

COVID-19 Estate Planning

Anne Arundel County Bar Association

July 9, 2020

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Opportunities Under Historic Low Interest Rates and/or Significant Valuation Adjustments

Intra-Family Loans:

- Outright loans.
- Sales to grantor trusts with a note take back.

Gifts:

- Gifts of artificially low asset values.
- Use \$15,000 early in year.

Gifts of Partial Interest in Family Partnerships/LLCs:

Grantor Retained Annuity Trusts:

- Particularly with "depressed stock portfolios."

"Taxable:"

- Transfers to use high FET/GST exemptions.
- SLATs as hedge against 2026 possible change and leveraging lack of a Maryland gift tax.

Defer 2020 Required Minimum Distribution From Qualified Plans:

COVID-19 Estate Planning
Maryland Planning and Social Distancing

- Maryland Executive Order 20-04-10-01 is a remote witnessing order that permits witnesses to be within the "electronic presence" of the person signing certain documents. This Executive Order requires a video conferencing to permit the various individuals to observe and communicate with each other to the same extent as if physically present in the same location. The Order should be reviewed and followed exactly.
- Remote Notarization: Maryland Executive Order 20-03-30-04 permits remote notarization of certain documents. The remote notary must use "communication technology" which permits real time communication among the various participant and the remote notarization must be recorded and preserved for 10 years after the electronic notarization. Once again, the procedures should be followed as set out in the Executive Order.
- If clients do not have access to audio-video technology but still need to engage in planning there are certain "work-arounds" such as the declaration of trust instead of the trust agreement which, if following the statutory requirements under the real estate article for statute of frauds, will be "funded" by real estate. See Estates & Trusts § 14.5(2) (Creation of Trust) and Real Property § 5-105 (Writing Required for Declaration of Trust). Additionally, health care directives which generally require witnesses, the statute also permits "any authentic expression made by an individual while competent" shall be considered. Health General § 5-602(a)(1).

COVID-19 Estate Planning
Clients Need the Basics Created or Reviewed

- Wills: Clients should review existing Wills with particular attention to whether the personal representatives are correct and, if there are minor children, whether there is a guardian designation that is appropriate for the circumstances.
- Health Care Directives: Clients should verify that designee is appropriate and is aware of the client's wishes; the health care directives ought to have sufficient detail to reflect the client's approach to health care decision making.
- Durable Powers of Attorney: Clients should check to verify the agents are appropriate and special care that there are checks and balances built in at least on the back up level of agents if necessary.
- Revocable Trusts: The revocable trust still is the best tool to manage disability. It is especially critical if the client is actively managing a business and the management succession is a consideration.
- Non-Probate Accounts: The client should check any designations on non-probate dispositions such as pay on death accounts, beneficiary designations on retirement plans, and the like. Remember the Impact of the SECURE Act.

COVID-19 Estate Planning
Historic Low Interest Rates
(July 2020)

The "7520 rate" is 0.6%:

- Since 1989 the average 7520 rate has been closer to 6.0%.
- This is the so-called "hurdle rate" for GRATs.

The applicable federal rate (the "AFR"):

AFR

Term	Interest Payments Annual	Interest Payments Semi-Annual	Interest Payments Quarterly	Interest Payments Monthly
Short Term (Less Than 3 Years)	0.18%	0.18%	0.18%	0.18%
Mid-Term (3-9 Years)	0.45%	0.45%	0.45%	0.45%
Long-Term (9 Years or Longer)	1.17%	1.17%	1.17%	1.17%

- Loans below the AFR rates may be considered gifts.
- The AFR rates are used for intra-family loans or sales to family members or trusts for the benefit of the family members.

COVID-19 Estate Planning
Gifts Partial Interest of Businesses
(The Whole is Not the Sum of Its Parts)

Basic Premise:

Assume a business is worth \$1 million. A ¼ interest would not be \$250,000 because the minority owner could only rely on the fiduciary duty owed to him or her by the majority owner and not be able to control business decisions (lack of control). An additional reduction in value is because a partial interest is not easily sold, not easily traded and, unless it is on a publicly traded exchange or otherwise, as an established market (lack of market). Assume these factors reduce the ¼ interest from \$250,000 to \$170,000 then a gift of that interest would use up only \$170,000 of the unified/lifetime credit estate and gift tax exemption not \$250,000.

Most Acutely For Retail Space But Also For Other Broad Categories of Properties:

Assuming that the values will recover, discount planning with real estate or other temporarily depressed properties will leverage the estate planning savings on the discount.

Entity Structures:

Most often used structure would provide for voting and non-voting interest. LLCs can easily be structured to provide for differences in voting rights. Even S Corps (with the "one class of stock" requirement) can be recapitalized to permit voting and non-voting shares because the one class of stock rule essentially means no preferred stock is permitted.

