The Jaffe Update
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THE ECONOMIC EFFECTS OF THE COVID-19 PANDEMIC CREATE WEALTH TRANSFER PLANNING OPPORTUNITIES

The COVID-19 pandemic has had an unprecedented economic impact on Americans, including a substantial decline in investment stock portfolios and historically low interest rates. However, amidst the stock market turmoil and as a result of the low interest rate environment, planning opportunities exist for transferring greater wealth and future appreciation of assets from one generation to another.

What follows is an explanation of a few planning opportunities. Please note that in an effort to outline examples of these planning opportunities in simple and concise terms, we are not including numerous technical requirements; therefore, these techniques should not be undertaken without consulting a member of Jaffe's estate planning group.

GRANTOR RETAINED ANNUITY TRUSTS

Grantor retained annuity trusts (GRATs) work well with low interest rates and assets that are anticipated to appreciate in the short term. The parent creates, and contributes assets to, an irrevocable trust providing for payment of an annual annuity to the parent for a specified term such as 2 years. The annuity amount is structured so that over the annuity term, the parent will receive back the total value of the assets originally contributed plus an assumed growth factor (Section 7520 rate) dictated by the IRS. In a low interest rate environment, the Section 7520 rate is also low (1.2% for April 2020). If the assets in the trust appreciate at a greater rate than the Section 7520 rate during the specified annuity term, the entire excess passes to the trust remaindermen (children) following the annuity term, with no transfer taxes. The low Section 7520 rate coupled with extremely low investment portfolios make GRATs an extremely effective way to transfer wealth.

CHARITABLE LEAD ANNUITY TRUSTS

Charitable lead annuity trusts (CLATs) also work well in low interest rate environments, permitting you to benefit charities, receive an income tax deduction for up to the entire amount contributed to the CLAT, and efficiently transfer wealth to your children. Like the GRAT, a parent creates, and contributes assets to, an irrevocable trust that provides for payment of an annual annuity for a specified term (we typically recommend a term between 10 - 20 years); however, the annuity here is paid to a charity rather than back to the grantor. The annuity amount is structured so that over the specified term, the charity will receive the total value of the assets originally contributed plus an assumed growth factor dictated by the IRS (again, the Section 7520 rate - 1.2% for April 2020). If the assets in the trust appreciate at a greater rate than the Section 7520 rate, the entire excess passes to the trust remaindermen (children) following the annuity term, with no transfer taxes. This technique provides an opportunity for someone who is looking to benefit a charity, fund a family foundation, or fund a donor advised fund to also transfer wealth to family members should their investment portfolio have increased in value by the time the specified annuity period has ended.

LOW INTEREST RATE LOANS TO FAMILY ENTITIES

Another transaction that works well in low interest rate environments is a simple low interest rate loan from parent to children. Parent loans funds to a family partnership or limited liability company which is owned and managed by the children. The entity invests the loan proceeds in marketable securities or other investments at the children's direction. To the extent that the entity realizes a greater return on its investments than the debt service due to the parent, that excess inures to the benefit of the children who are owners in the entity. Loans with a maturity date of between 3 years and 9 years bear interest at the mid-term AFR (0.99% for loans made in April 2020). Extremely low interest rates make it very affordable and attractive for parents to loan money to their children. Loans between family members (or their related entities) should be documented with a promissory note and should require at a minimum that interest be paid annually by the borrower to the lender. If the entity is newly created for this purpose, the children need to either make an initial capital contribution to the entity (which can be funded through gifts from the parent) or, if they are sufficiently creditworthy, they can guarantee repayment of the entity's loan to the parent.

REFINANCING LOANS TO FAMILY ENTITIES OR FAMILY MEMBERS

If a parent has previously made a loan to a family partnership, limited liability company, or to a family member as described above, now may be the time to refinance this existing loan to take advantage of lower interest rates. Refinancing of an existing loan should not cause any negative tax implications to either the lender or borrower if the original loan provides for penalty free prepayments by the borrower at any time, the lender has a full tax basis in the loan balance and the payment terms have and are continued to be adhered to.

Questions? Contact a member of the Estate Planning Group.

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