

## Estate Planning Update Summer 2020

*The following is a summary of some estate planning developments and opportunities that may be of interest to you. We hope you find this helpful and look forward to hearing from you with any questions.*



The current pandemic is a sobering reminder of how important it is to have your affairs in order, and we hope you will take the opportunity to review your current estate planning documents to be sure they still reflect your wishes. In addition, the resulting economic tumult has led to historically low interest rates and what we hope will be temporarily low values for marketable securities and closely held businesses, both of which may create planning opportunities for those of you who are comfortable making gifts at this time.

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### Review Basic Estate Plan Documents

As you review your current documents, here are some questions you may want to consider:

- Are the individuals named as fiduciaries under your estate planning documents still appropriate? For example, if your children were young when you last updated your estate planning documents, you may wish to consider including one or more of them as an executor, trustee, health care agent or agent under your durable power of attorney.
- Are there charities you would like to add to your estate plan? Many of us have expanded our charitable giving during this crisis or have been the beneficiaries of charitable enterprises. You may have new thoughts on which charities to remember at your death.

\* You can access the online version of this *Estate Planning Update*, with links to other articles, at [bit.ly/EPUSUMMER2020](https://bit.ly/EPUSUMMER2020). Or, to access a particular article mentioned in this *Update*, type in the web address shown—for example, to see the article “Retirement Account Planning May Need to Be Reviewed Because of New Law” from our special January 2020 *Update*, which is mentioned on page 2, type [bit.ly/EPUJAN2020](https://bit.ly/EPUJAN2020) into your internet browser.

- Is your revocable trust a beneficiary (either primary or contingent) of a retirement plan? If so, it may be appropriate to amend your revocable trust to be sure that withdrawals from the account after your death can be deferred for as long as possible under the new federal law (go to [bit.ly/EPUJAN2020](http://bit.ly/EPUJAN2020)).

### **Wealth Transfer Opportunities**

Amid the detrimental consequences of the current environment lie unique wealth planning opportunities for individuals with estates that may be subject to federal or state estate taxes.

### **Gift and Estate Tax Overview**

The current federal gift and estate tax exemption is now \$11.58 million per person (\$23.16 million for a married couple). This exemption is scheduled to increase annually for inflation through 2025. In general, transfers made in excess of the gift and estate tax exemption are subject to a 40 percent federal tax. The generation-skipping transfer (GST) tax exemption now also is set at \$11.58 million per person in 2020, with identical inflationary increases. Under the Tax Cuts and Jobs Act of 2017, both exemption amounts are scheduled to sunset at the end of 2025, meaning that these figures will revert on January 1, 2026, to \$5 million per person (plus inflation adjustments).

In addition to the federal gift, estate and GST taxes, several states – including Massachusetts, Connecticut and New York – still impose a separate state estate tax with lower exemption amounts. Connecticut also imposes a state gift tax.

2020 is a unique year in that we are likely heading into a global recession coupled with a U.S. presidential election. Accordingly, 2020 may be an ideal year during which to transfer assets out of your estate at a lower value while leveraging the use of the \$11.58 million exemption. If the 2020 election results in a political change in Washington, the potential exists for the estate tax exemption to be significantly reduced in 2021 or subsequent years.

### **Taking Advantage of Low Asset Values and Low Interest Rates**

As noted above, values of marketable securities and many business interests have dropped significantly from the all-time highs of just a couple of months ago. In addition, the IRS interest rates for intra-family loans are now extremely low (ranging from 0.25 percent to 1.15 percent for loans made in May, depending on the loan term). Similarly, the IRS interest rate used to calculate certain remainder values has dropped to 0.8 percent for transactions in May. The cumulative impact of these reductions is that assets can be transferred to intended beneficiaries at a much lower cost. Today's environment is ideal for considering the following strategies.

#### *Intra-family Loans*

As noted above, applicable interest rates are exceptionally low, allowing family members to make loans to one another at low rates without gift tax consequences. For instance, a parent can lend funds to a child for up to three years and charge interest as low as 0.25 percent if the loan is made in May. Such loans allow family members or trusts to borrow funds that may be needed to buy a house, start a business or make investments. The benefit of this technique is that the growth of the loan principal in the lender's estate is frozen at the interest rate of the loan, while the increase in value of any investments made with the borrowed funds belongs to the borrower.

Clients with existing loans to family members or trusts may wish to consider refinancing in order to take advantage of lower rates. As with all of the transactions discussed here, you should consult with your Day Pitney estate planning attorney before refinancing intra-family loans.

