

2020 essential tax and wealth planning guide
COVID-19 special edition

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Welcome

Dear Reader,


Driving a car is not as simple as pointing the car in the right direction. Successfully arriving at the intended destination requires careful attention to directions, signs, and obstacles. With experience, some of those adjustments become instinctual. However, sometimes the driver must respond to something unexpected or even perhaps stop and ask for new directions and adjust accordingly. The *2020 essential tax and wealth planning guide* is doing just that. The current state of our country and our economy in light of the novel coronavirus disease 2019 (COVID-19) pandemic has caused us to add some new destinations along the route. While the original map had us exploring issues of tax policy, charitable planning, and wealth transfer planning, we have pivoted the direction of those discussions.

- First, our tax policy section, **How the 2020 presidential candidates propose to tax affluent individuals**, includes familiar, but now altered, discussions of the upcoming presidential election and continuing legislative guidance and relief in response to the COVID-19 pandemic.
- Next, **How can private foundations respond to COVID-19? Seven key questions to ask** examines how private foundations and individuals are reexamining their role in the community and seeking alternative philanthropic avenues to make a social impact. Since the federal government has declared the COVID-19 pandemic a national disaster, there is additional flexibility in how foundations can be powerful tools in times of crisis.
- Finally, **When given lemons, make lemonade** provides insights on the new path you may consider when furthering your wealth transfer roadmap in the current economic climate. The current volatility of the financial markets, coupled with the low-interest-rate environment, presents unique considerations around wealth transfer and utilization of the increased applicable exclusion amount provision of the 2017 Tax Cuts and Jobs Act (TCJA).¹

As you progress through 2020, please let us join you along the curves in the road. We hope that the 2020 *Guide* provides you with signs and valuable insights to guide you, your family, and perhaps your family business along the road and through the obstacles as you continue forward on the journey toward meeting your goals.

To find a member of the Deloitte Private Wealth practice who specializes in your area of interest, please contact us at ustaxprivatewealth@deloitte.com.

Regards,



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¹ P.L. 115-97, known informally as the Tax Cuts and Jobs Act and officially as *An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018*.

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How the 2020 presidential candidates propose to tax affluent individuals

The November 3 general election is still months away, but the ballot for the presidential race is for all intents and purposes now set: former Vice President Joe Biden is expected to officially become the Democratic party's standard-bearer at its convention in August, and President Donald Trump is the presumptive Republican nominee.

Although the economic impact of the COVID-19 pandemic is likely to dominate fiscal policy debate this election cycle, one of the issues implicitly on the ballot this year is the fate of President Trump's signature TCJA, which, among other things, lowered the tax burden for many individuals, estates, and passthrough entities. For budgetary and procedural reasons, these provisions in the TCJA as enacted are scheduled to expire at the end of 2025.

Former Vice President Biden contends that the TCJA benefits are skewed to more affluent taxpayers and has offered policy proposals to address that perceived imbalance. President Trump, on the other hand, is making the case that the TCJA's temporary tax cuts were necessary to fuel economic growth and should be made permanent—and, in some cases, even expanded.

Our aim here is to provide a high-level discussion of how the two candidates' proposals would work, along with a side-by-side comparison of where they stand on certain key tax issues.

There are a few significant caveats worth keeping in mind. First, very little detail is currently available on any of the proposals that either candidate has put forward so far. Additional details may emerge during the campaign, and their tax plans could change over time. We will update this discussion periodically as significant new details emerge.

It's also important to note that tax legislation originates with Congress, not the White House, so any new tax laws enacted will necessarily also carry the imprimatur of the legislative branch with its many competing interests and priorities.



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The candidates: Biden vs. Trump

Biden: Broadening the base

Former Vice President Biden is campaigning on the premise that the income tax system needs to be retooled to ensure that high net worth individuals are paying “their fair share.” But unlike some of his former rivals for the Democratic presidential nomination—most notably, Vermont Sen. Bernie Sanders and Massachusetts Sen. Elizabeth Warren—he has not called for enacting a so-called wealth tax that would be imposed on affluent individuals based on their net worth. Instead, he has adopted a fairly traditional approach to redistributing the tax burden that calls for higher taxes on realized income (from wages and capital gains) and on the value of an individual’s estate at death (beyond an exemption threshold) through proposals to:

- Restore the top rate for individuals to its pre-TCJA level of 39.6 percent,
- Cap value of itemized deductions at 28 percent,
- Tax capital gains and dividends as ordinary income for those with income over \$1 million,
- Tax carried interest income as ordinary, and
- Modify the estate tax to repeal the basis step-up for inherited assets.

