

BakerHostetler



When Opportunity is Knocking:
Legacy Planning with Low Interest
Rates, Volatile Markets and High
Transfer Tax Exemptions

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Presenters

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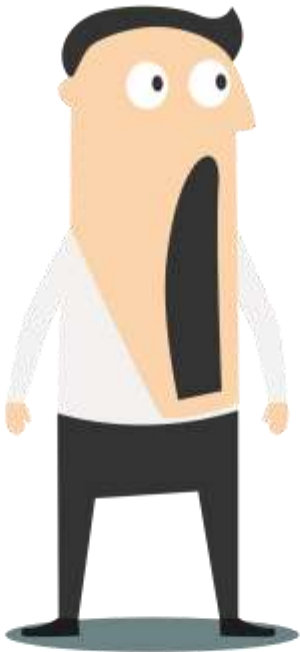
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Agenda

- I. Current market conditions and tax laws
- II. Best planning options
- III. Election 2020

October 2020 AFR and 7520 Rate

Impossible...WHAT?



- Short-term AFR = 0.14% (0-3 years)
- Mid-term AFR = 0.38% (3-9 years)
- Long-term AFR = 1.12% (over 9 years)
- 7520 Rate = 0.4%

Asset Values

The Market

- Dow Jones 2020
 - As of the preparation of these slides, at nearly 28,000
 - Dipped to approximately 18,500 in March



Making History-7520 Rates

Year	October Rates
1989	10.2%
1995	7.6%
2000	7.4%
2020	0.4%

Lifetime Exemption Since 2001

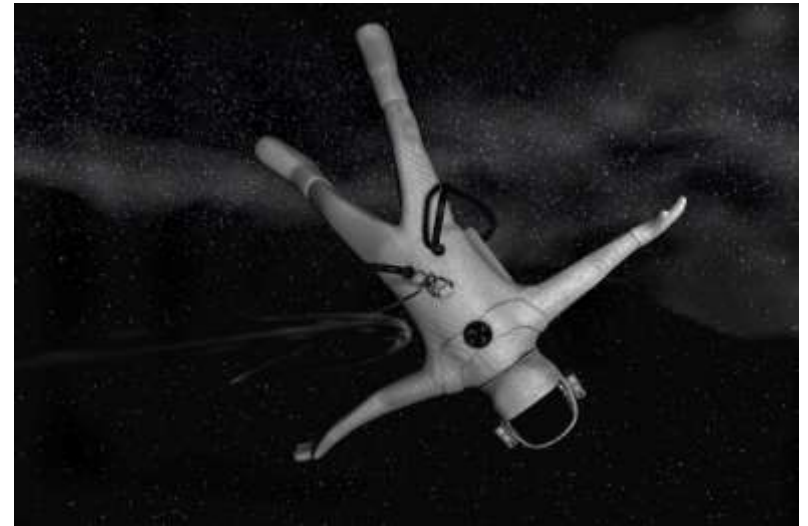
Year	Exclusion Amount	Max/Top tax rate
2001	\$675,000	55%
2002	\$1 million	50%
2003	\$1 million	49%
2004	\$1.5 million	48%
2005	\$1.5 million	47%
2006	\$2 million	46%
2007	\$2 million	45%
2008	\$2 million	45%
2009	\$3.5 million	45%
2010	Repealed	
2011	\$5 million	35%
2012	\$5.12 million	35%
2013	\$5.25 million	40%
2014	\$5.34 million	40%
2015	\$5.43 million	40%
2016	\$5.45 million	40%
2017	\$5.49 million	40%
2018	\$11.18 million	40%
2019	\$11.4 million	40%
2020	\$11.58 million	40%

**2020:
\$11.58M per
person.**

**2021:
\$11.7M per
person.**

“Danger Will Robinson”

- Rates at their bottom
- Dow bounce-back
- Exemption sunsets 12/31/25
- Change in tax policy (Dems win)



What Do I Do?



Opportunities are all around...

Family Loan

- \$1M, nine-year loan, only requires annual interest of \$3,800 (0.38% mid-term rate).
- Parent lends assets to children that will produce income and appreciation exceeding interest rate. The excess would accrue to the benefit of the borrower without transfer tax implications.



