



## Trusts and Estates Legal Update



SUMMER 2019

To Our Clients and Friends -

As we enter the summer season, we extend our best wishes for your safety and security during these unsettling times. And with the national elections less than four months away, we want to take this opportunity to offer our perspective on certain timely planning opportunities available as well as some warning flags on the horizon.

### Temporarily High Transfer Tax Exclusions and GST Exemption and Possible Reduction By or Before 2026

As you are no doubt aware there are currently two historically high transfer tax exemptions, one which applies to the estate and gift tax as transfers are made and then, if any is not used on lifetime gifts, on death, with any left over transferable to a surviving spouse (now known as the “basic exclusion amount” or “BEA”) and the other which applies to the GST tax and which is allocated to transfers at the discretion of the donor. However, even those individuals whose estates are well below the current high levels (\$11.58 million per person), may have reason for concern.

- The BEA is scheduled to be reduced to an inflation adjusted \$5 million in 2026 and there has been some speculation that the scheduled roll-back may be accelerated to help pay for the billions spent on Covid-19 relief over the past few months. Of course, it is also possible the reduction will be eliminated but we believe that is less likely than in the past.
- Based on current proposals, if the fall elections see the Democrats gain control of both houses of Congress and the Presidency, it is conceivable that the BEA and the GST exemption could be reduced to \$3.5 million per person effective as early as January 1, 2021.

We recommend clients consider making gifts now to lock in the benefit of current high BEA and GST exemption, or at a minimum having a plan so that they are prepared to do so on short notice. Methods for accomplishing these goals range from simple to quite sophisticated, and from less to more tax-efficient. We are happy to discuss the approaches most appropriate for your specific situation. We highlight some of the numerous opportunities below.

### **Locking in the Current Exemptions**

In final regulations issued last November, the IRS made clear what would have to be done to lock-in the current high exemption levels in light of the reduction in 2026. We expect that the same rules would apply if the reduction is accelerated or increased.

- If an individual uses his or her \$11.58 million available exclusions by making lifetime taxable gifts before any reduction and dies after the BEA is reduced, the earlier use of the larger exemption will not be “clawed back,” meaning that no additional tax will be due in the taxpayer’s estate with respect to the earlier gifts in excess of the exemption available at death (“the excess exemption”).
- On the other hand, if the only exemption used before the BEA is reduced is equal to or less than the BEA in existence at death, the fact that a higher BEA was in effect at the time of the gifts will not benefit the donor in any way. In other words, the only way to lock in any portion of the excess exemption is to use not only an amount equal to it but also the portion of the exemption that turns out to be in effect at death. There is simply no option to use only the top excess exemption before the law changes.
- The regulations also provide that using your full BEA now means you will have no benefit from post 2025 inflation adjustments until the post 2025 BEA exceeds the BEA used prior to 2026.
- In the case of a taxpayer whose has “carry-over” exemption from a deceased spouse (technically known as “DSUE” for “deceased spousal unused exclusion”), that DSUE must be used first, before a taxpayer’s BEA, but this will not be reduced in 2026.

### **Opportunistic Valuations**

In the case of assets with values that are believed to be temporarily depressed due to the current economic environment, such seemingly low values present opportunities for outright gifting and other wealth transfer strategies.

## Interest Rate Opportunities

We also encourage clients, particularly those who have already used the bulk of their full current BEA, to think about wealth transfers that involve very small taxable gifts or no use of exclusion at all. The IRS assumed rate for valuing certain gifts in trust, the section 7520 rate, is at an all time low of 0.4% in August 2020. The applicable federal rates (AFR's) for intra-family loans are also at historical lows.

<b>August Section 7520 Rate = 0.4%</b>	
<b>August AFRs are as follows</b>	<b>Annual, Semi-annual, Quarterly and Monthly</b>
Short-term (not over 3 years)	.17%
Mid-term (over 3 years but not over 9 years))	.41%
Long-term (over 9 years)	1.12%

### Attractive Loan Options

This means that a taxpayer can lend a family member funds for up to 3 years charging only .17% interest, and even a 30-year loan can be at the rate of 1.12%. If the family believes that the borrower will be able to invest the borrowed funds to earn considerably more than the interest due, this is an attractive estate planning option. There may also be opportunities for parents to provide loans to children or other beneficiaries to refinance more expensive third-party debt.