Former Vice President Biden also proposes to shore up future Social Security shortfalls through payroll tax changes targeting upper-income wage earners. Currently, a payroll tax of 12.4 percent is equally split between employers and employees on the first \$137,700 of an employee’s

wages (the wage cap for 2020, indexed for inflation). The former vice president would expand the payroll tax regime by establishing a second threshold at which the tax would be imposed. Under his plan, the Social Security payroll tax would apply to:

- Wages up to the inflation-adjusted limit under current law, and
- Wages above \$400,000.

The result would be a “donut hole” where wages above the current-law threshold (adjusted for inflation) and below \$400,000 would not be subject to the payroll tax.

Trump: Doubling down on the TCJA

President Trump, for his part, has not released a set of official tax policy proposals as part of his reelection campaign. However, the three budget blueprints he has submitted to Congress since the enactment of the TCJA in December of 2017 all assume that the temporary provisions addressing individuals, estates, and passthrough entities will be made permanent.

Moreover, the president has called for building on the TCJA through what he has dubbed a “Tax Cuts 2.0 package,” which would focus on providing additional tax relief to low- and middle-income taxpayers. He is currently set to unveil his proposal this coming September when the general election season begins in earnest.

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The general elections are still months away, and it is impossible to know who will be setting the tax policy agenda when the next presidential administration begins in 2021. Moreover, as the nation continues to grapple with the economic uncertainty stemming from the COVID-19 pandemic, the tax proposals put forward in a Trump or a Biden administration next year may be influenced—possibly in ways we cannot yet anticipate—by the status of the economic recovery at that time.

Despite this uncertainty, significant tax law changes over the next few years remain a real possibility, and it is not too early to start evaluating the proposals being put forward, modeling potential outcomes, and planning the appropriate actions to take if and when these proposals go from high-level plans and talking points to fully framed legislative policies with substance, effective dates, and, presumably, anti-avoidance rules.

It's not too early to start evaluating the proposals, model potential outcomes, and plan for taking action.

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SOURCES CONSULTED

Details on the candidates' stated positions as summarized in this discussion and in the table are drawn from the sources listed below.

Joe Biden: joebiden.com; *Bloomberg*, December 4, 2019; Democratic National Committee debate, June 27, 2019.

Donald Trump: Office of Management and Budget, *A Budget for America's Future (Fiscal Year 2021): Analytical Perspectives*, February 2020; *A Budget for a Better America (Fiscal Year 2020): Analytical Perspectives*, March 2019; *An American Budget (Fiscal Year 2019): Analytical Perspectives*, February 2018.

CNBC, "Kudlow says 'tax cuts 2.0' will be unveiled later this year during Trump presidential campaign," January 15, 2020.

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Taxing income and wealth: Comparing the candidates' proposals

The table below provides an overview of how former Vice President Joe Biden (the presumptive Democratic presidential nominee) and President Donald Trump (the presumptive Republican nominee) would address a variety of issues related to the taxation of high net worth individuals and

how their respective proposals compare with current law. The policies outlined here are still being fleshed out and may be subject to significant refinement as the 2020 presidential campaigns continue.

Individual income- and asset-based tax proposals			
Issue	Current law	Joe Biden	Donald Trump
Ordinary income	Top rate of 37% through 2025 Additional 0.9% Medicare income tax applies to earned income >\$250,000 for joint filers and \$200,000 for single taxpayers	Restore top rate to 39.6%	FY 2019, 2020, and 2021 budget blueprints assume permanent extension of current law
Limitation on itemized deductions	Pease limitation repealed through 2025	Cap value of itemized deductions at 28%	FY 2019, 2020, and 2021 budget blueprints assume permanent extension of current law
Capital gains, dividends	20% tax rate applies to long-term capital gains and qualified dividends Additional 3.8% net investment income tax applies to individuals with income >\$200,000 and joint filers with income >\$250,000	Tax capital gains and dividends as ordinary income for those with income >\$1 million (possibly combined with a mark-to-market regime for those taxpayers)	FY 2019, 2020, and 2021 budget blueprints assume permanent extension of current law
Carried interests	Treated as long-term capital gain if held for at least three years	Tax as ordinary income	No specific proposals to change the tax treatment of carried interest
Passthrough income	Generally taxed at owner's individual rate, subject to a 20% deduction under section 199A for domestic business profits (deduction expires after Dec. 31, 2025)	No proposal	FY 2019, 2020, and 2021 budget blueprints assume permanent extension of current law
Payroll taxes	Social Security: 12.4% tax is equally split between employers and employees on first \$137,700 of employee's wages (the cap for 2020, indexed for inflation) Medicare: 2.9% tax is equally divided between employers and employees; no income limit applies	Expand Social Security payroll tax to apply to wages >\$400,000	No specific proposals for permanent structural changes to payroll taxes
Estate tax	40% estate, gift, and generation-skipping tax; basic exclusion of \$10 million per taxpayer, adjusted annually for inflation (\$11.58 million in 2020); increased exemption sunsets Dec. 31, 2025	Repeal stepped-up basis at death	FY 2019, 2020, and 2021 budget blueprints assume permanent extension of current law