Refinancing Family Loans

- Comfy?
- No cases, regulations or rulings. Proposed regulations under §7872 include a section titled “Treatment of Renegotiations,” but merely reserves the subject for later guidance.
- Commentators have generally concluded that refinancings at lower AFRs should be possible.



Refinancing Family Loans

“Help me help you”

- Consistently refinancing
- Compensating the lender
- Personal guarantee
- Increased collateral
- Trustee woes



Sale to Grantor Trust

- Example:
 - Family assets sold to an irrevocable trust in exchange for a 9-Year Note using October Mid-Term AFR of .38%.
 - \$126.5 million is transferred to the trust (\$115 million of which is sold and \$11.5 million of which is gifted).
 - Assumptions:
 - No down payment, balloon payment at end of the term of Note;
 - No discounts on the sale; and
 - Assets in trust appreciate at 5% each year.
- Transfer Tax Benefit:
 - After paying off the Note, trust will have approximately \$76 million in remaining assets which have been removed from seller's estate (in addition to all future appreciation on such assets).

GRAT

- Simplicity
- Conservative approach
- Hurdle rate is only 0.4%.
- Income + appreciation > hurdle rate =
Success!

GRAT Example

- \$10 million to a two-year GRAT, at the October Section 7520 rate of 0.40% will be zeroed out if the annuity payment is 50.2992806% or \$5,029,928 annually (\$10,059,856 total).
- If assets transferred to the GRAT increase by 5% each year for 15 years, then:
 - In year 1, \$5,029,928 is paid to the grantor. \$5,470,072 remains in the trust.
 - In year 2, \$5,029,928 is paid to the grantor. \$713,647 remains in the trust. This is the net amount that is transferred to the trust free from gift tax.
 - In year 15, the assets of the trust are worth approximately \$1,345,688.

I'm Drowning - Underwater GRAT

- Use Power of Substitution
- Tom Pauloski in a recent presentation references a 2008 article:
 - https://www.alliancebernstein.com/abcom/Perspectives_Web/IntheNews/PrivateClient/PDFs/ACTEC_Grat_Immunization_010208.pdf?uuid=bc6f67c0-4198-11df-a00c-33b6b4640398
 - “Out of the Money” GRAT
 - If a two-year GRAT invested in equities for its entire term and it delivers a return between 20% and 10% below the 7520 rate in its first year, **it has only an 8% chance of succeeding** after the end of the first year. **If, however, the equities are contributed to a new GRAT, the new GRAT will have a 62% chance of succeeding.**
- “In the Money” GRAT
 - Immunize “in the money” GRATs with bonds/cash?
 - Immunizing after a strong first year helps to protect gains in that year, but it also forgoes the opportunity to maximize improvement on those gains in Year 2. Study also shows long-term rolling GRAT strategy, drastically increases the likelihood and magnitude of the wealth transfer.



CLAT

- A GRAT corollary.
- 7520 safe hurdle (.4%)!
- Taxes saved all around.
- Benefit charity and family.



CLAT Example

- \$10 million to a two-year CLAT, at the October Section 7520 rate of 0.40% will be zeroed out (no taxable gift) if the annuity payment is 50.2992806% or \$5,029,928 annually (\$10,059,856 total).
- If assets transferred to the CLAT increase by 5% each year for 15 years, then:
 - In year 1, \$5,029,928 is paid to charity. \$5,470,072 remains in the trust.
 - In year 2, \$5,029,928 is paid to charity. \$713,647 remains in the trust. This is the net amount that is transferred to the trust free from gift tax.
 - In year 15, the assets of the trust are worth approximately \$1,345,688.

Depending on the structure of the CLAT, the grantor may receive a \$10 million income tax charitable deduction. The grantor's estate will be reduced by \$10 million.

Grantor Versus Nongrantor CLT

- Grantor CLT
 - A CLT can be structured as a grantor trust (a “grantor CLT”) which provides the grantor with an immediate income tax deduction for the grantor’s contribution to the CLT.
 - However, since a grantor CLT is a grantor trust, the grantor must report all of the income realized by the grantor CLT each year on his or her personal income tax return.
 - Moreover, the grantor CLT is not permitted to claim a charitable deduction under Section 642(c) for payments made to charity each year.
 - If the grantor dies during the term of the grantor CLT then it is subject to a special recapture rule where a portion equal to the original deduction minus the discounted value of all the amounts paid to charity prior to the grantor’s death will be subject to income tax when the grantor dies.

