that generates a robust yield, there will be some excess to pass to your children free of gift tax.

**Roth IRA conversion.** Conversion of traditional IRA to a Roth is not typically thought of as a wealth transfer planning technique. However, if you are willing to pay the income tax on the conversion now, preferably with money from outside the Roth, and are able to let it incubate without withdrawals for five years, and you are 59½ or older, then all withdrawals from the account will be tax free, forever. What’s more, you and your spouse will not have to take required minimum distributions from the account when you reach age 72. If and when you leave the Roth IRA to your child, your child will also take out the money tax free. Of course, after the SECURE Act, the money will have to come out of the account by the 10<sup>th</sup> year after you pass away. Conventional wisdom is that the ideal setting for the Roth conversion is where you are in a low income year (or period of years) and the value of the traditional IRA is down, as it might be as of this writing.

Even in times of uncertainty, you have a variety of planning techniques to choose from that can help you strike a balance between near-term concerns and longer-term objectives. As always, the key is to work with your advisors to make well informed decisions with respect to both the selection and design of these techniques.

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