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How can private foundations respond to COVID-19? Seven key questions to ask

In the midst of the uncertainty surrounding the COVID-19 pandemic, it's hard to know the best way to respond. But as the pandemic grows, private foundations have an opportunity to make a significant difference.

For many large, staffed foundations, it's a matter of starting with their current grantees and the existing focal issues of the foundation as a base for developing criteria for how to give emergency funding and to whom. For smaller and less established private foundations, getting started can be more difficult.

Many private foundations have a purpose that is as broadly defined as "any purpose allowed under 501(c)(3)" or "any charitable purpose." If that describes your foundation, permitted charitable purposes can include a wide range of support related to COVID-19, such as:

- Relief of the poor and distressed
- Provision of housing to low-income individuals
- Promotion of health
- Promotion of social welfare
- Lessening the burdens of government¹

That leaves a huge degree of latitude in what you can do. The challenge, though, is to determine where to start and how to do it. We at Deloitte and the Monitor Institute by Deloitte recommend beginning with a short set of interconnected questions:

1. What should you give to?
2. What is your time horizon?
3. Where do you want to give?
4. What will you do about your current grantees?
5. What is the fastest way to deploy resources quickly and effectively?
6. Can you undertake direct charitable programs?
7. Can you make grants directly to individuals and nonpublic charities?



¹ Treas. Reg. § 1.501(c)(3)-1(d)(2)

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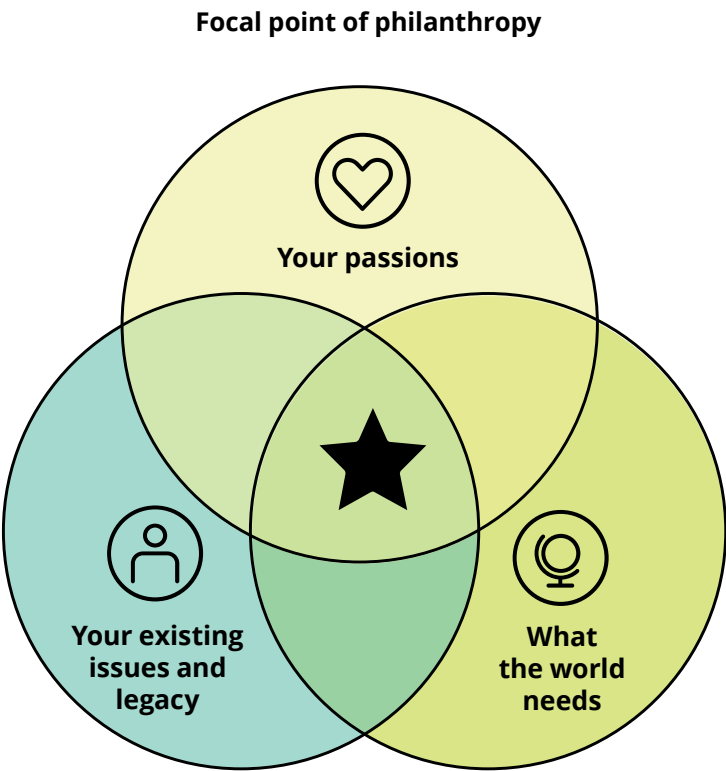
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1 What should you give to?

The range of critical needs in our communities in the midst of COVID-19 is almost too vast to comprehend. We often help philanthropists address this question using a construct that we adapted for philanthropy from Jim Collins’s famous business diagram,² which helps identify the “focal point of philanthropy” at the nexus of:

- Your passions, since philanthropy is always, ultimately, a form of expression of people’s beliefs, loves, and values;
- The established issues and focus of your organization and what fits with your existing activities, capabilities, and legacy; and
- What you believe your community (or the world) needs most.

By focusing on the areas at the intersection of these three factors, your foundation can begin to discern what is right for you—helping you make choices about whether to invest in a medical response, economic consequences for a selected charitable group, or any number of any other options.



² Jim Collins, “The Hedgehog Concept,” <https://www.jimcollins.com/concepts/the-hedgehog-concept.html>.