Grantor Versus Nongrantor CLT

- Nongrantor CLT
 - A CLT can be structured as a nongrantor trust (a “nongrantor CLT”). A nongrantor CLT offers no income tax deduction for the grantor’s contribution to the CLT.
 - A nongrantor CLT is a taxable trust. The nongrantor CLT is permitted to claim a charitable deduction under Section 642(c) for payments made to charity each year.
 - If income realized by the CLT is greater than the current year’s charitable distributions, IRC Section 642(c)(1) allows the trustee to elect to “borrow” some of the next year’s charitable deduction to offset the extra income in the current year. Any amounts so “borrowed” cannot be used by the trust again as a deduction in the subsequent year.

CLAT Example #1

- Assets to CLAT

- \$10 million

- Term of CLAT

- 10 years

- Section 7520

- 0.4%

- Growth of CLAT Assets**

- **5%**

- Annuity

- \$1,022,129

- Taxable Remainder

- \$0

- Total Assets to Charity

- \$10,221,291

- Remaining Assets After Term

- \$3,432,716

<u>Year</u>	<u>Beginning Principal</u>	<u>5.00% Growth</u>	<u>Payment</u>	<u>Remainder</u>
1	\$10,000,000.00	\$500,000.00	\$1,022,129.10	\$9,477,870.90
2	\$9,477,870.90	\$473,893.55	\$1,022,129.10	\$8,929,635.35
3	\$8,929,635.35	\$446,481.77	\$1,022,129.10	\$8,353,988.02
4	\$8,353,988.02	\$417,699.40	\$1,022,129.10	\$7,749,558.32
5	\$7,749,558.32	\$387,477.92	\$1,022,129.10	\$7,114,907.14
6	\$7,114,907.14	\$355,745.36	\$1,022,129.10	\$6,448,523.40
7	\$6,448,523.40	\$322,426.17	\$1,022,129.10	\$5,748,820.47
8	\$5,748,820.47	\$287,441.02	\$1,022,129.10	\$5,014,132.39
9	\$5,014,132.39	\$250,706.62	\$1,022,129.10	\$4,242,709.91
10	\$4,242,709.91	\$212,135.50	\$1,022,129.10	\$3,432,716.31

CLAT Example #2

- Assets to CLAT
 - \$10 million
- Term of CLAT
 - 10 years
- Section 7520
 - 0.4%
- Growth of CLAT Assets**
 - 5%**
- Varying Annuity
 - Increases by 20% each year
- Taxable Remainder
 - \$0
- Total Assets to Charity
 - \$10,279,757
- Remaining Assets After Term
 - \$4,242,903

<u>Year</u>	<u>Beginning Principal</u>	<u>5.00% Growth</u>	<u>Payment</u>	<u>Remainder</u>
1	\$10,000,000.00	\$500,000.00	\$396,005.11	\$10,103,994.89
2	\$10,103,994.89	\$505,199.74	\$475,206.00	\$10,133,988.63
3	\$10,133,988.63	\$506,699.43	\$570,247.00	\$10,070,441.06
4	\$10,070,441.06	\$503,522.05	\$684,296.00	\$9,889,667.11
5	\$9,889,667.11	\$494,483.36	\$821,155.00	\$9,562,995.47
6	\$9,562,995.47	\$478,149.77	\$985,386.00	\$9,055,759.24
7	\$9,055,759.24	\$452,787.96	\$1,182,463.00	\$8,326,084.20
8	\$8,326,084.20	\$416,304.21	\$1,418,956.00	\$7,323,432.41
9	\$7,323,432.41	\$366,171.62	\$1,702,747.00	\$5,986,857.03
10	\$5,986,857.03	\$299,342.85	\$2,043,296.00	\$4,242,903.88

