Tax News Alert

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Income Tax and Estate Planning Techniques in a Volatile Economic Environment

First, and foremost, we are thinking about all our clients, colleagues, and friends, and we hope everyone is safe and healthy at this challenging time. As we write this alert, the stock market's major indices have lost about a third of their value over the past several weeks and interest rates have been reduced again, as a result of the government's efforts to support the economy. From a tax professionals' standpoint, we wanted to communicate some planning opportunities presented by this unfortunate volatility.

Income Tax Planning

Roth Conversions: The opportunity to move money from a tax deferred vehicle, a traditional IRA, to a nontaxable vehicle, the Roth IRA, can be beneficial without a required minimal distribution (RMD).

- Attractive in the relatively low-income tax rate and low market value environment.
- Taxable ordinary income is based on the value of the assets on the date of conversion.
- Recovery of appreciation is sheltered to all future income tax and the withdrawals are tax-free.
- Undoing of a Roth conversion (recharacterization) in the event of further market decline is no longer available after the 2018 TCJA tax reform. Consider incremental small conversions to dollar cost average out of a Traditional IRA.

Harvesting Capital Losses: Selling assets at a loss and using those losses to offset capital gains realized on other assets.

- It reduces or eliminates current capital gains.

- If the asset is repurchased, it gives the taxpayer a lower basis in the repurchased asset. This increases the amount of gain that is recognized when the asset is later sold. Despite the total potential gain, the loss harvesting creates a tax deferral.

- Don't overlook trusts and estates. An asset with the built-in loss could be distributed to a beneficiary thereby shifting the loss.

- Be aware of the “wash sale rules” where capital losses are denied to the extent that a taxpayer has acquired (or has entered into a contract or option to acquire) a “substantially identical” stock or securities within a period beginning 30 days before the sale and ending 30 days after the sale of a stock which was sold at a loss.

- One can simply sell stock and reinvest in a diversified portfolio which locks in gain and eliminates downside risk.

Consider Exercise of Options: An exercise of an option will cause an income recognition event. The lower the FMV of the stock at exercise, the lower the income recognized by the taxpayer, and the sooner the start of the holding period for potential lower long-term capital gain tax rate.

Gift & Estate Tax Planning

Estate & Gift Planning: Each person has the ability to transfer $11.58 million of assets (less any taxable gifts previously made) without having to pay any federal gift tax.

- Now is also a good time to review your estate plan. Make sure your current estate planning documents (e.g., wills, revocable trusts, power of attorney, health care documents, etc.) are up to date and accurately reflect your wishes.

Gifting in Specific Down Markets: The amount of gift tax exemption used and the amount against which gift tax is accessed is based on the fair market value of the gifted asset. Assets which are undervalued in down market are efficient gifts:

- Low transfer gift tax cost and utilization of lifetime exemption.

- Potentially high appreciation of gifts for recipients.

Consider Late Allocation of GST Exemption Minimizing GST Tax: A late allocation requires the use of values as of the date the GST gift return is filed. An excellent strategy for gifts previously made to a trust or a successfully completed GRAT transfer, when market values have decreased.

Minimizing Estate Tax: The value of the gross estate may be determined, if the executor so elects, by valuing all the property included in the gross estate as follows:

- In the case of property distributed, sold, exchanged, or otherwise disposed of, within six (6) months after the decedent’s death, such property shall be valued as of the date of distribution, sale, exchange, or other disposition.

- In the case of property not distributed, sold, exchanged, or otherwise disposed of, within six (6) months after the decedent's death, such property shall be valued as of the date six (6) months after the decedent's death.

- Markets falling post death can yield significant estate tax savings utilizing one of these alternative valuation dates.

Grantor Trust Asset Substitution Maximizing Basis & Growth Potential: Grantors will generally hold a power of substitution over the assets in a grantor trust (aka "swap powers"). The power allows the grantor to swap assets in the trust of equal value owned directly by the grantor.

- Market volatility presents opportunities to use this power. For example, a grantor could swap assets primed for growth into the trust in exchange for assets with a lower growth potential or low basis.

Low Interest Rate Planning

The low interest rate environment is ideal for mortgage refinancing, business loans, and investment debt. In addition to the low cost of borrowing, an income tax deduction is still often possible if structured correctly. Low interest rates are also advantageous for many common estate tax planning techniques. Those who expect a taxable estate may be prudent to act when rates are low. In general, lower interest rates permit a greater value of the assets to pass to the next generation. Lower rates favor the following estate planning tools:

- Grantor Retained Annuity Trust (GRAT)
- Intentionally Defective Grantor Trust (IDGT) sale
- Installment sales between related parties
- Intra-Family loans with low IRS AFR rates
- Charitable Lead Annuity Trust (CLAT)
- Qualified Personal Residence Trust (QPRT)

Contacts

The planning ideas mentioned above can be complex. For more information and a discussion on how this may affect you, please contact the FLSV professional with whom you work or any of the below FLSV professionals:

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