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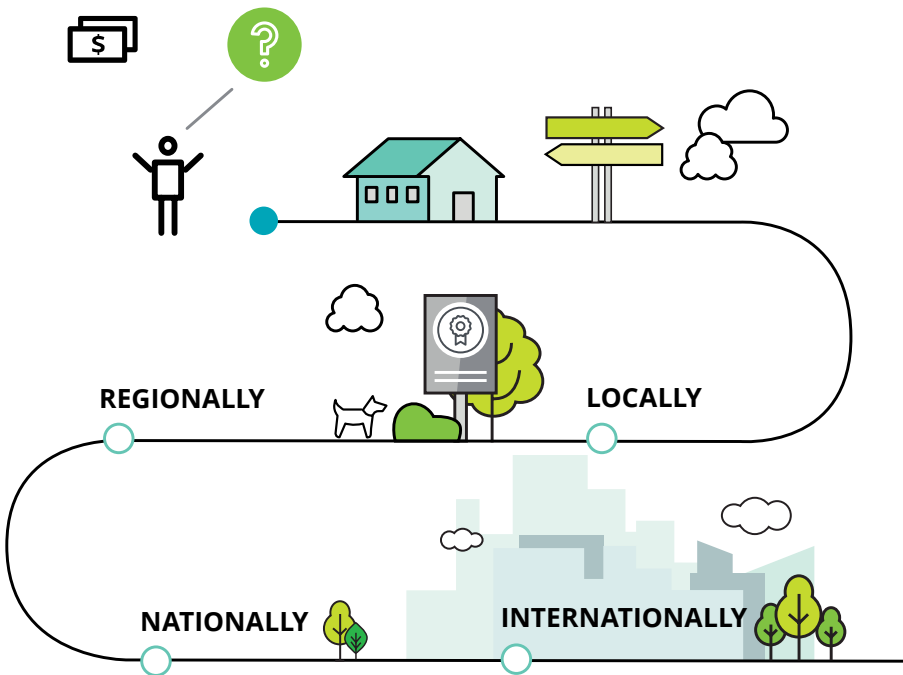
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2 What is your time horizon?

Figuring out your giving isn't just a question of what you give to, but also of *when*. In the aftermath of a crisis, there is often an outpouring of support for immediate relief efforts. This is absolutely critical money. But it's also important to recognize that once donations trail off in the months after the peak of a crisis, it can be difficult to find additional funds for long-term recovery efforts—activities that can often take years, if not decades. Since the repercussions of the COVID-19 pandemic are likely to continue over the coming months and years, it may also be important to support preventative measures and preparation for whatever aftershocks and challenges might come next (especially because they may compound the more immediate impacts of the COVID-19 pandemic). Building the long-term resilience and capacity of our communities to respond to future crises may often be left underexplored and underfunded.

3 Where do you want to give?

Historically, with disaster funding, the question of where you give has been straightforward. Usually the area of impact for a crisis is restricted to a limited geographic region or place. The global nature of the COVID-19 pandemic means donors will have to make choices about whether they give locally, regionally, nationally, or internationally. All of these options have real merit; it's more a question of what is the right fit for your foundation, given its mandate and interests? A private foundation is allowed to make international grants to foreign organizations that have obtained US public charity status or to foreign governments without incurring additional administrative burden. For all other foreign grantees, either an equivalency determination or expenditure responsibility oversight is required.



Potentially both may be required if the equivalency determination only determines the charity is the equivalent of a private foundation. These additional administrative requirements are not significantly burdensome and should not be prohibitive barriers to international giving. Timing is important, and funds should be disbursed only after first determining the status of a grantee.

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4 What will you do about your current grantees?

Even as some funders shift their giving to support urgent relief and recovery efforts, it's important to remember your existing grantees may be significantly affected by the crisis. Many funders are adding additional years of support for their current grantees, making emergency grants available to assist with operating cash challenges, relaxing the timing of grant reporting requirements, and converting project-based grants to unrestricted ones to provide greater flexibility to grantees. All of these actions can help your current grantees continue their work in the midst of growing and shifting community needs.

Once you've answered these four strategic questions, the next set of choices are operational—about *how* you can most productively and efficiently do your giving:

- What is the fastest way to deploy resources quickly and effectively?
- Can you undertake direct charitable programs?
- Can you make grants directly to individuals and nonpublic charities?

5 What is the fastest way to deploy resources quickly and effectively?

The quickest way to deploy resources may be for a foundation to make a grant to a public charity that already has a program in place providing necessary services the foundation wishes to support. This could include

food banks, hospitals, and other local human service organizations—and can be both quick and effective.