#### *Direct Gifts to Individuals or Irrevocable Trusts*

A straightforward strategy is to gift assets to individuals or to an irrevocable trust for the benefit of descendants or other intended beneficiaries. A gift to an irrevocable trust presents numerous benefits: creditor protection for beneficiaries, including protection from divorcing

spouses; potential estate and GST tax savings over multiple generations; income tax benefits; consolidated management of assets; and controlled distributions to the beneficiaries by the trustee.

Gifts of assets made now, while using some of the donor's lifetime estate and gift tax exemption, will freeze the gift tax value of those assets at today's low values, allowing the recipients to receive the benefit of the expected subsequent appreciation.

Also, as discussed above, the current federal gift, estate and GST tax exemptions are very high but are scheduled to be cut approximately in half in 2026, when the current federal law sunsets. By making gifts large enough to use up the donor's current exemptions, the donor can capture the benefit of the current exemptions even if the exemptions are reduced in the future.

### SLATs

A spousal limited access trust (also known as a spousal lifetime access trust, or SLAT) is an irrevocable trust to which a married person gifts assets from which his or her spouse may receive distributions of income and principal, typically at the discretion of the trustee. This strategy removes the assets from the grantor's estate while still affording access through the spouse as long as the parties are married and the spouse is living. The potential access may make the spouses more comfortable with making a large gift and utilizing the current exemption before a potential future decrease in the exemption amount.

### GRATs

A grantor retained annuity trust (GRAT) is a technique used to transfer the appreciation of an asset in a tax-efficient manner. The grantor gifts assets to an irrevocable trust and retains the right to a fixed annuity for a specific term of years (the GRAT term). Over the GRAT term, the grantor receives back the value of the initial gift plus interest calculated at a rate determined by the IRS (0.8 percent for GRATs funded in May 2020). At the end of the GRAT term, the remaining assets (i.e., the appreciation on the assets transferred less the interest payable to the grantor) typically transfer to an irrevocable trust for the benefit of the grantor's descendants.

Because the grantor has retained an economic benefit, the value of the initial gift is discounted, often down to \$0, for gift tax purposes. As a result, provided the grantor survives the GRAT term, the grantor effectively gifts the appreciation on the grantor's assets with virtually no gift tax consequences.

A GRAT is an ideal strategy to transfer business interests or marketable securities that are currently undervalued. The greater the growth or appreciation of the assets during the GRAT term, the larger the tax savings. In addition, as noted earlier, the interest rate used in the annuity payment calculation is historically low, making this strategy even more attractive. *For an illustration of the GRAT technique, go to [bit.ly/DPGRAT](http://bit.ly/DPGRAT).*

For clients with existing GRATs that have lost value during the economic downturn, it may be possible to "swap" the assets held by the GRAT for cash or other assets of equal value owned outside the GRAT. This allows the original assets to fund a new GRAT even before the current GRAT terminates, thus taking advantage of the assets' currently low value and higher potential for future appreciation.

### CLATs

A charitable lead annuity trust (CLAT) is in some ways similar to a GRAT, but the annuity payments pass to charity rather than back to the donor. It allows a charitably-minded donor to benefit from low interest rates while passing property appreciation to beneficiaries in a tax-advantaged way. To create a CLAT, a donor irrevocably transfers property to a trust for a specific term of years, during which a "lead" interest is paid to one or more charities annually. At the end of the term, the remaining property passes to noncharitable beneficiaries free of gift or estate tax. The value of the annual lead payments to charity is determined based on the number of years the lead interest lasts and interest rates determined by the IRS. In May 2020, the lowest available rate is 0.8 percent.

A donor might structure a CLAT to provide fixed annual payments to charity. Alternatively, payments can be "backloaded" over the term (each year's payment

is 20 percent higher than the prior year's payment). Backloading leaves more property in the trust over the term to generate appreciation, which is better for the noncharitable beneficiaries but reduces the amount paid to charity in the early years of the CLAT.

*For example, assume a CLAT is funded in May 2020 with \$10 million for a 20-year lead term, with payments increasing by 20 percent each year and designed so there will be no taxable gift to the remainder beneficiaries. The trust would distribute a total of \$11,335,500 to charity over its 20-year term. If the trust were to earn a steady 6 percent rate of return instead of the 0.8 percent the IRS assumes, then in addition to distributing more than \$11 million to charity, the trust would have \$16.8 million on hand to distribute, free of gift or estate tax, to the noncharitable beneficiaries at the end of the 20 years.*

The actual results will depend on investment returns, but the low interest rate provides an important opportunity for those who are looking both to benefit charity and to pass wealth to the next generation free of gift or estate tax.