Type of Businesses:

A fairly elastic concept. It can be a traditional family business or even a stock portfolio. The requirement is there needs to be an underlying business purpose for having the portfolio in a family structure. One such business purpose would be to meet the threshold of various financial advisors so that family money collectively can be managed. Accordingly, even publicly traded stocks can be held within a family entity and be subject to a discount for market or control purposes. The degree of the discount is, however, effective.

COVID-19 Estate Planning
Sales to Defective Grantor Trusts
("IDGT")

Benefit:

It is a freeze technique that effectively passes appreciation to the next generation.

Technique:

It is not sanctioned by statute. The trust needs to be "seeded" with 10% of the value of the asset that will be held by the trust. Generally this may trigger a gift tax. Once seeded, the trust purchases the asset from the grantor for a promissory note. The terms of the note must at least follow the AFR rate for long-term notes (1.17%). If the donor dies while the note is outstanding only the balance due on the note is includible in his or her estate. The income tax considerations of the donor's death, however, are uncertain (it could possibly be that the gain on the installment payments are taxable). Other IRS issues are whether it was a bargain sale using a low value so valuation is incredibly important.

Downside:

As with a GRAT, if the asset does not outperform the note's interest rate there will be no appreciation to the beneficiaries.

COVID-19 Estate Planning
Grantor Retained Annuity Trust
(GRAT)

Purpose:

To pass appreciation of assets to a next generation without a gift tax.

Technique:

GRATs are statutory creatures (IRC § 2702). The donor transfers property to an irrevocable trust in exchange for an annuity. Generally GRATs are structured as short-term trusts (2 years) and the donor retains a "qualified annuity interest." Gifts to the next generation are valued by the fair market value of the property placed in the GRAT less the fair market value of the annuity interest. A zeroed out GRAT is when the annuity back approximately equals the annuity received.

Hurdle Rate:

The GRAT is successful if the assets appreciate at a greater rate than a 7520 rate. The 7520 rate for July 2020 is 0.6%. If the asset appreciates at a greater rate there will be an effective transfer of property to the next generation to the extent of that appreciation.

Example:

Assume \$1 million of stock with a rate appreciation potential is put in a GRAT with 0.6% 7520 rate in a zeroed out GRAT over 2 years. The return to the donor is almost flat. Thus, if the portfolio had been placed in a GRAT at a time when the market was 25% off due to COVID-19 but recovered over the 2 years it would transfer substantial assets from the portfolio to the next generation.

Structural Limitations:

The annuity payments cannot be made by note, debt instrument, or a similar arrangement. The annuity payments may not increase more than 20% each year so the annuity payment cannot be all required to pay at the end. The payment can, however, be made in cash or in kind.

Stock and bond portfolios are the best assets to use for GRATs. Real estate has complex valuation issues that would make transfers problematic. Due to the rule that the annuity payments cannot exceed a 20% increase each year, it would mean that in a 2-year GRAT almost half of the annuity payment would need to be paid. If it were real estate an appraisal would need to set the in-kind distribution making the technique less than ideal because of the audit risk for real estate transactions.

COVID-19 Estate Planning
Spousal Lifetime Access Trust
(SLAT)

Benefit:

Locks in a higher unified credit amount. Currently the threshold for federal estate or gift tax is \$11,580,000 **???** It is by its terms that amount is to terminate and revert back to the earlier threshold of \$5 million (indexed). Given the federal spending and the fact that there may not be a political appetite for extending the higher threshold, this would be a technique that would permit to lock in part, or all, of the higher threshold.

Technique:

A SLAT is a way for one spouse to put his or her assets into a trust for the benefit of the other spouse for that other spouse's lifetime. It is similar to a QTIP but there would be no QTIP election made but, instead, would be using the unified credit amount. It is an irrevocable trust and the term of the trust would be for the donor spouse's lifetime containing similar terms as in a standard testamentary credit shelter trust. The donor spouse could be the trustee and if distributions to the spouse are limited by HEMS the spouse may have discretionary distribution powers to children of the secondary beneficiaries. The spouse could have a 5&5 withdraw right. The spouse could have a limited power of appointment exercised at death, testamentary power of appointment, but the drafter should carefully consider 2036 issues and the potential for the creditors of the donor to be able to follow the assets.

Reciprocal Trust Rules:

It is tempting to create 2 SLATs – one for each spouse. Under the Reciprocal Trust Rules where 2 "interrelated" trusts leave the grantors "in approximately the same economic position as they would have been in had they created trusts naming themselves as life beneficiaries" it will be set aside. There are techniques to alter to alter these trusts in a way that presumably would avoid the Reciprocal Trust Rules but it is one of the drafting issues.