Another powerful option is to give through an established charitable “pooled fund.” Community foundations, online giving platforms, and regional associations of grantmakers in many places have created collaborative funds that make it easy for foundations and individuals to participate and contribute. These pooled funds help aggregate resources and allow funders to piggyback on the research and due diligence of experts with deep, local, issue-based knowledge. Sometimes the best way to show *leadership* is to *follow* those who already are working on an issue or who have deep experience in a place.

6 Can you undertake direct charitable programs?

Foundations can engage in direct charitable programs. Generally, a private foundation can undertake any charitable program a public charity can undertake. It is more a question of whether the private foundation has the staff, experience, and resources to undertake such an endeavor effectively. However, assuming it does—either through hiring outside contractors or utilizing hired staff and volunteers—a private foundation may undertake any direct charitable activity, from building temporary hospital facilities for patients to providing infrastructure services, such as food and meal delivery to homebound residents. This can also assist with providing temporary employment for displaced workers.

One thing we know about many people with existing private foundations: they have an entrepreneurial spirit. They often see solutions to an

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immediate, local problem which is actionable and could keep that problem from becoming another disaster. Understanding the problem and determining if the proposed solution is charitable for the foundation is one key place where the professionals at Deloitte can provide guidance.

7 Can you make grants directly to individuals and nonpublic charities?

A unique tool available to private foundations is the ability to make direct distributions for charitable purposes to individuals and entities that are not public charities. This is permitted by law, but the caveat is that, when making grants to individuals, foundations must have a plan that benefits a broad enough group to constitute a “charitable class.” This means there must be a large enough group of individuals to ensure there is not private benefit being incurred. For example, generally a foundation would not be allowed to make grants to just the current employees of one business, as this would not constitute a broad charitable class of individuals. In addition, if the plan is going to be related to the COVID-19 pandemic, payments will likely not be for travel, study, or other similar purposes. Because the plans are not for these purposes, the plans will not have to gain prior approval from the IRS. Even though advance approval is not required, the plans do still need to be objective and nondiscriminatory.

The good news is that private foundations that are already in existence are a **nimble** and **powerful tool** in times of crisis.

Once the foundation has a plan that details who is eligible and what type of assistance the foundation wants to provide, expenditure responsibility oversight is required for any nonpublic charity grants or program-related investments. None of this additional oversight is prohibitively complicated, but it should always be done with the assistance of a qualified adviser.

The good news is that private foundations that are already in existence are a nimble and powerful tool in times of crisis. By answering a few key strategic and operational questions, you can take steps to focus and respond quickly in the face of the current crisis and ensure you are deploying your assets appropriately and effectively.

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When given lemons, make lemonade

Experience tells the author that the number of potential donors was much larger at the end of 2019 (coming off one of the most successful investment return years ever)¹ than it is at the end of the first quarter of 2020, which ended the worst first-quarter performance ever.² However, that shouldn't mask the sound of a potential opportunity knocking. Simply stated, if one buys into the notion that recovery follows a correction, as inevitably as geese flying north in the spring (one simply doesn't know how long that migration might take), then giving now can be the lemonade made from the current economic lemons. Best yet, you don't even have to borrow the required cup of sugar.

If one buys into the notion that recovery follows a correction, then **giving now can be the lemonade made from the current economic lemons.**



¹ Joe Hoft, "IT'S OFFICIAL: 2019 Was the Greatest Year in Stock Market History – First Time Ever DOW Gained More Than 5,000 Points In a Single Year!", The Gateway Pundit, www.thegatewaypundit.com, January 1, 2020.

² Lucy Bayly, "Wall Street Just Had One of Its Worst Quarters in History," NBC, www.nbcnews.com/business/market, March 31, 2020.

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Under the TCJA, the applicable exclusion amount (AEA)—the amount that can be left to others by gift or bequest without incurring a gift or estate tax—was increased from \$5 million to \$10 million, indexed for inflation. In 2020, the AEA is \$11.58 million. The TCJA states that the increased \$10 million exclusion will only be in place until the end of 2025, when it will revert to the previous \$5 million limit indexed for inflation. Under current law, the increased AEA is a “use it or lose it” proposition. Once it sunsets, it will be as if it had never existed.

Thus, those in a position to make gifts should consider making gifts that absorb part or all of the AEA. For those concerned that future changes in the law might somehow simply defer any gift tax but leave the donor exposed to a higher estate tax later, on November 26, 2019, the IRS released final regulations, clarifying that when the AEA amount reverts back to \$5 million at the end of 2025, the AEA amount governing the computation of the estate tax will be the greater of the AEA at the date of death or the AEA actually used before 2025.



