Personal Planning Strategies

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By Andrew M. Katzenstein and Henry J. Leibowitz

The Personal Planning Strategies Newsletter provides articles addressing the latest statutory changes and developments affecting retirement, estate, insurance and tax planning, as well as cutting-edge corporate, real estate and tax concepts.

With over a century of combined experience, the lawyers of Proskauer's Private Client Services Department regularly provide their diverse clientele – from business entrepreneurs and corporate executives to sports figures and performing artists – with their Personal Planning Strategies Newsletter, a critical source of information which identifies significant issues of interest to Proskauer's clients.

Clients and Friends:

We at Proskauer wish you health and safety during these tumultuous times. It is our hope that you are handling this new reality with as much normalcy as is possible.

Our Private Client Services Department is working remotely and able to assist with any of your estate planning needs. We are also available to discuss unique estate planning considerations due to the impact of COVID-19.

We are sending you this communication so that we can share with you some of our thoughts:

Estate Planning Documents

We are hearing from our clients that they want to modify their estate plans and amend their wills and trusts. Each state has special rules as to how this can be accomplished, and we are able (in most cases) to arrange for those changes to be made.

Please contact any of us and we can help you through that process.

Estate Planning Considerations

Gifts Using Zero-Out GRATs

The primary focus of estate planning is to transfer assets when they are not worth a lot, so that when they become worth a lot there is no 40% transfer tax imposed on the transfer of those assets by gift.

The significant pullback in the stock market allows the transfer of assets. Assume a person owned 1,000 shares of stock worth $100,000. Due to the market tumble, those 1,000 shares are now worth $60,000. Giving those shares to trusts for the children, now, is an opportunity to avoid a 40% tax on the $40,000 of lost value – assuming that the value eventually comes back.

Though we all hope values will return, we cannot know if that will occur or when it will occur. Therefore, making a gift of those 1,000 shares worth $60,000 will use up $60,000 of the transferor's lifetime exemption against state or gift tax. Assuming that the value recovers to $100,000, that is a good use of that lifetime exemption. If the value does not recover – say the company goes out of business – that is $60,000 of exemption wasted.

Using a zero-out GRAT can provide the estate planning opportunity without wasting the lifetime exemption. With this technique, the transferor gives the 1,000 shares worth $60,000 to a 2-year GRAT, retaining for him or herself a $30,000 payment in year one and a $30,000 payment in year two. The value of the $60,000 gift is reduced by the value of the two payments the transferor retained – 2 x $30,000 = $60,000. (To make this example easier to understand, interest has been ignored.) Therefore, the value of the gift is $60,000 - $60,000 = $0. *No lifetime exemption is used*.

If the stock recovers its $100,000 value by the end of the first year and before the first payment is due, the transferor will receive 300 shares for the first year payment, and (assuming values remain constant) 300 shares for the second year payment. After the second payment is made, the 400 shares remaining ($40,000) pass to the transferor's children without the imposition of the 40% gift tax. The plan worked.

On the other hand, if the company goes out of business, the transferor will receive all the shares back in payment but nothing will pass to the children. The plan was not successful in transferring appreciation to the children without gift tax. *But, no lifetime exemption was wasted in the attempt*. A zero-out GRAT is a "no harm, no foul" technique.

It makes sense for clients to establish zero-out GRATs now, when the market is down. We are available to assist. For a more detailed analysis of GRATs, please see our recent client alert devoted soley to GRATs that can be retrieved at this link.

Save Failed GRATs

Clients who set up GRATs in the last year are likely now looking at "failed GRATs" – GRATs with assets that are unlikely to appreciate in value from the date of contribution to the GRATs. In the example above, if the clients contributed shares worth $100,000 and now the shares are worth only $60,000, the clients would love to have those shares back in hand to transfer them to new zero-out GRATs that had a chance to succeed.

This can be accomplished if the clients simply purchases those shares back from the GRAT in exchange for cash. There is no gain or loss on the sale of those shares back to the clients because the GRAT is a "grantor trust" and ignored for income tax purposes. The clients can then re-GRAT those shares to new zero-out GRATs.

When the failed GRATs have to make the annual payments to the clients, the trustees of the failed GRATs will simply make those payments in cash. In the meantime, the re-GRATed shares have an opportunity to transfer appreciation without transfer tax cost.

Renegotiate Outstanding Promissory Notes

Many people have sold assets to grantor trusts in exchange for promissory notes in an attempt to transfer appreciation to children (or trusts for their benefit). Those "IDIT" sale promissory notes charge the applicable federal rate ("AFR") – the least amount of interest that can be charged without the IRS treating the lender as having made a gift of forgone interest. In an IDIT sale transaction, the appreciation that passes to children (or trusts for their benefit) is the value that the asset sold increases in excess of the AFR (the AFR is effectively the "hurdle rate").

As the Federal Reserve drops interest rates, the AFR plummets. That means that promissory notes outstanding to IDITs can now be renegotiated down – reducing the hurdle rate and increasing the amount that can be transferred without the imposition of gift tax.

For a more detailed analysis of estate planning using promissory notes, please see our recent client alert devoted soley to promissory notes that can be retrieved at this link.

Tax Filing Extensions

The IRS has announced that individuals and corporations now have until July 15 to file their income tax returns and to make tax payments. The time for making first-quarter estimates has been similarly extended. These rules apply to income tax returns for trusts and estates as well.

California has adopted similar rules. New York has not – to date – but these things change almost on a day-to-day basis. Please contact us if you have questions.

The IRS has not specifically addressed the due date for filing gift tax returns or paying gift tax. Though the time for filing a gift tax return is automatically extended when a taxpayer extends the filing date for his or her income tax return, it is not entirely clear whether the moving of the due date for filing income tax returns automatically moves the date for filing gift tax returns. And since the extension of time to pay tax under recent

legislation applies to “income” taxes, at least for the moment it does not look like gift taxes can be paid later.

The IRS has also not specifically addressed the due date for filing estate tax returns. At the moment, it appears as if legislation passed to date has not impacted the due dates for filing estate tax returns or paying estate tax.

We will work to keep you updated if these rules change.

Funding Revocable (Living) Trusts

Many clients have created revocable living trusts and “pour over” wills. In California, where the probate process is especially burdensome, a good portion of those trusts have been funded in order to avoid probate. In other states, like New York and Florida, because probate is not a burdensome process those trusts may not have been funded.

Probate proceeds through the probate court also known as the Surrogate’s Court in some jurisdictions like New York. When courts are closed, it is unclear if there was a death whether a court would be available to make funds available to a surviving spouse or other heirs.

Revocable trusts do not require court supervision. Therefore, if there is a death, surviving spouses and other heirs will have access to funds to provide for their daily needs if those funds are part of a revocable trust before that death occurs. For this reason, we recommend that people fund their revocable trusts now.

Even with stay at home orders, banks have been working with our clients to re-title accounts into trust name. We are available to help.

Please let us know if you are interested in pursuing any of the ideas set forth above. We are all sitting at our computers and by our cell phones (at home) ready to assist.

Stay safe everyone!

The Private Client Services Department at Proskauer is one of the largest private wealth management teams in the country and works with high-net-worth individuals and families to design customized estate and wealth transfer plans, and with individuals and institutions to assist in the administration of trusts and estates.

If you have any questions regarding the matters discussed in this newsletter, please contact any of the lawyers listed below:

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