CLAT Example #3

	<u>Year</u>	<u>Beginning Principal</u>	<u>9.00% Growth</u>	<u>Payment</u>	<u>Remainder</u>
• Assets to CLAT					
• \$10 million	1	\$10,000,000.00	\$900,000.00	\$396,005.11	\$10,503,994.89
• Term of CLAT	2	\$10,503,994.89	\$945,359.54	\$475,206.00	\$10,974,148.43
• 10 years	3	\$10,974,148.43	\$987,673.36	\$570,247.00	\$11,391,574.79
• Section 7520	4	\$11,391,574.79	\$1,025,241.73	\$684,296.00	\$11,732,520.52
• 0.4%	5	\$11,732,520.52	\$1,055,926.85	\$821,155.00	\$11,967,292.37
• Growth of CLAT Assets*	6	\$11,967,292.37	\$1,077,056.31	\$985,386.00	\$12,058,962.68
• 9% (BREAK EVEN POINT)	7	\$12,058,962.68	\$1,085,306.64	\$1,182,463.00	\$11,961,806.32
• Varying Annuity	8	\$11,961,806.32	\$1,076,562.57	\$1,418,956.00	\$11,619,412.89
• Increases by 20% each year	9	\$11,619,412.89	\$1,045,747.16	\$1,702,747.00	\$10,962,413.05
• Taxable Remainder	10	\$10,962,413.05	\$986,617.17	\$2,043,296.00	\$9,905,734.22
• \$0					
• Total Assets to Charity					
• \$10,279,757					
• Remaining Assets After Term					
• \$9,905,734					

* If Section 7520 Rate is 3.00%, break even point is 10.75%

CLAT Example #4

- Assets to CLAT

- \$10 million

- Term of CLAT

- 20 years

- Section 7520

- 0.4%

- Growth of CLAT Assets**

- **5%**

- Annuity

- \$521,265

- Taxable Remainder

- \$0

- Total Assets to Charity

- \$10,425,300

- Remaining Assets After Term

- \$9,296,852

<u>Year</u>	<u>Beginning Principal</u>	<u>5.00% Growth</u>	<u>Payment</u>	<u>Remainder</u>
1	\$10,000,000.00	\$500,000.00	\$521,265.01	\$9,978,734.99
2	\$9,978,734.99	\$498,936.75	\$521,265.01	\$9,956,406.73
3	\$9,956,406.73	\$497,820.34	\$521,265.01	\$9,932,962.06
4	\$9,932,962.06	\$496,648.10	\$521,265.01	\$9,908,345.15
5	\$9,908,345.15	\$495,417.26	\$521,265.01	\$9,882,497.40
6	\$9,882,497.40	\$494,124.87	\$521,265.01	\$9,855,357.26
7	\$9,855,357.26	\$492,767.86	\$521,265.01	\$9,826,860.11
8	\$9,826,860.11	\$491,343.01	\$521,265.01	\$9,796,938.11
9	\$9,796,938.11	\$489,846.91	\$521,265.01	\$9,765,520.01
10	\$9,765,520.01	\$488,276.00	\$521,265.01	\$9,732,531.00
11	\$9,732,531.00	\$486,626.55	\$521,265.01	\$9,697,892.54
12	\$9,697,892.54	\$484,894.63	\$521,265.01	\$9,661,522.16
13	\$9,661,522.16	\$483,076.11	\$521,265.01	\$9,623,333.26
14	\$9,623,333.26	\$481,166.66	\$521,265.01	\$9,583,234.91
15	\$9,583,234.91	\$479,161.75	\$521,265.01	\$9,541,131.65
16	\$9,541,131.65	\$477,056.58	\$521,265.01	\$9,496,923.22
17	\$9,496,923.22	\$474,846.16	\$521,265.01	\$9,450,504.37
18	\$9,450,504.37	\$472,525.22	\$521,265.01	\$9,401,764.58
19	\$9,401,764.58	\$470,088.23	\$521,265.01	\$9,350,587.80
20	\$9,350,587.80	\$467,529.39	\$521,265.01	\$9,296,852.18

CLAT Example #5

- Assets to CLAT
 - \$10 million
- Term of CLAT
 - 20 years
- Section 7520
 - 0.4%
- Growth of CLAT Assets**
 - 5%**
- Varying Annuity
 - Increases by 20% each year
- Taxable Remainder
 - \$0
- Total Assets to Charity
 - \$10,638,232
- Remaining Assets After Term
 - \$12,976,746