Those in a position to make **gifts should** consider making gifts that **absorb** part or all of **the applicable exclusion amount.**

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Gifts of “hard-to-value” assets where a valuation discount can be taken is another planning consideration to enhance the performance of gifted assets relative to a simple gift of cash. Examples of hard-to-value assets include minority interests in closely held business and investment entities and fractional interests in real estate. While a discussion of the nature and depth of discounts is beyond the scope of this article, conveying discounted assets allows the gift transfer of “more” assets for the same quantum of AEA and, as a result, improves the possibility of greater returns to the donee since more property is at work. For this and other reasons, the depth of any discount is often challenged by the IRS and has been the object of regulatory control as recently as 2017. It is reasonably foreseeable that future focus on the ability to discount appropriate assets will occur.

One measure of the current economic downturn is extraordinary volatility in the securities markets. Since 2004, the Volatility Index (VIX) has been employed to project volatility over the short term. Measures of volatility play a vital role in several valuation models with a higher volatility correlating with lower asset values. Similarly, the VIX score is directly correlated with higher marketability discounts, which are generally applied to the valuation of interests in closely held companies.



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Consider transferring assets now

Perhaps an example might help. Let's assume three identical taxpayers (the three little pigs) all with the same identical estates on October 31, 2019, of \$25 million, and all of whom have a fateful appointment with the Big Bad Wolf on January 1, 2026 ([figure 1](#)). Assume, even considering recent market swings, that the \$25 million will grow to \$30 million by January 1, 2026.

- The first little pig doesn't believe in estate tax planning and does nothing, leaving an estate worth \$30 million.
- The second little pig made a gift of \$11 million in December 2019.
- The third little pig was still planning an \$11 million gift when the recent market correction occurred.

At the end of April 2020, each had lost 20 percent of his net worth, leaving the first and third little pigs with \$20 million and the second with \$11.2 million. It is at this time that the third little pig structured his \$11 million gift, leaving him with an estate of \$9 million on May 1, 2020.

As indicated, total wealth will recover to \$30 million by January 1, 2026, implying appreciation of 50 percent. The accompanying figure reflects the after-tax wealth left to each family as of January 1, 2026. The moral of the story? A gift utilizing the enhanced AEA will always preserve more family wealth, but the timing of the gift, from a tax perspective, is better when values are depressed—assuming that a recovery ultimately follows.

A gift utilizing the enhanced AEA will always **preserve more family wealth**, but the timing of the gift, from a tax perspective, is **better when values are depressed**—assuming that a recovery ultimately follows.

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Figure 1

	Little Pig 1 No Planning	Little Pig 2 Gift in 2019	Little Pig 3 Gift in 2020
Estate Assets	30,000,000	16,800,000	13,500,000
Adjusted Taxable Gifts	-	11,000,000	11,000,000
Taxable Estate	30,000,000	27,800,000	24,500,000
Gross Estate Tax (40%)	11,945,800	11,065,800	9,745,800
Less Applicable Credit Amount	(2,185,800)	(4,345,800)	(4,345,800)
Net Estate Tax	9,760,000	6,720,000	5,400,000
Transferred Wealth (\$30 million estate value at date of death less net estate tax)	20,240,000	23,280,000	24,600,000
Benefit from gifting in 2019		3,040,000	
Benefit from gifting in 2020			4,360,000

CONSIDERATIONS:

- Doing nothing will result in the most estate tax liability upon the taxpayer’s death, resulting in less of the estate going to the heirs
- If the taxpayer gave in 2019 before the estate value decreased, the heirs will receive \$3.04 million more upon the taxpayer’s death than if no gifts were made during life (an increase in their inherited wealth of 15 percent)
- If the taxpayer gifts in 2020 while the estate value is decreased, the heirs will receive \$4.36 million more upon the taxpayer’s death than if no gifts were made during life (an increase in their inherited wealth of 21.54 percent) and \$1.32 million more than if the gift was made in 2019

