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# Estate Planning Risks and Opportunities in 2020

by Michael D. Whitty

A FREEBORN & PETERS LLP CLIENT ALERT

Estate Planning in the third quarter of 2020 continues to be shaped by recent events. This Client Alert provides information on **three hot topics**:

1. **Estate Tax Changes** in Current Law or in Candidate Proposals Would Increase Costs of Transferring Wealth; Early Planning Needed to be Prepared to Act Before Year-End

2. **Lowest-Ever Interest Rates** Offer Estate and Gift Tax Savings From Intra-family Loans, Installment Sales, Loan Refinancing, and Grantor Retained Annuity Trusts

3. **Tax Incentives for Charitable Giving in 2020** After the CARES Act

All of our clients who are serious about reducing estate tax exposure should arrange a call to discuss how to best take advantage of the opportunities presented by current conditions of low valuations and lowest-ever interest rates, as well as the currently high estate and gift tax exemptions that will be reduced by the end of 2025 if not sooner.

Our prior 2020 Client Alerts (found here, here, and here) addressed other topics that remain current:

- Health Care Documents and Estate Plans in the face of **Coronavirus**
- Planning for Retirement Accounts After the **SECURE Act** of 2019
- The new **Illinois Uniform Trust Code** and Its Effects on Trust Design
- Planning for Possible Changes in **Estate and Gift Tax Exemptions**
- Gift and Intra-family Loan Refinancing Opportunities with **Low Interest Rates**

If any of these topics raises concerns or questions for you, contact one of the Freeborn & Peters attorneys listed below (Email would be best under current conditions, as most of us are working remotely for much of the time as of August 2020).


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### 1. Costs of Transferring Wealth Would Increase After Estate Tax Changes in Current Law or in Candidates' Proposals

In our June 2020 Client Alert, we reminded readers that even under current law, the **generous gift and estate tax exemptions** ($11,580,000 per individual, $23,160,000 per couple) are already subject to a "sunset" provision that will cut them in half at the end of 2025.

Leading up to the 2020 elections, some candidates have proposed even faster and greater changes to the estate and gift taxes, to accelerate the reduction of the exemption, to reduce it even more than called for in current law, and even to increase the rates from the current 40% flat rate.

Sen. Sanders continues to cooperate with the Democratic nominee, former Vice President Joe Biden, on their Unity Task Force which recently published a 110-page plan submitted to the Democratic Party 2020 Platform Committee on July 8.

**QUESTIONS AND DECISIONS BEFORE IMPLEMENTING WEALTH TRANSFER TECHNIQUES IN Q3, Q4 of 2020**

**Decisions to be Made**

- How Much To Give? Full Remaining Exemption? Less? More?
- Which Family Members or Trusts Will Receive the Gifts or Loans?
- Do Donor and Spouse Need To Retain Any Access or Benefit?
- Which Assets to Give?
- How Much to Loan Instead?
- Will Appraisals Be Needed?

The July 8 Unity Task Force Plan was short on specific tax proposals compared to the prior proposals reviewed in our June 2020 Bulletin, which referenced proposals to cut the estate tax exemption, raise the estate tax rates, and eliminate the step-up in income tax basis at death.

Instead, the July 8 Plan made more general declarations such as:

- "Estate taxes should also be raised back to the historical norm" (Page 15).
- "Building a More Progressive Tax System: ... Use taxes as a tool to address extreme concentrations of income and wealth inequality. (Page 75)

In addition to reducing the estate tax exemption to as low as $3.5 million, Sen. Sanders had also proposed to reduce the gift tax exemption to $1 million, and Biden has proposed to eliminate the step-up in basis at death *and* Section 1031 tax-free exchanges (which are currently only available for real estate).

**Prompt Advance Planning is Better Than Procrastination**

Procrastinators may suffer if they wait for a new administration to take office. In 1993, the new administration with a unified Congress passed an increase to the estate tax rate ***retroactive to January 1,*** and that retroactive effect was upheld by the courts. It is possible that with a clean sweep on Election Day, a White House and Congress under a unified Democratic Party could make changes to the estate tax exemption retroactive to January 1, 2021. The change might be to accelerate the "sunset" already in the current law for January 1, 2026, or it might be to cut the exemption further to $3.5 million as proposed by Senator Bernie Sanders.

**DECISION TREE FLOWCHART FOR IMPLEMENTING WEALTH TRANSFER TECHNIQUES IN Q3, Q4 of 2020**


Those clients who feel they are ready to take action now should contact us. We would arrange a conference call with our team and other relevant advisors to formalize an action plan. Once that plan is approved, we would move forward with implementing the plan while conditions are optimal.

For those clients who are not ready to act immediately, ***we still recommend a preliminary discussion*** with us and other relevant advisors to create a standby action plan. Such a call may take an hour or less, and take us an hour to write up a summary of the call into a standby action plan. We have already had several of these preliminary discussions with clients and continue to do more.