<u>Year</u>	<u>Beginning Principal</u>	<u>5.00% Growth</u>	<u>Payment</u>	<u>Remainder</u>
1	\$10,000,000.00	\$500,000.00	\$56,983.86	\$10,443,016.14
2	\$10,443,016.14	\$522,150.81	\$68,381.00	\$10,896,785.95
3	\$10,896,785.95	\$544,839.30	\$82,057.00	\$11,359,568.25
4	\$11,359,568.25	\$567,978.41	\$98,468.00	\$11,829,078.66
5	\$11,829,078.66	\$591,453.93	\$118,162.00	\$12,302,370.59
6	\$12,302,370.59	\$615,118.53	\$141,794.00	\$12,775,695.12
7	\$12,775,695.12	\$638,784.76	\$170,153.00	\$13,244,326.88
8	\$13,244,326.88	\$662,216.34	\$204,184.00	\$13,702,359.22
9	\$13,702,359.22	\$685,117.96	\$245,021.00	\$14,142,456.18
10	\$14,142,456.18	\$707,122.81	\$294,025.00	\$14,555,553.99
11	\$14,555,553.99	\$727,777.70	\$352,830.00	\$14,930,501.69
12	\$14,930,501.69	\$746,525.08	\$423,396.00	\$15,253,630.77
13	\$15,253,630.77	\$762,681.54	\$508,075.00	\$15,508,237.31
14	\$15,508,237.31	\$775,411.87	\$609,690.00	\$15,673,959.18
15	\$15,673,959.18	\$783,697.96	\$731,628.00	\$15,726,029.14
16	\$15,726,029.14	\$786,301.46	\$877,954.00	\$15,634,376.60
17	\$15,634,376.60	\$781,718.83	\$1,053,545.00	\$15,362,550.43
18	\$15,362,550.43	\$768,127.52	\$1,264,254.00	\$14,866,423.95
19	\$14,866,423.95	\$743,321.20	\$1,517,105.00	\$14,092,640.15
20	\$14,092,640.15	\$704,632.01	\$1,820,526.00	\$12,976,746.16

CLAT Example #6

- Assets to CLAT
 - \$10 million

- Term of CLAT
 - 20 years

- Section 7520
 - 0.4%

- Growth of CLAT Assets***

- 4.25% (BREAK EVEN POINT)**

- Varying Annuity

- Increases by 20% each year

- Taxable Remainder

- \$0

- Total Assets to Charity

- \$10,638,232

- Remaining Assets After Term

- \$9,950,147

Year	Beginning Principal	4.25% Growth	Payment	Remainder
1	\$10,000,000.00	\$425,000.00	\$56,983.86	\$10,368,016.14
2	\$10,368,016.14	\$440,640.69	\$68,381.00	\$10,740,275.83
3	\$10,740,275.83	\$456,461.72	\$82,057.00	\$11,114,680.55
4	\$11,114,680.55	\$472,373.92	\$98,468.00	\$11,488,586.47
5	\$11,488,586.47	\$488,264.92	\$118,162.00	\$11,858,689.39
6	\$11,858,689.39	\$503,994.30	\$141,794.00	\$12,220,889.69
7	\$12,220,889.69	\$519,387.81	\$170,153.00	\$12,570,124.50
8	\$12,570,124.50	\$534,230.29	\$204,184.00	\$12,900,170.79
9	\$12,900,170.79	\$548,257.26	\$245,021.00	\$13,203,407.05
10	\$13,203,407.05	\$561,144.80	\$294,025.00	\$13,470,526.85
11	\$13,470,526.85	\$572,497.39	\$352,830.00	\$13,690,194.24
12	\$13,690,194.24	\$581,833.26	\$423,396.00	\$13,848,631.50
13	\$13,848,631.50	\$588,566.84	\$508,075.00	\$13,929,123.34
14	\$13,929,123.34	\$591,987.74	\$609,690.00	\$13,911,421.08
15	\$13,911,421.08	\$591,235.40	\$731,628.00	\$13,771,028.48
16	\$13,771,028.48	\$585,268.71	\$877,954.00	\$13,478,343.19
17	\$13,478,343.19	\$572,829.59	\$1,053,545.00	\$12,997,627.78
18	\$12,997,627.78	\$552,399.18	\$1,264,254.00	\$12,285,772.96
19	\$12,285,772.96	\$522,145.35	\$1,517,105.00	\$11,290,813.31
20	\$11,290,813.31	\$479,859.57	\$1,820,526.00	\$9,950,146.88

* If Section 7520 Rate is 3.00%, break even point is 6.00%

The CARES Act 2020

- Individual AGI limit lifted
- Limit was 60%, now 100%
- Only gifts to public charities (not private foundations or DAFs)

Sale of GST Non-Exempt Trust Assets

- Family had non-exempt (GST) trust.
- Assets have grown.
- Sell those assets to new trust.
- Use AFR
 - Short-term AFR = 0.14%
 - Mid-term AFR = 0.38%
 - Long-term AFR = 1.12%



Help is on the way...