### Estate Freeze Transfers

Similarly, there may be an opportunity to freeze the value of an appreciating asset by selling it in exchange for a note at the AFR.

### Grantor Retained Annuity Trust ("GRAT")

Assets contributed to a GRAT in August need only outperform the 0.4% section 7520 rate to result in a wealth transfer. This rate creates tremendous opportunities, especially combined with potentially depreciated asset values.

## **GST Exemption Allocation**

Keep in mind that the current high GST exemption can be allocated not only to 2019 and 2020 gifts, but also to trusts you may have created prior to 2019 that are not otherwise exempt from generation-skipping transfer tax you may have created prior to 2019. With regard to reporting 2019 gifts, consider whether the value of the property has decreased since the date of the gift. If so, you may have the option to make a late allocation of GST exemption at the lower value. Note, however, that a timely gift tax return to report the gift still should be filed and if the gift qualifies for the automatic allocation of GST exemption, an election to not have that allocation apply must be made. Note also that the rules for locking in the higher GST exemption are similar to those for the BEA. You have to use the excess amount in order to not lose it when or if the exemption is reduced.

## **Other Considerations**

- We want to remind you that the SECURE ACT, which became law at the end of 2019, as discussed in our recent Client Alert, makes it imperative to review your beneficiary designations on all IRAs and 401(k)s.
- Decisions whether to make current gifts should factor in the loss of a step-up in basis for the transferred asset at the donor's death in most cases.
- Finally, remember that IRS Notices 2020-18, 2020-20, 2020-23 and 2020-66 extended federal tax filings and payments that would have been due between April 1 and July 1 were extended to July 15. If you have filed an extension using Form 4768 or 8892, your extension due date continues to be October 15, 2020, at least pending further guidance.

## Kathryn H. Crary Elected to Partnership

We are pleased to announce the election of counsel Kathryn H. Crary to the partnership as of July 1, 2020. “We are proud to welcome such a talented lawyer who has demonstrated commitment to delivering superior service to our clients through her deep legal expertise and teamwork with firm colleagues. The firm looks forward to continue working with Kate in the years ahead,” stated Christopher H. Gadsden, one of three founding partners of Gadsden Schneider & Woodward LLP.

Kate’s practice focuses on sophisticated estate planning for high net worth individuals, charitable planning, estate and trust administration, and Orphans’ Court litigation, including guardianships. Kate also has significant experience in the creation and management of nonprofit organizations. She was named a Pennsylvania Super Lawyer® for 2020, and a Pennsylvania Super Lawyer® “Rising Star” for 2016.

Kate is the current Vice Chair of the Philadelphia Bar Association’s Probate and Trust Law Section and a Vice Chair of the Charitable Planning Committee of the American Bar Association’s Real Property Trust and Estate Law Section. She is also a member of the Pennsylvania Bar Association. Kate is a recent presenter for the Pennsylvania Bar Institute and the National Business Institute. She also serves on the Board of Directors of Darlington Arts Center in Garnet Valley, PA.

Kate began her legal career as a judicial law clerk for the Honorable Paul S. Diamond in the United States District Court for the Eastern District of Pennsylvania. She received her J.D., *magna cum laude*, and her LL.M. in Taxation from Temple University Beasley School of Law and her A.B., with distinction, from Cornell University. Prior to joining the firm, Kate practiced at Saul Ewing LLP and Cozen O’Connor in Philadelphia.



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## Gadsden Schneider & Woodward LLP

Please refer to our website [www.gsw-llp.com](http://www.gsw-llp.com) for information about the firm and our attorneys, directions to the office, and copies of this and prior years' newsletters.

### Our Team

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### Experience and Extraordinary Expertise

Gadsden Schneider & Woodward LLP combines the sophisticated legal skills of a national or global law firm with the intimacy, informality and attentiveness to client needs that is characteristic of smaller firms. Contact us for all of your estate planning, trust and estate administration, trust and estate litigation, charitable gift planning and related areas of tax and fiduciary matters.



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