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Top 6 Positive Planning Strategies in a Challenging Environment

Amid chaos, planning opportunities may present a silver lining

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Key Points

- While today's geopolitical, economic, and market concerns have created a challenging environment, there may be a silver lining for planning opportunities
- There are several wealth planning strategies that can be beneficial while the interest rate environment for planning is still low and asset values are depressed
- As with any planning strategy, it's important to consult with your advisors to be sure you are incorporating strategies that are right for your particular situation

Although we are facing many challenges on the geopolitical, economic, and market fronts, we would be remiss not to explore the positive ways that your wealth plan can benefit from low interest rates and depressed asset values. There are several wealth planning strategies that are particularly attractive in this kind of climate.

This article will discuss some of the more compelling planning opportunities, including: gifting assets with depreciated value; using the low interest rate environment to your advantage through vehicles such as grantor retained annuity trusts, intrafamily loans, and sales to intentionally defective grantor trusts; converting a traditional individual retirement account (IRA) to a Roth IRA; and tax-loss harvesting. For those who already have an existing wealth plan in place, now may also be an opportune time to examine your plan to be sure that it's optimally designed as you intended, and to explore any potential enhancements that could be made. The volatility in the market also brings heightened scrutiny and opportunities for executors of estates.

1. Gifting assets with depreciated value

If the value of your assets has declined due to challenging market conditions, this may be a perfect time to gift those assets. The federal estate, gift, and generation-skipping transfer (GST) tax exemption (collectively, the federal exemption), which is the amount you can transfer tax-free, is at an all-time high of $12.06 million for individuals and $24.12 million for married couples[1]. While asset values are low, you may gift more of your assets to maximize the use of your federal lifetime gift tax exemption. This is because the amount of exemption used in making a gift is based on the fair market value of the asset transferred at the time of the gift. It should also be noted that any future appreciation of these assets would be outside of your estate.

Making the most of today's high federal exemption

As mentioned earlier, the federal exemption amount is at an all-time high; however, this increased exemption is set to revert to $5 million, adjusted for inflation, on January 1, 2026[1], unless legislation is enacted prior to 2026 extending this increase. While 2026 may seem a long way off, it may be best to take advantage of the increase now by making larger gifts that use up some or all of your exemption. The earlier a gift is made, the longer it has to potentially grow outside of your estate. Importantly, the Internal Revenue Service (IRS) recently issued

[1] (www.irs.gov)

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Given the nature of politics and fiscal realities, there exists a very real possibility that today's transfer tax exemption will be modified prior to its expiration on December 31, 2025.

guidance that, if the exemption does decrease at some point in the future, gifts made prior to the decrease will not be clawed back and retroactively taxed.

It must be noted that there is a very real possibility that, before 2026, the exemption could revert to previous levels and possibly go lower even still (as recently as 2003 the exemption was $1 million). Additionally, there has been much discussion by the current administration in the White House of changing the estate and gift tax laws and potentially adding new wealth taxes altogether[1]. This is yet another reason why it may be best to make larger gifts now while the exemption remains high and there is some certainty about the taxation of these gifts.

Considering cost basis

It is important to think about the cost basis of an asset when determining a gift. Generally speaking, while property transferred at death by bequest receives a cost basis[2] "step-up" equal to its fair market value on the date of death, property gifted during lifetime maintains its cost basis in the hands of the recipient. This means that the cost basis of a lifetime gift is the same for the person receiving the gift as it is for the person giving the gift. By gifting high basis assets and allowing low basis assets to receive the step-up at death, beneficiaries may have zero or minimal gain, resulting in less capital gains tax.

Understand that there are exceptions. For example, if you gift property and the fair market value is currently below basis, the cost basis of the recipient depends on whether the asset will be sold for a gain or a loss. If sold for a loss, the recipient's basis will be the fair market value of the property at the time of the gift. On the other hand, if sold for a gain, the recipient's basis is the adjusted basis in the hands of the donor.

Consider a share of stock purchased for $150 that has since declined in value to $100. If you gift the stock to your child and he sells the stock for $90, it would result in a $10 loss because the fair market value at the time of the gift was $100. However, if the child were to sell the stock for $200 later on, it would mean a gain of $50 because the child's basis is the adjusted basis ($150) at the time of the gift. A sale price that falls between your basis and fair market value at the time of the gift would mean no gain or loss is realized.