- Old GRAT
- Flawed life insurance trust
- Depressed assets
- Increased GST exemption

Solution = Late GST allocation!

Election 2020

Trump:

- The Trump fiscal year 2021 budget would extend 2017 TCJA provisions past 2025 (\$10M exemption adjusted for inflation).

ELECTION 2020 

Biden:

- “The wealthy and corporations pay their fair share, and provide tax relief for working families.”
- Biden has mentioned eliminating the stepped-up basis rule that “allows individuals to pass capital gains to heirs without tax after death.”
- Biden has opposed the 2017 TCJA.

Elimination of Basis Adjustment

- I.R.C. § 1014 generally provides that the basis of property in the hands of a person acquiring the property from a decedent or to whom the property passed from a decedent (by bequest, devise or inheritance) shall, if not sold, exchanged, or otherwise disposed of before the decedent's death by such person, be the fair market value of the property at the date of the decedent's death.
- How would an elimination of a basis adjustment work?

Potential Changes to Wealth Transfer Taxes

Potential changes to the wealth transfer tax system, particularly if Democrats win control of both the Senate and the House:

- Lowering the estate tax exemption
- Lowering the gift tax exemption
- Modification of rates

Additional Potential Changes to Wealth Transfer Taxes

More dramatic changes to the wealth transfer tax system and trusts generally:

- Elimination or reduction of certain valuation discounts
- Mandatory term for grantor retained annuity trusts
- Certain treatment of grantor trusts
- Elimination of GST exemption on long-term trusts
- Limitations on ability to make annual exclusion gifts

Coronavirus (COVID-19) Resource Center

The screenshot shows the BakerHostetler website's Coronavirus (COVID-19) Resource Center. The navigation bar includes links for Services, Professionals, About Us, Offices, Resources, Diversity, Careers, and Alumni, along with a search function. The main heading is "Coronavirus (COVID-19) Resource Center".

Overview

Professionals

News

Publications

Blog Posts

Events

Related Services

- Bankruptcy and Restructuring
- Business and Corporate
- Digital Assets and Data Management
- Digital Transformation and Data Economy
- E-Discovery Advocacy and Management
- Employee Benefits
- Energy Industry
- FDA, Products Promotion, and Defense
- Healthcare
- Intellectual Property
- International Arbitration and Litigation
- Labor and Employment
- Litigation
- Pharmacy and Reimbursement

This Resource Center provides guidance and addresses questions about legal and business concerns arising from the Coronavirus (COVID-19).

A cross-disciplinary team of BakerHostetler attorneys publish useful information about the fast-changing environment and about actions businesses may, or must, lawfully take to address a number of issues to protect employees and business operations.

We are committed to providing companies with consistent, frequent and transparent communication regarding COVID-19.

Should you have any questions, please feel free to contact any of our attorneys to help navigate you through this global medical crisis.

Return-to-Work Toolkit

- **NEW** - [Reopening Your Doors: BakerHostetler's Return-to-Work Toolkit](#)

The CARES Act

- [May 5, 2020 - PPP Borrowers Should Take Steps To Document Their Borrowings, Use of Funds and Related Transactions](#)
- [May 4, 2020 - IRS Clarifies Availability of Employee Retention Tax Credit](#)
- [May 4, 2020 - No Deduction Allowed for Expenses Resulting in PPP Forgiveness](#)

Prior Communications: April | March

CARES Act SWAT Team

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In The Blogs

DISCOVERY ADVOCATE
Adapting E-Discovery Workflows to a Remote Work Environment
By May Tal Gongolevsky, Edward J. Jacobs, Victoria M. Rutherford, Joshua A. Satter
May 21, 2020
As courts and filiants adapt to the

<https://www.bakerlaw.com/Coronavirus-COVID-19>

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