



Post-Election Year-End Estate & Gift Tax Planning Webinar

Panelists:

Maury B. Reiter, Esquire

Thomas D. Begley III, Esquire

Devin S. Fox, Esquire



Welcome and Introduction

- ▶ Webinar is 1 hour with time for questions built in at the end of the hour
- ▶ You have joined in listening mode only but will have the opportunity to submit questions to your panelists using the “Chat” feature
- ▶ This session is being recorded and a playback link will be made available

- ▶ AGENDA:
 - ▶ *What May Change:* Comparison of current tax law and changes proposed by President Elect Biden as part of his campaign platform
 - ▶ *Likelihood of Change*
 - ▶ *Tax Mitigation Techniques*



Proposed Changes to Estate, Gift & GST Transfer Tax Rules

- ▶ Reduce current lifetime exemption of \$11.58 million per person (\$11.7 million for 2021) to as low as \$3.5 million (or \$5 million, which is what it was in 2017) with an adjustment for inflation
- ▶ Increase top estate tax rate from 40% to 45% or even as high as 55%
- ▶ Repeal step up in basis on assets inherited at death of taxpayer
- ▶ Impose time limit on GST exemption
- ▶ Limit or eliminate use of discounting techniques and grantor trust status



Proposed Increases to Income and Capital Gains Tax Rates

- ▶ Impose a 12.4% Social Security payroll tax on income earned above \$400,000, evenly split between employers and employees
- ▶ Revert the top individual income tax rate to pre-TCJA rate of 39.6% for taxable income above \$400,000 (up from 37%)
- ▶ Tax long-term capital gains and qualified dividends at the ordinary income tax rate of 39.6% on income above \$1 million and eliminate step-up in basis for capital gains taxation
- ▶ Cap tax benefit of itemized deductions to 28% of value for those earning more than \$400,000



Why You Should Act Now Regardless of the Election Outcome

- ▶ Separate from the election, current environment is favorable for making transfers of substantial amount of assets
 - ▶ Interest rates are at historic lows
 - ▶ Depressed asset values as a result of COVID-19 pandemic make certain assets ideal candidates for gifting
- ▶ Nothing to lose by making gifts now since it is very likely the exemption amounts will decrease - even if it's not until 2025
- ▶ PA inheritance tax avoidance - for every \$1 million, donor saves \$45,000 in inheritance tax on transfers to lineal heirs (4.5%)



Lock in 2020 Exemption Amounts

- ▶ Apply just shy of your total increased exemption amount to gifts made now rather than applying only the difference between the amount of the current increased exemption and the prior exemption amount
 - ▶ Treasury regulations have already confirmed that the IRS will not claw back gifts made using a donor's increased exemption amount if the exemption amounts are later reduced
 - ▶ To benefit from the current higher exemption amounts, however, total lifetime gifts must be more than the amount of the lower exemption amount which we expect we will revert to the lower "basic exemption amount"
- ▶ Techniques to lock in 2020 exemption amounts:
 - ▶ Establish a spousal lifetime access trust (SLAT)
 - ▶ Transfer assets to a GST exempt family trust for descendants and future generations
 - ▶ Gift fractional interests in assets to take advantage of valuation discounts
 - ▶ Sell assets to an intentionally defective grantor trust



Spousal Lifetime Access Trusts

- ▶ An irrevocable trust established by one spouse for the benefit of the other using the transfer tax exemption of the donor spouse to make a gift to the SLAT
- ▶ The SLAT is administered for the benefit of the other spouse until his or her death (or divorce depending on how the SLAT is written)
- ▶ Donor spouse can indirectly benefit from the SLAT if the spouse beneficiary decides to use distributions the spouse receives from the SLAT for the donor spouse's benefit or their household
- ▶ Disadvantages:
 - ▶ Must be funded with assets owned solely by the donor spouse (i.e., cannot be funded with jointly owned assets)
 - ▶ Donor spouse's indirect access to the SLAT ends when spouse beneficiary dies or if the parties divorce
 - ▶ Cannot be (easily) accomplished for both spouses concurrently



Multi-Generational “Dynasty Trusts”

- ▶ Established for beneficiaries other than the donor’s spouse - normally multiple generations of descendants or other family members
- ▶ Continues for multiple generations to avoid incurring additional estate or GST taxes at each generation
- ▶ Creditor protection
- ▶ Donor decides who will benefit from trust upon death of primary beneficiary (way to keep assets within the donor’s bloodline)



Family Limited Partnerships/LLCs

- ▶ Transfer ownership interest in closely held business to remove economic interests in the gifted property, including current income, from the donor's taxable estate
- ▶ Gifting an interest in a closely held business entity permits the donor to leverage gifts to the donee using valuation discounts that can further reduce the value of the assets owned by the entity for transfer tax purposes
- ▶ A lower valuation means the donor can fit more assets into the donor's "exemption bucket" and remove them from the donor's estate by leveraging the exemption with lower appraisals
- ▶ Illustration: Taxpayer owns a building which was worth \$17.5 million a year ago but is worth \$15 million today (based on current depressed market valuations and COVID-19 discount) in an LLC. The taxpayer owns a 50% non-managing member interest in the LLC.
 - ▶ If the taxpayer gifts his 50% non-managing member interest, he can (conservatively) take a 25% discount on the value of the gifted interest. The result is that the taxpayer will be deemed to have made a gift of \$5,625,000, not \$7,500,000 (or 50% of the building value), effectively reducing the value of the gift by nearly \$2 million.
 - ▶ The leveraging achieved by applying discounts in computing the enterprise value and valuing the non-managing member interest brings the value down from the pre-pandemic valuation of \$8,750,000 (50% of \$17.5 million) to \$5,625,000, a savings of more than \$3 million, and a transfer tax savings of over \$1.2 million (assuming the taxpayer's overall estate exceeds the exemption amount).



Estate “Freeze” Technique – Sale to IDGT

- ▶ Sell assets to Intentionally Defective Grantor Trust (IDGT) in exchange for promissory note bearing currently low interest rates
 - ▶ IDGT is effectively ignored for federal income tax purposes – no income taxable event when assets are sold to IDGT and income earned on IDGT assets is still taxed to the grantor
- ▶ To accomplish the sale, the grantor trust gives the grantor a promissory note to buy property from the grantor at its current (depressed) value. Alternatively the grantor could sell his non-managing member LLC interest instead and possibly pile on other valuation discounts as noted above.
 - ▶ The cash flow generated from the property sold to the grantor trust is used to service the debt to the grantor.
 - ▶ Current minimum interest rates which must be charged are historically low, meaning that less of the cash generated from the property will be needed to service the note to the grantor and therefore more appreciation and cash flow can be transferred to the grantor’s heirs.
 - ▶ The grantor essentially freezes the value of his estate by swapping property which has a depressed value but is expected to appreciate for a promissory note with a fixed principal amount and a low interest rate.



Questions?

If you have additional questions or if you'd like to schedule time to discuss the specific details of your estate plan on an individual basis, please contact any one of our panelists:

Maury B. Reiter - mreiter@kaplaw.com

Thomas D. Begley III - tbegley@kaplaw.com

Devin S. Fox - dfox@kaplaw.com

Thank you for joining us!