Gifting into a trust

When considering gifts of significant size, you may wish to utilize a trust structure rather than an outright gift for maximum potential flexibility, tax efficiency, and creditor protection. A trust may be structured as a so-called "grantor trust." A grantor trust is disregarded for income tax purposes, meaning that the grantor continues to be responsible for the income tax associated with the trust assets, not the trust itself. Therefore, the basis of the property remains unchanged in the hands of the trust. If the grantor trust were to subsequently sell the assets, you, as the grantor, would recognize a gain or a loss as if you had held the assets in your individual name. As a result, the income tax you pay on behalf of the trust is effectively another "gift" to the trust that does not utilize your federal gift tax exemption.

If you're looking for multigenerational gifting, you might also consider gifting depressed assets to a dynasty trust. This type of trust is an irrevocable trust with the ability to stay in effect for multiple generations. Because future growth of the trust's assets is not subject to estate, gift, or GST taxes, the trust can in effect become a "family legacy fund" for future generations.

[1] (www.taxfoundation.org)

[2] Cost basis is the original value or purchase price of an asset or investment for tax purposes.

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2. Estate planning in low interest rate environment

Certain estate planning strategies are particularly advantageous in a low interest rate environment. These strategies do not need to utilize the federal gift tax exemption amount. Therefore, if you do not wish to use your exemption or have used it already, these could be good strategies to consider.

Grantor retained annuity trust (GRAT)

A GRAT is a popular method of transferring the growth on assets to future generations at a greatly reduced gift and estate tax cost. In short, a GRAT is an irrevocable trust to which you as the grantor of the trust transfer assets expected to appreciate, and you then retain an annuity stream for a fixed term. At the end of the period, the remaining assets pass to family members outright or in further trust.

Although the transfer of assets to the trust is considered to be a gift, the amount of the gift is reduced by the actuarial value of the annuity retained by you, so the amount of the taxable gift may be small compared to the value of the assets transferred. If the asset growth outperforms the IRS statutory rate used to value the remainder interest (Section 7520 rate), the additional growth is transferred free of gift and estate taxes to the trust's remainder beneficiaries. When the Section 7520 rate is low, as it is today, GRATs can be very effective, as appreciation of the asset above that rate passes to your family free of gift and estate tax. In addition, you may also be able to take advantage of the exemption from GST tax for transfers to long-term trusts at the end of the GRAT term.

Setting the length of the GRAT term is critical—you must survive the term of the trust in order for the tax benefits to be realized; otherwise, if you die before the end of the GRAT term, most to all of the assets in the trust will be includable in your estate. You may consider mitigating that risk by purchasing life insurance to cover the estimated amount of federal estate tax that would be due if you did not survive the term of the GRAT.

Intrafamily loans

An intrafamily loan provides an opportunity for a family member to provide low-cost capital to another family member. When properly structured, an intrafamily loan can provide attractive lending rates without gift tax consequences. Intrafamily loans come with no limitations on how a borrower uses the proceeds. Intrafamily loans can provide credit opportunities to family members who might not be able to obtain credit, and at lower rates than commercially available, whether it's to assist a business in challenging times, purchase a home or a car, to add to a trust, or to fund an investment. This feature can be particularly attractive in today's low interest rate environment.

In order to avoid treatment as a gift, an intrafamily loan must bear interest at least equal to the Applicable Federal Rate (AFR) set by the IRS. This rate is currently at low levels. Therefore, there is a higher possibility that the rate of return earned on an investment made with the borrowed funds will exceed the AFR, and all of those earnings will be effectively transferred wealth-tax-free.

It's important to structure an intrafamily loan properly in order for it not to be treated as a gift. In addition to bearing interest at the current AFR, the loan must also be repaid. The lender may set a repayment schedule that is most beneficial to the borrower, but it's important to note that interest payments will be treated as taxable income to the lender. The loan must also be properly documented and its terms followed, or the IRS could reclassify the loan as a gift, and tax it accordingly.

For those with existing intrafamily loans, now may also be a time to consider a refinance of those loans with lower interest rates.

Sale to an intentionally defective grantor trust (IDGT)

This strategy leverages both the low valuation and interest rate environments. As a first step, you as the grantor make a completed gift to an irrevocable trust to provide the so-called "seed money." This initial funding of the IDGT will remove future appreciation of the gifted asset from your estate, and also sets up the IDGT in anticipation of an eventual sale of assets to the trust. Typically, you will also allocate an equivalent amount of GST tax exemption so the trust can grow for future generations without being subject to both estate and GST taxes. By retaining certain trust powers (e.g., the power to substitute assets of equivalent value) you will continue to be the owner of the IDGT assets for income tax purposes. You can then sell additional assets to the IDGT in exchange for a note. This note will bear the AFR rate, which again, is at current low rates. This way, any growth in the assets that exceeds the AFR rate will inure to the benefit of the IDGT and may be available for multiple generations to come.

