IPB Tax, Trusts & Estates

NEWSLETTER

Planning Ideas for Challenging Times

March 2020

These past few weeks have been tough. But not all the news is bad. The recent market crash has given you the opportunity, at least from a wealth transfer perspective, to realize some potential benefits during the current climate of uncertainty.

1. Take advantage of low interest rates

The IRS recently released the new long-term applicable federal rates (AFR) in Revenue Ruling 2020-9:

- Section 7520 rate: 1.2%;
- Short-term AFR rate, monthly compounding: 0.91%;
- Mid-term AFR rate, monthly compounding: 0.99%;
- Long-term AFR, monthly compounding: 1.44%.

Now a great time to refinance intra-family loans (assuming, of course, the lender agrees). Refinancing allows less wealthy family members to retain money otherwise due as interest and excludes these amounts from income and estate taxation in the hands of the wealthier family. For example, a son who borrowed $1 million from his mother to purchase a home in April 2018 (when the long-term AFR rate was 2.28%), would save $8,400 a year by refinancing the loan to the current long-term AFR rate of 1.44%. The result of this refinance is a gift tax-free benefit for the son.

Now is also a good time for wealthy individuals to fund a grantor-retained annuity trust (GRAT). Individuals who fund a GRAT retain an annuity for a set time period. At the end of that time period, any growth in the value of trust assets over the Section 7520 rate passes on a gift tax-free basis to the remainder beneficiaries of the trust. With a lower AFR rate, it is more likely that the rate of return of assets in the GRAT will exceed the § 7520 rate.

2. Defer federal tax payments

Notice 2020-18 provides that any person (defined as any individual, trust, estate, partnership, association, or company) may postpone making up to $1 million in federal income tax payments and need not file most income tax returns until July 15, 2020. As long as an individual files and pays the required tax by that time, the IRS will not subject that person to penalties or interest for the period between April 15 to July 15. The $1 million limitation applies based on filing status (i.e., a single individual and married individuals filing a joint return will each be subject to a single $1 million limit). The payment applies to income and self-employment tax but does not apply to other types of taxes. It is unclear whether the notice applies to gift tax returns, fiscal year entities, or employment tax information returns.

3. Harvest tax losses

Consider selling, or "harvesting," your losses in your taxable accounts. You may buy a similar security to stay invested in the market so long as you did not buy or do not buy a "substantially identical security" within 30 days of the sale. These losses can offset other capital gains that you have realized during the year. If your tax losses exceed your capital gains for the year, you may use up to an additional $3,000 of losses and carryforward (indefinitely) any remaining losses.

4. Convert a traditional IRA to a Roth IRA

As we discussed in our March newsletter, the SECURE Act enacted late last year ended an estate planning technique known as the "Stretch IRA." This technique allowed beneficiaries who inherited IRAs to stretch distributions from those IRAs over the course of their lifetime, thereby maximizing the amount of tax-deferred growth within the IRA. Post SECURE Act, most beneficiaries can only stretch out the distributions from an inherited IRA over a maximum 10-year period.

A beneficiary who inherits a traditional IRA will owe income tax on each distribution, while a beneficiary who inherits a Roth IRA will owe no income tax (the decedent will have pre-paid the tax for him). Given the market decline and the death of the Stretch IRA, some clients may wish to convert a traditional IRA to a Roth IRA. A Roth conversion has a few benefits:

- allows the owner not to take required minimum distributions (RMDs), thereby allowing for longer tax-free growth;
- reduces the amount subject to income taxation so long as asset values within the IRA increase between now and 10 years after the owner's death; and
- provides an income tax rate benefit if the owner is subject to an income tax rate lower than the beneficiary's future income tax rate.

The effectiveness of this type of strategy depends on a few variables (e.g., whether the client can use after-tax money to pay for the income tax on the conversion; whether the client intends to use the retirement accounts to fund his or her retirement; whether the client intends to use the retirement funds for retirement or as an estate planning device for children or grandchildren).

5. Use any remaining gift tax exemption

Given that marketable securities have tumbled in value, now is a great time to make gifts to younger generations (outright or in trust). With the existing higher estate and gift tax exemptions scheduled to be cut in half in 2026, now is a better time than most to make a gift. That said, given the economic uncertainty, a client should not rush to give away assets that he or she might later want or need.

6. Consider future COVID-19 legislation

Congress has been moving quickly in response to the COVID-19 crisis. It has already passed one bill—The Families First Coronavirus Response Act (H.R. 6201)—and is considering another bill that aims to provide economic stimulus. Be on the lookout for future IPB alerts about these bills.

Please feel free to reach out to a member of our Estate Planning Team if you have any questions or want to discuss your estate plan. And please stay healthy.