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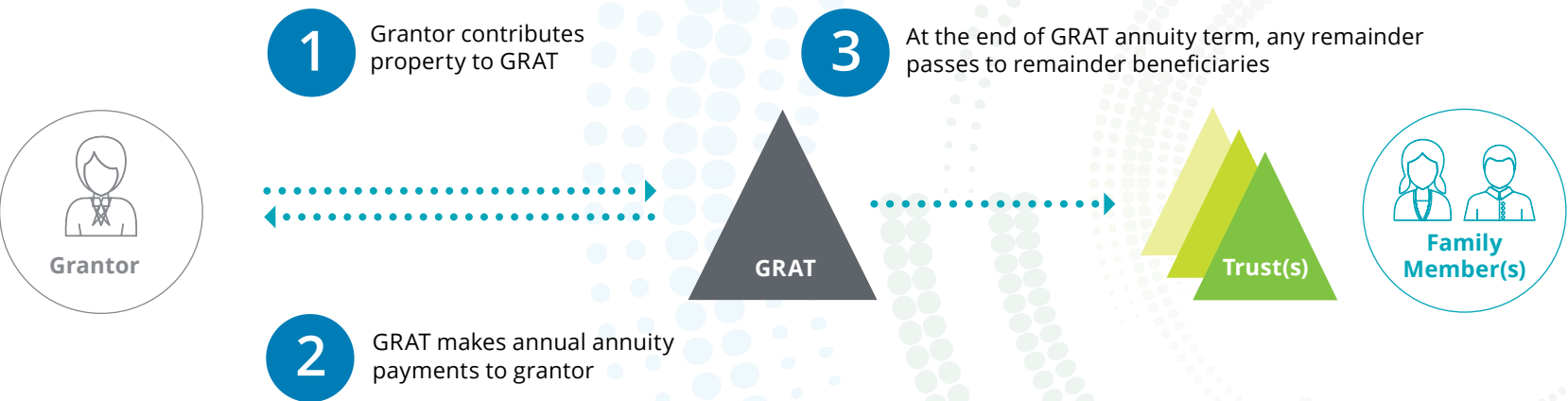
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For those that have already used their AEA and would like to transfer more, but are uninterested in paying gift taxes, consider selling assets in exchange for a note or using grantor retained annuity trusts (GRATs). While the legal rights and interests are different, both of these techniques share similar economics—in a sale, the seller monetizes the current value of the sold property and, if cash is not paid at closing, takes back a note that compensates her for the time value of money; in a GRAT, the donor actually retains the full value of the contributed property to be returned to her over an established annuity period (figure 2).

Another measure of the recent economic downturn has been a rapid decline in minimum interest rates mandated by the IRS. These rates have been mandated since 1984 and are adjusted monthly. June 2020 will see the lowest applicable federal interest rates in the 36-year history of such rates. The interest rate on the note and the discount rate applied in determining the value of the retained annuity are both mandated by the aforementioned government-dictated interest rates. In the end, what is left for the buyer (in a sales transaction) and the remainderman of the GRAT is the appreciation in the transferred property over and above the prevailing interest rate. Thus, the lower the interest rate, the more effective these planning considerations are likely to be—provided an economic recovery ultimately follows.

Figure 2



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The use of trusts can provide a number of benefits when it comes to gift and estate tax planning. Trusts have been around since the Crusades³ and settlors have been motivated to set them up, fundamentally to separate the beneficiary from the property and to impose professional asset governance. Typically, a transfer to an irrevocable trust is considered a completed gift, and the assets contributed to the trust are out of the grantor’s estate, assuming the grantor has retained no interest in the trust assets or the ability to dictate changes to the beneficial enjoyment of trust assets. An outcome of gifts in trust is that the trust’s net asset value, including all subsequent appreciation and all accumulated income (subject to the GST rules discussed below) is outside the reach of the estate and gift tax rules while such assets remain in trust.

A second potential benefit of a trust arises if, for income tax purposes, it is structured as a grantor trust. Grantor trust status arises where the grantor retains either an economic interest or power over trust property, which are significant enough to require the income of the trust to be taxed to the grantor as if the trust’s assets were owned by the grantor. Thus, the trust is disregarded for income tax purposes, with two significant outcomes. First, the trust grows income tax–free, since the grantor is legally obligated to report and pay tax on the trust’s tax attributes; and second, transactions between the trust and the grantor are disregarded.

If the grantor trust is structured in a manner that precludes estate inclusion, these two outcomes allow a gift in trust to convey more wealth for the same AEA than is possible for an outright gift.

Grantor trust status ends when the grantor dies or revokes the grantor trust powers. The income tax paid by the grantor is not considered an additional gift to the trust since the payment of the tax is in satisfaction of the grantor’s legal obligation.



