Fiduciary Trust International

Putting Market Volatility to Work in Your Estate Plan

INSIGHTS

Heightened market volatility can be unsettling for investors, but market fluctuation can present ideal estate planning opportunities. Bryan Kirk, Managing Director and Trust Counsel, discusses several strategies that take advantage of fluctuating asset prices to manage gift and estate taxes.

BRYAN KIRK
Managing Director
and Trust Counsel

Q. How can market volatility actually help for estate planning?

Bryan: From an estate tax planning perspective, market volatility can provide great opportunities. Today, an individual can transfer up to $11.18 million ($22.36 million per married couple) during lifetime or at death free of federal gift and estate tax. But any additional amounts transferred are subject to tax at 40%. In addition, after 2025, the exemption amounts are set to revert to roughly half the amounts above, meaning that any estate over roughly $5 million currently may be subject to that 40% tax in the future.

As a result, a tax-savvy estate plan for investors who may have assets over the exemption amount is oriented to try to transfer assets when their value is lower. When markets are volatile, these low-value opportunities can open up.

In addition, a tax-savvy estate plan looks for opportunities to transfer assets you believe will appreciate over time. The appreciation of an asset after you make a gift is not included in your estate for estate tax purposes, and in effect, passes to your heirs tax-free. In volatile markets, assets can appreciate significantly in short time periods. Making gifts to capture that appreciation in the hands of your heirs can yield major tax savings.

Q. Are specific tax planning strategies used to take advantage of market volatility?

Bryan: Yes, Grantor Retained Annuity Trusts (GRATs) are a great way to make use of market volatility. You transfer undervalued or potentially highly-appreciating securities into the trust for a predetermined amount of time, usually two or three years. Your original

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contribution plus interest at a “hurdle rate” set by the IRS is returned to you via an annual annuity payment over the trust’s term. At the end of the term, any appreciation above the hurdle rate goes to your beneficiaries, free of gift and estate tax. Today’s hurdle rate remains relatively low, so you don’t need much appreciation to generate tax savings.

And a GRAT can be structured so that for tax purposes you make only a very small or no gift in connection with the original contribution to the trust. That makes the only downside of a GRAT the cost to prepare the trust instrument and administer the trust, which together may be nominal in comparison to the potential tax savings. At the current IRS hurdle rate of 3%, a $1 million contribution to a 2-year GRAT that appreciates at 10% would pass over $115,000 to your heirs free of gift and estate tax. Even if assets were to appreciate by just 5%, you would still pass over $32,000 tax-free.

Q. How do you decide on the assets to contribute to a GRAT?

Bryan: The key is active portfolio management. Publicly-traded securities with ready values and straightforward transfers make the administration of a GRAT easy. But it requires a skilled investment professional with an eye toward tax savings to realize an undervalued security in your portfolio may represent a tax planning opportunity. Our portfolio managers can help identify securities that are adversely impacted by market conditions or have the potential for significant appreciation.

GRATs are also often used with long-term, concentrated holdings in a single company. Those securities are likely to pass to your heirs in any case, so if there’s a chance to do so tax-free it is almost always worth the effort.

Q. Are there other strategies to use to make more direct or larger gifts?

Bryan: Gifts of interests in family businesses, such as family limited partnerships or limited liability companies, can also be well-timed during periods of market volatility. The value of the underlying assets owned by the business, whether publicly-traded securities, real estate or an operating business, may be impacted by market swings or other financial considerations. In that event, a gift during a dip in value can maximize the assets passed to future generations. And if you transfer a partial interest in the business, discount opportunities in the range of 25% to 50% off the pro rata share of the business's value remain possible under the current IRS rules due to the lack of control and lack of marketability associated with the partial interest.

You also can make direct gifts of securities, outright or in trust. Gifts for the benefit of minor children or grandchildren can be made to Crummey or 2503(c) trusts that limit the minor's access to the trust funds until a certain age. Gifts can also be made to Delaware Dynasty Trusts, using your exemption from generation-skipping transfer (GST) tax (currently $11.18 million per individual). A Delaware Dynasty Trust can exist in perpetuity, and if exempt from GST tax, the trust assets will not be subject to gift, estate or GST tax for generations. Trusts can also be used as the remainder beneficiary of a GRAT or the recipient of a gift of a partial interest in a family business.

Q. Is market volatility relevant for estate planning for persons with assets under the $11.18 million exemption?

Bryan: Volatile times emphasize the importance of estate planning in general. Our portfolio managers attempt to mitigate the effects of market volatility on portfolios. However, market forces can be difficult to control, especially in the short term. In contrast, estate planning is largely within your control. The benefits of creating and maintaining a solid estate plan, with your intentions clearly defined and professionals in place to make sure your estate is properly handled, can mean more to your family's financial and non-financial future than any investment return. In addition, as mentioned before, the $11.18 million exemption sunsets in 2025, so ongoing attention to tax implications of your estate is necessary.

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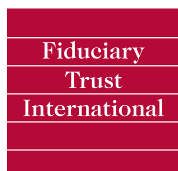

fiduciarytrust.com

Fiduciary Trust International Offices

New York, NY
(877) 384-1111

Arlington, VA
(703) 647-4132

Boca Raton, FL
(561) 988-8460

Coral Gables, FL
(800) 618-1260

Fort Lauderdale, FL
(561) 988-8460

Los Angeles, CA
(800) 421-9683

San Mateo, CA
(877) 284-2697

St. Petersburg, FL
(800) 618-1260

Washington, DC
(888) 621-3464

Wilmington, DE
(866) 398-7414

Fiduciary Trust Company of Canada Offices

Calgary
(800) 574-3822

Toronto
(800) 574-3822

FTCI (Cayman) Ltd.

Grand Cayman
(877) 384-1111

(212) 632-3000
(calling from outside the US)

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