Wealth Planning **Update**

The time for estate planning is now

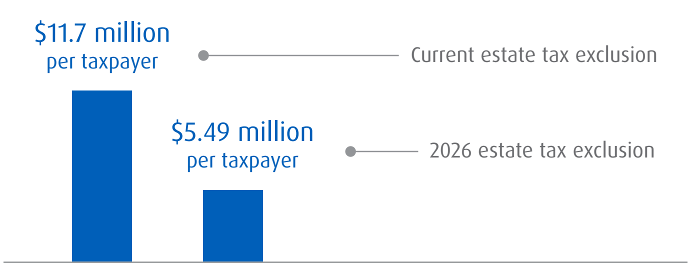
Planning is important in any environment. When done correctly, you may be able to both minimize transfer taxes while exerting control over your legacy assets. But the environment in which you execute your plan is just as critical because it determines both the manner in which you pass assets and the amount you're able to shield from taxation.

Today's environment is perfect for high net worth individuals and families to maximize flexibility, minimize taxation, and execute their desired plan. But given the current economic and political climate, the outsized benefits available today may not be available tomorrow. That is why it is critical to execute your plan now.

Estate tax

Estate tax is a tax the government collects on the value portion of a person's assets above a certain exemption amount when that person passes away. Currently that exclusion amount is $11.7 million per taxpayer, or $23.4 million per couple. Unfortunately, at the end of 2025 a number of tax benefits contained in the *Tax Cuts and Jobs Act of 2017* are scheduled to sunset, including this increased exemption. At that time, the exemption will fall back to an inflation-adjusted $5.49 million, the amount it was in 2017.

While legislation has not yet been drafted, President Biden's recently announced *Jobs Plan* and *American Families Plan* provide a high-level list of proposed policy changes—many of which would result in higher tax liabilities for high net worth families. For example, the plans propose to eliminate the "step-up" in basis of transferred assets, which could result in an immediate capital gains tax on appreciated assets at death.



The good news is that the estate planning you do now should hold up over time. The Internal Revenue Service has been reluctant to "claw back" money from estates that took planning steps prior to future tax laws. But please note, if you don't use the full exemption and the threshold is reduced, there won't be retroactive opportunities to take advantage of these generous exemption amounts.

Gifting vs. selling strategies

We can achieve estate planning objectives through a variety of sometimes complex, but very well-established trust strategies. But in order to move the asset into a trust, we have two options: gifting and selling. Gifting is a sound strategy for estates under the exemption amount. But for larger estates or those looking for flexibility in their plan, selling offers a number of great opportunities.

One obvious strategy planners are quick to utilize today is to lock-in the increased gifting allowances described above before they expire. For estates larger than the exemption amount, today's historically low interest rates also offer significant additional opportunities to minimize the estate tax.

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Today's low interest rates allow us to implement selling strategies that result in lower estate taxes. For example, we might recommend transferring an appreciating asset, such as a business, to a family member through a grantor retained annuity trust (GRAT). In order to execute the GRAT, once an asset is transferred into the trust, the grantor receives payments from the trust for a certain number of years. The amount of these annual payments is based on the 7520 rate set by the IRS. As of June 2021, the rate was just 1.2%. Meaning, any appreciation of the underlying assets over 1.2% passes to the next generation free of the estate tax."

At the end of the term, any assets that remain in the trust pass to the beneficiary. If the grantor outlives the trust, any amount within the GRAT is excluded from the estate.

Valuation discounts

Another tax minimizing strategy available today is valuation discounts, which can artificially reduce the value of an asset for transfer purposes.

Assume that a husband and wife owns real estate that is worth $100 million. Gifting it outright would subject the vast majority of the asset to estate and gift tax. Instead, under current law, the couple may choose to use a family limited partnership (FLP) to recapitalize their asset into 10 general partner voting shares and 90 limited partner non-voting. The underlying asset is worth the same but the non-voting shares don't have the same value as voting shares due to their lack of marketability and control.

A valuation expert can determine how much of a discount the non-voting shares should have, but for the sake of argument, let's assume a 30% discount, meaning 90% of the real estate can be transferred for a value of $73 million, not $90 million. At the current 40% federal estate tax rate, that $17 million reduction in valuation saved the couple $6.8 million in federal transfer taxes.*

In this case, gifters retain control of the entity and assets, while also transferring the future value of the asset to the next generation.

Valuation discounts are one area we continue to watch for legislative action. We worry that it may not survive future tax reform, so taxpayers who want to employ this strategy should do so sooner rather than later.

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*For illustration purposes only.

No time like the present

Naturally, estate taxation is affected by shifts in the government and political landscape. The amount of value in an estate that avoids the estate tax is a constant source of policy discussions and changes can have significant financial implications. The estate tax rate itself can and does change, and each state has a different approach to how it taxes an individual's wealth upon death. Other factors, such as the step-up in basis to market value on the date of death that estates now benefit from, are also subject to change.

While the forces that push and pull on the taxation of estates are as unpredictable and varied as anything in politics, what we can control is our ability to act. A high debt, low tax, high exemption, low interest rate environment is highly unusual and historically not sustainable; but it does offer planners a plethora of options to meet your needs.

On a more personal level, having a plan can create a feeling of security for next of kin and harmony for everyone in the family. Parameters can be placed on the use of inherited wealth, and it works out best when everyone understands the need for those parameters, or at the very least has a chance to hear the rationale behind them. Family communication is perhaps the most important element of good financial planning. The favorable conditions that exist today for estate planning, the potential changes that could be imminent, and the massive benefits of proper planning have created an environment where planning is necessary, rewarding, and worth exploring. Communication and the need for careful, well-reasoned forethought are just as relevant in successful estate planning as they are in any other area of life. The time is now to start learning how you, your heirs, and your legacy can benefit from a well-crafted estate plan.

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