#### *Installment Sale to an Irrevocable Grantor Trust*

Structuring the sale of an asset to an irrevocable grantor trust can be an effective estate planning strategy to remove assets from your estate while preserving an income stream. When a gift or sale is made to a grantor trust, the grantor still is treated as the owner of the trust's assets for income tax purposes. The grantor, rather than the trust, pays the tax on the trust's taxable income, and transactions between the grantor and the trust are not subject to income tax. In an installment sale, the grantor "seeds" the trust with a gift and then sells to the trust additional assets that are expected to increase in value in exchange for an interest-bearing promissory note. The trust pays interest on the note (at current low interest rates, described above) and gets the benefit of the appreciation of the gifted assets during the note term. The appreciation, minus the interest paid, is removed from the grantor's estate.

#### **Other Considerations**

It is essential to understand that most techniques described above cannot be undone or reversed once completed. Furthermore, there may be some downside from an income tax perspective because the recipients of the assets (trusts or individuals) receive the grantor's cost basis in the property rather than the stepped-up basis they would receive if the same assets were transferred at the grantor's death. It is important to weigh the potential income tax disadvantages associated with a lifetime gift of an asset against the estate tax savings achieved.

Before committing to any estate planning technique, it also is essential to understand the cash flow impact of any gifting strategy. We recommend that your financial adviser assist in quantifying your projected cash flow needs to help make sure you do not give away more than you can afford to, taking into account your own future needs.

Remember too that the sooner you act, the more quickly the asset is removed from your control and all future appreciation will be removed from your estate.

#### **Next Steps**

The gifting opportunities discussed above have many pros and cons and may not be appropriate for every situation. We encourage you to contact your Day Pitney estate planning attorney to discuss any changes to your estate planning documents and to discuss whether any of these gifting strategies may be appropriate for you. ■



Up until a few months ago, there was a pretty clear routine for signing a new or updated package of estate planning documents. Make an appointment, go into your attorney's office to go over the plan and ask any questions. The attorney calls in a few colleagues for some conversation and a round of signing, witnessing and notarizing. Head on back home with the satisfaction of having checked an important item off the list of things you wanted to accomplish this year. When you think about it, this routine has been pretty much the same for hundreds of years.

Social distancing sure has changed that routine for our clients and for us. Our footprint states have been authorizing remote notarization (go to [bit.ly/DPCRCTE](https://bit.ly/DPCRCTE) for remote notarization advisories for NJ, NY and MA), which helps in many cases, but lately getting documents signed has called for some creativity:

- Clients expecting a child imminently were able to execute all of their core estate planning documents by videoconference, following some careful planning by the supervising attorney. Two friends served as witnesses, and the four of them met outside on a beautiful New York City spring day to sign the documents under the attorney's supervision via videoconference, the whole process taking a record 41 minutes!
- We were able to assist two nonagenarians with signing their documents remotely and safely

from the comfort of their own homes as they utilized a videoconferencing app on their laptop.

- We prepared new estate planning documents for a client who is a dog owner and regularly walks his dog with others in his hometown, maintaining appropriate distances. There is a notary in that group and plenty of adult witnesses, so the will and trust were fully executed at the dog park.
- One of our attorneys and his spouse took a walk at the end of the day over to a client's house. He was waiting on his porch. He signed his will, and they witnessed on counterpart documents while standing on the front walk, a safe distance away. ■



Even before President Donald Trump declared a national emergency with respect to the COVID-19 outbreak on March 13, the pandemic had disrupted the lives of many in the United States and around the world. Private philanthropists have been quick to respond.

#### **Assistance to Impacted Individuals from Private Foundations**

Because the COVID-19 pandemic is a presidentially declared national emergency and therefore a "qualified disaster," private foundations can more easily provide assistance directly to impacted individuals. In these circumstances, the Victims of Terrorism Tax Relief Act of

2001 permits charities (including private foundations) to make grants to individuals without undertaking a specific assessment of any individual's need; rather, a charity is required to make payments in good faith, using a reasonable and objective formula that is consistently applied. Distributions must be made to individuals who qualify as members of a particular "charitable class." The charitable class could include all individuals impacted by a particular disaster or a specific group of individuals, like employees of a particular employer. Any such "qualified disaster payments" (QDPs) are not taxable income to the recipients. QDPs include reasonable and necessary personal, living or funeral expenses incurred as a result of a qualified disaster as long as they are not otherwise covered by insurance. Expenses that reasonably could result from the pandemic include medical and other health-related expenses; medications; hand sanitizers; child care or tutoring expenses due to school closings; increased home, utility or communications expenses due to stay-at-home restrictions; and increased cost of home supplies. However, QDPs do not include income replacement payments (like lost wages or lost business income).

If you have a private foundation and would like to pursue a QDP program, we can help you structure it.

