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LEGAL UPDATES

Estate Planning During a Pandemic

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Dear Clients & Friends

We hope you are well and safe during this stressful time that is challenging both personally and professionally for many. As you continue to deal with the personal and legal implications of this crisis, Hopkins & Carley is here to help. We continue to be available to answer your questions and meet with you via telephone, video conference, or through email exchange.

Three factors existing at this moment combine to create an historic opportunity to transfer wealth to your family and other beneficiaries. These factors are:

- **Historically low interest rates.** The IRS uses federal interest rates to value certain gift transfers and to determine the correct interest rate to use when making a loan to family members. These federal rates have steadily been decreasing the past few months, and in May 2020 they will be at an all-time low.
- **Depressed asset values.** The fact that current asset values are temporarily depressed presents an opportunity to shift substantial wealth to your family and other designated beneficiaries at a much lower gift tax value.
- **Historically high gift and estate tax exemption amounts.** The current \$11.58 million dollar gift, estate and generation-skipping transfer tax exemption amount per individual is at an all-time high, and is not scheduled to revert to prior levels of approximately one-half that amount until January, 2026 (the "Sunset Date"). However, because the political climate in Washington is extremely uncertain, and because the federal government has spent, and continues to spend, so much with respect to the COVID-19 crisis, there is a very real risk that the Sunset Date could be moved up to as early as January, 2021.

All three of these factors are time-sensitive. Accordingly, the time to implement one or more estate planning tools is now. The most impactful of these tools are:

- **Grantor Retained Annuity Trust ("GRAT").** A GRAT is an irrevocable trust designed to last a certain number of years, in which the grantor (donor) retains

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the right to receive back the contributed assets over the term of the GRAT, plus a “hurdle rate” that is calculated using the applicable federal interest rate. The hurdle rate for May, 2020 is 0.8%, which means that for a GRAT that you establish and fund in May, 2020, any appreciation in the contributed assets greater than 0.8% a year for the term of the GRAT will pass gift and estate tax free to your designated remainder beneficiaries. Note that you must survive the term of the GRAT in order for this planning to be successful.

- **Installment sale to defective grantor trust.** A way to avoid the mortality risk and hurdle rate of a GRAT is to sell assets to an irrevocable trust for the benefit of your designated beneficiaries. The trust is designed to be a “grantor trust” which means that for income tax purposes, it will be taxed to you. As a result, there is no capital gains tax recognition on the sale of assets by you to the trust. The sale is usually done using a promissory note with interest at the appropriate federal rate based on the term of the note. For example, in May, 2020, the applicable interest rate for a “short-term” (less than 3-years) note is an all-time low of 0.25%, while the applicable interest rate for a “mid-term” (less than 9-years) note is an all-time low of 0.58%. The applicable interest rate for “long-term” notes (longer than 9 years) is 1.15%. There are both advantages and disadvantages to using this estate-planning tool as opposed to a GRAT, all depending on your specific situation and wishes, and it may be wise to use a combination of both tools.
- **Intra-family loans.** You may merely wish to take advantage of these low federal rates by making a direct loan to a beneficiary. The loan must be evidenced by a promissory note that is usually secured (for example, if cash was loaned to enable your beneficiary to purchase a residence, then the residence would be used to secure the loan). Additionally, if you have already made an intra-family loan to a beneficiary, you and your beneficiary may wish to renegotiate the loan and have the interest rate be lowered to the current applicable federal rate. In order for such a renegotiation to be respected by the IRS, some other aspect of the note (its term, the payment schedule, etc.) must be slightly adjusted in your favor as the lender.
- **Charitable lead trusts.** A charitable lead trust is an irrevocable trust that is somewhat similar to a GRAT, except that the recipient for the initial term of years is one or more charitable organizations, rather than yourself. If the contributed assets can appreciate more than the hurdle rate (0.8% in May, 2020), then the excess appreciation will pass relatively free from gift and estate tax to your designated non-charitable beneficiaries. You should always have charitable intentions when using an estate planning tool involving a transfer of assets to one or more charitable organizations.
- **Family limited partnerships and Family LLCs.** Most of the foregoing tools can be made using a limited partnership interest in a limited partnership or a membership interest in a limited liability company (LLC) that you have already established and funded. When valuing a limited partnership or LLC interest that you wish to transfer to your beneficiary, that interest is generally eligible for valuation adjustments for lack of marketability and/or lack of control over the operation of the entity. Valuation experts have informed us that, due to the current volatility of the world markets, valuation discounts are significantly higher than what is typically seen.

We remain committed to supporting our clients and providing excellent client service and practical advice during this difficult time. Our Private Client Services group is engaged and available to assist you with any services that you may need during these difficult times. Above all, we wish health and safety to you, your families, and your colleagues.