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There are a number of reasons a Roth IRA conversion may be desired if you:

- **Are not eligible for deductible Roth IRA contributions**
- **Expect higher taxes in retirement**
- **Do not want/need required distributions**
- **Want to leave tax-free money for your heirs**

3. Roth IRA conversion

The threat of higher tax rates in the future emphasizes the importance of a tax-free source of income. For this reason, a Roth IRA can be a very effective planning tool. By preserving the Roth IRA for as long as possible, you are providing the opportunity for maximum growth to an account that can be 100% income-tax-free.

Given the long-term benefits that Roth IRAs can provide in planning, conversions from traditional IRAs to Roth IRAs should be evaluated in the scope of one's overall income tax and estate planning. Although there is an upfront tax paid when the conversion takes place, the current market environment could make this tax less burdensome than in the past and the conversion more beneficial in the long run.

The benefit of a Roth IRA is that it is essentially an income-tax-free vehicle. While assets in a traditional IRA benefit from tax-deferred growth, future distributions are taxed at ordinary income rates. Alternatively, Roth IRA accounts not only grow on a tax-free basis while in the account, but distributions are also income-tax-free in the future. Furthermore, there are no required minimum distributions from Roth accounts unless they are inherited accounts.

Converting to a Roth IRA is a taxable event where the tax is based on the fair market value of the traditional IRA at the time of conversion. However, if the traditional IRA is currently undervalued, then the resulting conversion tax would be lower as well. Additionally, once converted, any rebound of value inside the Roth IRA would be income-tax-free.

As with all tax strategies, there are many variables that factor into the decision to make the conversion, such as the expected future tax rate and investment growth, the age of the account holder, and aggregation rules. A detailed analysis of the various factors is highly recommended.

4. Tax-loss harvesting

During challenging market conditions, it is important to focus on the long term and to understand that losses today can be an asset in the future. If your portfolio is experiencing a loss, consider harvesting that loss now. This way, if you have any existing gains, or when there are gains on your investments later in the future, you can use your harvested loss against those future gains.

The IRS offers taxpayers a way to ease the pain of a losing stock investment: sell the security to offset capital gains incurred on redeemed "winning" securities (short- and long-term losses against short- and long-term gains, respectively). You can, in general, stay invested in the market or even same type of company, but still harvest any losses (e.g., sell Home Depot, then realize the loss and buy Lowe's, or opt into an index fund to maintain equity exposure). However, there is a caveat. If you buy back the same or substantially the same stock 30 days before or 30 days after, you will trigger the "wash sale rule" established by the IRS and the loss will be disallowed.

You can also harvest losses for individual bonds, which may be particularly important going forward as bond prices typically decline when interest rates rise. Either way, it's important to be alert to portfolio pain points and opportunities to turn around a loss to your tax advantage.

Also, remember that for income tax purposes, the assets in your grantor trust are treated the same as the assets held in your individual name. Therefore, any tax-loss harvesting you may consider in your personal portfolio should also be evaluated with the assets held in your grantor trust, and vice versa.

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5. Enhancing your existing wealth plan

Think about a trust you may already have. Should it be restructured? Does the trust still work given the current environment? Perhaps you have a trust with depressed assets, in which case there could be an opportunity to enhance your plan. A decline in market value and lower interest rates are good reasons to reexamine what you currently have in place.

Move assets to help mitigate state income taxes

Changes in the federal tax laws have provided a renewed focus on state income taxes and strategies available to help minimize these taxes. While personal trusts have been used most commonly as estate and gift tax planning tools, they now have increased importance as vehicles for potentially minimizing a family's state income tax liability.

Those in high-tax states may have opportunities to reduce or eliminate state taxes on some income by establishing a new trust or moving an existing trust to a tax-friendly jurisdiction, such as Delaware. Using Delaware as a trust planning jurisdiction is similar to using states that don't have any income tax for a well-structured trust. Regardless of a taxpayer's state of residence, a new trust may be created in Delaware and an existing irrevocable trust may be moved into Delaware for ongoing administration. Moving your trust to a tax-friendly jurisdiction such as Delaware may enhance any future gains on the trust once the market rebounds. Remember, asset allocation is important, but so is asset location. This strategy is very state-law specific and must be examined on an individual basis.