Clients who have contacted us in advance to establish a standby action plan will have a head start over those who wait until after Election Day to do so, and have a better chance for getting their transfers fully implemented by year-end.

## 2. Lowest-Ever Interest Rates Offer Estate and Gift Tax Savings From Intra-family Loans, Installment Sales, Loan Refinancing, and Grantor Retained Annuity Trusts

The IRS released the September 2020 Applicable Federal Rates on August 17, 2020, which are the lowest such rates since the rates began to be issued. These rates are "safe harbor" rates used to assure there is no imputed additional interest for income or gift tax purposes.

As discussed in greater detail in our June 2020 Client Alert bulletin, these rates offer savings not only for clients seeking to reduce estate tax exposure, but also for clients seeking to reduce their family members' interest expenses through refinancing.

| September 2020: The Section 7520 rate is 0.4% | | | | |
|---|---|---|---|---|
| The AFRs are as follows | Annual Compounding | Semi-annual Compounding | Quarterly Compounding | Monthly Compounding |
| **Short-term** (up to 3 years) | 0.14% | 0.14% | 0.14% | 0.14% |
| **Mid-term** (3 to 9 years) | 0.35% | 0.35% | 0.35% | 0.35% |
| **Long-term** (over 9 years) | 1.00% | 1.00% | 1.00% | 1.00% |

In addition, the lowest-ever Section 7520 Rate provides opportunities for certain techniques, validated by the tax laws, that use this rate to compute the present value of a retained or charitable interest. These techniques include the grantor retained annuity trust ("GRAT") and the charitable lead annuity trust ("CLAT"), described in detail in our June 2020 Client Alert bulletin.

## 3. Incentives for Charitable Giving in 2020 After the CARES Act

The CARES Act signed on March 27, 2020 created extra incentives for charitable giving in 2020 to address public needs during the COVID-19 crisis. These incentives have created a unique opportunity for clients who regularly donate to charity or who are otherwise charitably inclined to use 2020 charitable gifts to reduce their income and estate tax liabilities. As one example, taxpayers using the standard deduction generally do not take a charitable deduction because they do not itemize. Under the CARES Act, those taxpayers may deduct up to $300 ($600 on a joint return) for cash donations to public charities.

One major incentive is the lifting of the cap on income tax charitable deductions based on a percentage of adjusted gross income ("AGI"). Before the CARES Act, that cap was 60% of AGI, with any excess carried forward to future years. Under the CARES Act, for 2020 (only), taxpayers may deduct up to 100% of AGI for charitable gifts to public charities, with the excess carried forward. Note that other types of charitable gifts (of property other than cash, or to private foundations, or both) continue to have the same limits, but cash gifts are "stacked" on top of those other donations for purposes of testing their limits. Clients can use this 100% deduction against AGI to greatly reduce, if not fully eliminate, 2020 income tax liabilities in addition to removing the donated amounts from their estate for estate tax purposes.

References in this segment to "public charities" exclude private foundations as well as donor advised funds ("DAFs"), even though DAFs are legally public charities.

| Illustration of Increased Charitable Tax Deduction in 2020 after CARES Act | | |
|---|---|---|
| Item, Description | Prior Law | CARES Act (2020 Only) |
| **Taxpayer AGI, Current Year** | $100,000 | |
| **Taxpayer Charitable Donations** | $100,000 | |
| **Deduction Limit** | $60,000 | $100,000 |
| **Carryover to Following Year** | $40,000 | $0 |

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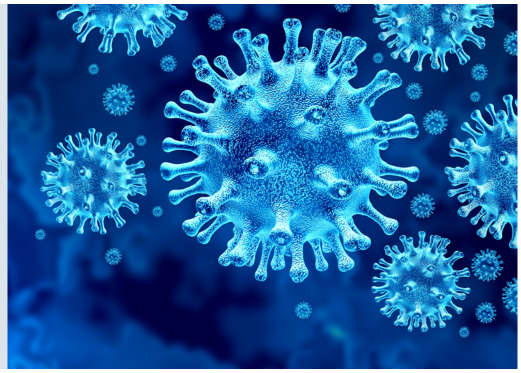
## Freeborn's Response to COVID-19

**Freeborn & Peters COVID-19 Task Force, with dozens of COVID-19 related Client Alerts and links:**
https://www.freeborn.com/practice/covid-19

**Bill Russell's White Paper on client result using a GRAT:**
https://www.freeborn.com/perspectives/real-life-example-transferring-growth-without-gift-tax



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Michael Whitty is a Partner in the Corporate Practice Group. He concentrates his practice in estate planning, taxation, and estate and trust administration. Michael represents business owners, principals of venture capital and private equity funds, key executives, investors, and other highnetworth individuals in planning for the preservation and transfer of their wealth.

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