### Relief for Charities Under the CARES Act

The CARES Act, which was signed into law on March 27, provides support for charitable organizations and their employees. The new Paycheck Protection Program loan and expanded Economic Injury Disaster Loan and SBA Express Loan programs have now been made available to many charitable entities. The act provided tax relief to nonprofits through an employee retention tax credit, payroll tax deferral and changes in the treatment of net operating losses for unrelated business taxable income.

If you work with a charitable organization that could benefit from these programs, please contact us; we can help.

### Individual and Corporate Charitable Giving Under the CARES Act

Individual donors who itemize deductions will be able to claim charitable contribution deductions for cash contributions up to 100 percent of adjusted gross income (AGI) in 2020. The previous limit was 60 percent of AGI.

In addition, the limit on charitable contributions by corporations has been increased to 25 percent of taxable income in 2020. The previous limit was 10 percent of taxable income.

It is important to note the increased charitable contribution limits only apply to cash contributions to certain types of charities, including publicly supported charities. The increased limits do not apply to contributions to private foundations (unless they are operating foundations), donor advised funds or supporting organizations.

Individual donors who do not itemize deductions can also claim a \$300 deduction on top of the standard deduction for cash charitable contributions in 2020. ■



One of the notable provisions relating to retirement accounts in the CARES Act is the waiver of 2020 required minimum distributions (RMDs) from certain retirement accounts, including defined contribution retirement plans and individual retirement accounts (IRAs). If an individual withdrew his or her 2020 RMD before the CARES Act waived this requirement, then the

individual will have 60 days after the date of withdrawal to roll back the distribution into the retirement account and avoid taxation in 2020.

The CARES Act also waives the 10 percent penalty imposed on early withdrawals of up to \$100,000 from qualified retirement plans. The withdrawal must be a COVID-19-related distribution as defined in the CARES Act and is subject to income tax over a three-year period unless recontributed to the retirement account within that three-year period.

Although not related to the CARES Act, this may be a good time to explore the conversion of a traditional

IRA to a Roth IRA. With the current market volatility, a conversion to a Roth IRA may result in a lower amount of taxable income recognized in the conversion and provide an opportunity for the account to grow income tax-free as the market recovers.

In addition to these planning opportunities, it is important to keep in mind the provisions of the SECURE Act, as discussed in our special edition of the *Estate Planning Update* in January 2020 (go to [bit.ly/EPUJAN2020](https://bit.ly/EPUJAN2020)), which made a variety of changes to the treatment of retirement accounts and may require changes to your estate plan. ■

### **Day Pitney COVID-19 Resource Center Provides Insights on Legal Issues in Light of Global Pandemic**

As the number of COVID-19 cases around the world grows, Day Pitney formed a COVID-19 Task Force to help clients fully understand and assess the legal, regulatory and commercial implications of the pandemic. Our mission is to offer timely and practical legal advice to our clients based on best available information in our COVID-19 Resource Center (CRC, go to [bit.ly/DPCOVID19](https://bit.ly/DPCOVID19)).

Here are a list of our alerts and advisories that we believe may be of particular interest to our individual and family office clients:

#### **Remote Notarization**

- COVID-19: Massachusetts Approves Temporary Remote Notarization
- COVID-19: New Jersey Temporarily Approves Remote Notarization
- COVID-19 Response: NY Executive Order Permits Video Execution of Wills and Other Documents

#### **Residency Planning**

- COVID-19 May Impact State Statutory Residency Planning

#### **Tax Relief and Deadline Extensions**

- IRS Provides Limited Relief to Cross-Border Taxpayers Stranded by COVID-19
- Summary of Certain Tax Relief Available in COVID-19 CARES Act
- IRS Significantly Extends Filing, Payment and Other Deadlines Due to COVID-19
- COVID-19 Impact on Tax Filings in Florida
- UPDATE: IRS Extends Deadline for Filing and Payment of Income Taxes Due to COVID-19 Pandemic

They can be found in the CRC at [bit.ly/DPCRCTE](https://bit.ly/DPCRCTE) and [bit.ly/DPCRCTAX](https://bit.ly/DPCRCTAX). In the CRC, we will continue to post our alerts and articles, as well as resources, articles and FAQs from reliable sources. So long as our clients continue to feel the impact of COVID-19, we will remain available to consult and provide guidance.

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COVID-19 DISCLAIMER: As you are aware, as a result of the COVID-19 pandemic, things are changing quickly and the effect, enforceability and interpretation of laws may be affected by future events. The material set forth in this document is not an unequivocal statement of law, but instead represents our best interpretation of where things stand as of the date of first publication. We have not attempted to address the potential impacts of all local, state and federal orders that may have been issued in response to the COVID-19 pandemic.

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