Reexamine your existing trusts

If you have an existing grantor trust that has the so-called "swap" power, you may wish to exercise that power during this time of low valuation and interest rates. A "swap" power is a power by which you, as grantor of the trust, can substitute assets of equal value with the trust. For example, if you have a grantor trust with highly volatile assets, you may wish to swap cash into the trust and take out the highly volatile assets. This would allow you to effectively "freeze" the assets inside your trust so that the trust is protected from any future downturn in value. Similarly, if you have low-basis assets inside your grantor trust, you may wish to swap cash or high-basis assets with the trust. This would allow you to take back the low-basis asset into your estate so that it may benefit from a step-up in basis upon your death. The trust, in turn, will get the benefit of the higher basis and hence lower capital gains in the future.

The swap power can be very powerful when it comes to GRATs that are currently under water because the trust assets are not expected to outperform the Section 7520 rate given the market downturn. Rather than continuing the GRAT until its term, which will likely be unsuccessful anyway from an estate planning perspective, this may be the time to substitute cash into the GRAT, remove the low-performing assets, and use those to create a new GRAT. The new GRAT can benefit from an initial lower valuation (because the assets have dropped in value) and lower Section 7520 rate (because of the current low interest rate environment), and therefore will have a much better chance of success upon the termination of the GRAT term. This type of "re-GRAT" strategy is a good way to cut your losses and restart anew to take advantage of the current low market and interest rate environment.

You may also have a long-term trust that you chose not to or neglected to allocate GST tax exemption to at the time of creation. If so, now may be the time to reconsider and perhaps allocate your remaining GST tax exemption and make this trust fully GST tax protected for the benefit of your grandchildren and beyond. Please keep in mind that similar to the gift and estate tax exemption, the GST tax exemption is also set to expire in year 2026 assuming the law does not change earlier. Therefore, there is a small window to deploy this strategy.

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6. Estate administration

When asset values experience declines, those given fiduciary responsibility over assets, such as executors, should consider their responsibilities with respect to preserving asset values. State laws differ with respect to an executor's responsibility to liquidate assets close to the date of death of the decedent, and the executor should be aware of the applicable laws relevant to liquidating estate assets. In addition, assets held in trusts making up a decedent's gross estate for federal estate tax purposes may explicitly allow for holding certain assets or investing assets in such a way that may not otherwise be possible if the assets are held in the decedent's individual name. For example, Pennsylvania law requires that assets held in a decedent's individual name at death should be sold and held in limited types of cash or cash equivalent vehicles, whereas Florida law has more liberal laws on the types of assets an estate may hold, consistent with the Prudent Investor Act. It is important for the executor to understand the interplay of the asset titling, the relevant documents, and applicable state law.

In addition, if tax is due on an estate, fiduciaries should consider their options with respect to valuation of the assets and minimizing the tax due on that value. While the date of death value is typically the value for estate tax purposes, the IRS allows the estate assets to be revalued six months after the date of death, and the lower value to be used if it would result in an estate tax savings. However, executors should also consider the impact of selling, exchanging, or disposing of assets during the six-month period between the date of death and the alternate valuation date. In some cases, the executor may want to sell or dispose of assets within the six-month period, thus locking in the value for estate tax calculation purposes. Such an analysis should be carefully considered with the tax advisor to the estate, as the decision as to which pathway is optimal is specific to the facts and circumstances of each individual estate.

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As part of the Wilmington Trust Emerald Family Office & Advisory team, Alvina is responsible for wealth planning, family office services, and thought leadership development for Wilmington Trust's Wealth Management division. She oversees a national team of wealth strategists, family office services professionals, and thought leadership experts, who together, serve as advisors to high-net-worth individuals and families, business owners, entrepreneurs, and foundations.

She holds a bachelor's degree in civil engineering from the University of Virginia where she was a Thomas Jefferson Scholar. She received her JD from the University of Pennsylvania, where she was a member of the Law Review and Order of the Coif. She also holds a Professional Tax Certificate in Estate Planning from New York University School of Law.

Alvina is a Fellow of the American College of Trust and Estate Counsel (ACTEC), a highly selective group of peer-elected trust and estate attorneys in the U.S. and abroad. She has been named as a recipient of the 2021 Outstanding 50 Asian Americans in Business Award by the Asian American Business Development Center. She also has been recognized by Crain's New York Business as one of their Most Notable Women in Financial Advice in 2020. The honor recognizes leading women executives in New York City for their dedication to excellence in the financial industry and significant professional, civic, and philanthropic contributions. In addition, she was recognized as one of Worth's Groundbreakers 2020: 50 Women Changing the World.