For example, consider our taxpayer who contributes \$11 million to a grantor trust structured not to give rise to estate inclusion. The grantor uses \$11 million of the AEA to make a gift of property to a grantor trust. Assume the trust generates income of \$500,000 annually, resulting in a combined federal and state income tax liability of \$200,000 each year. After five years, the grantor passes away. At the date of death, relatively speaking, the grantor’s taxable estate will be \$1 million less than it might have been because of the income taxes paid. Correspondingly, the value of the trust will be \$1 million greater because of the income tax obligation it was not required to pay. Similarly, we previously mentioned sales transactions as effective means of moving appreciation to younger family members. Because the sale is disregarded for income tax purposes (meaning no gain recognition) if transacted with a grantor trust, sales to grantor trusts are frequently encountered in estate tax planning.

³ Avisheh Avini, comment, The Origins of the Modern English Trust Revisited, 70 Tul. L. Rev. 1139, 1140 (1996).

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Consider trusts as the lemonade receptacles (cont.)

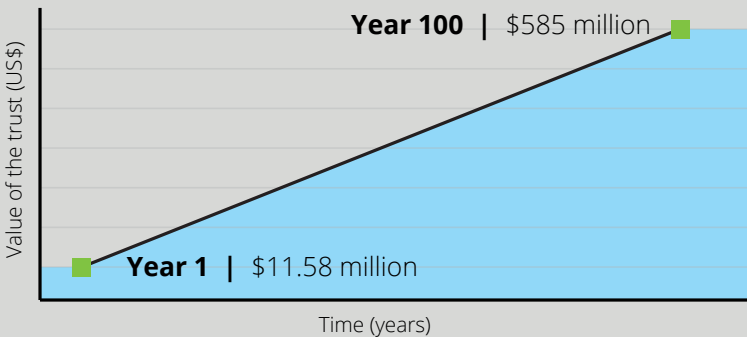
Thirdly, as noted above, assets that remain in trust fall outside the estate and gift tax regimes until they are ultimately distributed to beneficiaries. Thus, the longer the trust exists, the greater the wealth retention. The generation-skipping transfer (GST) tax is a separate tax regime put in place to impose a transfer tax at each generational level. How this is accomplished is complicated and beyond the scope of this article, but it is quite effective at preventing the accumulation of wealth in trusts over an extended period. However, each taxpayer is granted a GST exemption. Since 2010, the AEA and GST exemption have been equal. The 2020 GST exemption of \$11.58 million is also scheduled to sunset at the end of 2025. Judicious application of the GST exemption to a trust can make such a trust, funded with not more than the GST exemption, exempt from GST until such time as the trust terminates. Thus, there is a limited opportunity to respond to the increased GST exemption to benefit multiple generations by making gifts equal to the GST exemption to a GST trust and allocating the GST exemption to that trust. So-called dynasty trusts are GST trusts set up to benefit children and more remote descendants for so long a period as the state’s laws permit. Dynasty trusts are permitted in all 50 states; however, the laws on the duration of the trust vary from as little as 80 years to trusts that can exist in perpetuity. Make sure to investigate what your specific state laws are when setting up a dynasty trust.

One item of caution: A dynasty trust must reflect the flexibility to govern a trust for a significant period. Therefore, dynasty trusts have the tendency to be relatively more complex than other common types of trusts.

While a meaningful example of the economics of a GST trust is difficult to illustrate, it isn’t hard to appreciate the compounding effect of such a trust.



Assume a grantor sets up a 100-year dynasty trust with the entire \$11.58 million exemption. If the trust generates 4 percent annually, after income taxes and modest distributions, the value of the trust in 100 years will have grown to roughly \$585 million. While purposeful investing is required for such an outcome, it is almost as important that the corpus of the trust will not have been disturbed by an estate tax for three or four generations.



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When engaging in estate and gift planning, don't forget about the tried-and-true planning, including:

- annual exclusion gifts
- gifts to 529 plans
- or paying medical and education expenses directly to the institution.

Finally, where one's wealth makes the estate tax a certainty, the most tax-efficient gift is one that includes paying gift tax (as discussed in the [2019 Guide, Part 2](#)). The system was purposefully constructed to make this so.

When the economy offers you lemons, make lemonade. The lemons today seem particularly sour, but properly squeezed and sweetened in a trust receptacle, the outcome may be the ultimate preservation of greater wealth for many future generations. Where do you find the necessary sugar? In the sunseting applicable exclusion amount, the valuation protocols that now yield lower values, and the lower prevailing interest rates. However, that requires planning, now since these too will “sunset” with the passage of time. Call your advisers—it's time for a candid conversation.



Resources

Private Wealth Tax Services

**Monitor Institute by Deloitte:
Philanthropy**

**Wealth Planning Archive:
Part 1**

**US Business Impact of
COVID-19**

**Wealth Planning Archive:
Part 2**

**US Tax COVID-19 webcast
series**

COVID-19 Tax Policy Updates

Tax News & Views



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