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CRISIS CREATES OPPORTUNITY: The Coronavirus's Perfect Estate Planning Storm

First know that we are praying for you, your family and your community in this challenging time. This is a frightening time not only for your health, but also for your economic well-being. The Coronavirus is having a major impact on the world's economy. Commerce has slowed to a crawl and panic has caused irrational selling in the stock market. However, many Americans will see an opportunity when a crisis such as this hits us. Historically, when the economy is strong and a crisis hits, the economy takes less time to recover. For Americans with an eye on their long-term estate plans, this may be the perfect time to gift assets out of their estates.

Gifting opportunity

Several factors now exist that make this the perfect opportunity for gifting. First, asset values have dropped significantly. The broad stock market has sold off over 25% with more lows expected. Some sectors, such as oil and gas, hospitality, travel, entertainment and aerospace have been hit especially hard. Second, interest rates have hit new lows. Government bond rates, which are used by the Internal Revenue Service to value gift strategies, have dipped below 1%. The lower the rate, the more tax efficient it is to transfer wealth out of your estate. And finally, massive and unprecedented government spending to prop up the economy is sure to accelerate exploding federal deficits and cause large tax increases in the future. Considering the growing imbalance of wealth fueling discussions of higher taxes on wealth, and the sunsetting after 2025 of the current estate tax exemptions to much lower levels, gifting has never been more attractive.

Gifting benefit

Gifting can be as simple as outright gifts to children or grandchildren using the $15,000 gift tax annual exclusion or using the $11.58 million lifetime gift and estate tax exclusion. However, for those who want to take advantage of gifting but still want access to those assets, transfers to an irrevocable trust are much more attractive; and powerful. With a trust, one spouse can gift assets to the trust and the other spouse can be a beneficiary so that the couple may still enjoy the assets (children and grandchildren are often trust beneficiaries as well). Gifting also has asset protection benefits. With an irrevocable trust, the gift assets are not included on the balance sheet of either spouse, putting potential risk beyond the reach of creditors. With an irrevocable 'grantor' trust, all transfers between the gifting spouse and the trust are ignored for income tax purposes. This is very powerful when transferring assets to a trust in exchange for a note or interest income.

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GRATs and IGTs

A grantor retained annuity trust (GRAT) or a transfer to an irrevocable grantor trust (IGT) are two gift strategies to transfer appreciating assets out of an estate. A GRAT is ideal for marketable securities that have declined in value but are expected to rebound in the near future. An IGT has more flexibility for long-term growth, and works best with hard-to-value assets such as real estate and business entities.

Think of loaning an asset that has lost half of its market value to a trust in exchange for a fixed note with an interest rate of 1%. As the asset recovers its original value, whether it takes 1, 2 or 5 years, the increased value is captured in the irrevocable trust, safe from gift and estate taxes (and from predatory credit risk). All income and growth on the asset accumulates in the trust, escaping gift and estate tax. A transfer to a GRAT can be structured without the use of any lifetime gift exemption, making the GRAT transfer a 'no risk' gift strategy with unlimited amounts of wealth. A sale to an IGT requires a small amount of gift exemption, but has more flexibility in design.

Examples:

Stocks and mutual funds. Consider an investment account worth $10 million that is held in a fund that mirrors the returns of the S&P 500 stock index. Normally, such a fund can be expected to double every 7-12 years, resulting in $20 million in 10 years, or $40 million in 20 years. In the last month the S&P 500 index has lost 25% of its value. Transferring the portfolio with a value of $7.5 million now, will freeze the $7.5 million amount in your estate and, when the market rebounds, put the recovered $2.5 million outside of your taxable estate without using any gift exemption.

Concentrated stock positions. Concentrated stock positions have an even more powerful gift opportunity. Take Bank of America (BOA) for example. The stock value has dropped from a high near $36 to a low of $18 in a short period of time, resulting in a loss of 50% of its value. A $10 million position in BOA a few months ago now has a value of $5 million. A transfer to a trust will lock in the reduced value. When the stock recovers to $36, and it will over time, the growth will accrue to the trust, resulting in a $5 million transfer without the use of gift exemption. Spirit Aerosystems, with a 52-week high near $100 per share, hit $18 recently.

Closely-held assets. Similar to highly concentrated holdings in marketable securities, closely-held businesses have even more leverage opportunity for gift purposes. Businesses in industries hard hit by the Coronavirus, such as energy, travel, entertainment, hospitality and aerospace, offer greater wealth shift opportunities. Many small oil companies have lost more than 80% of their value with the price of a barrel of oil recently below $20. A transfer of assets now will save millions of dollars in estate taxes in the future.

Conclusion

A market collapse caused by a worldwide pandemic may cause many people to stockpile hand sanitizers and toilet paper. However, a taxpayer with a large estate may see this as a once in a lifetime gifting opportunity. Like the investor who buys when the price is low, the astute holder of wealth repositions that wealth at the same time.

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