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Estate Planning During COVID-19: Change Brings Opportunity

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By **Taylor Rosanova** | September 09, 2020 at 12:02 PM


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2020 started with near record low unemployment and record high stock market prices—not to mention pre-pandemic 20/20 hindsight jokes. Now that we are able to look back at the first eight months of 2020 with the benefit of hindsight, we can see many things that we did not view as possible eight months ago, and which are now becoming a reality. As with any meaningful paradigm shift, this change brings not only pain but opportunity.

While the core focus of this article is tax planning for individuals with taxable estates, estate planning is important for everyone. Many people put off estate planning because they think it's just for the retired and the wealthy. This mindset could not be more wrong. Almost everyone has an estate. Your estate is comprised of your possessions (cars, houses, bank/investment accounts, personal effects, etc.).

If you do not have an estate plan, you are not alone. According to Caring.com's 2020 Estate Planning and Wills Survey, only 32% of people have a will, a trust or a similar document in place. For the remaining 68%, death could mean additional headaches and costs for the decedent's loved ones.

The coronavirus and its effects have been awful. For some individuals, however, COVID-19 has created a unique opportunity that could significantly reduce future estate tax bills.

The Year of the Gift

Two key factors, largely out of the estate owner's control, are pivotal in determining the best time to make a gift from your estate: the dollar value of the current gift tax exemption and the fair market value of the asset you will gift.

Exemption

For now, the gift tax exemption is $11.580 million per person or $23.160 million per married couple. On its face, this may seem like a lot, but this figure is temporary. In 2026, this exemption is scheduled to sunset and will be reduced to $5 million per individual taxpayer (indexed for inflation). This assumes that current law does not change before 2026. Depending on the results of the upcoming presidential election, current legislation could change as early as 2021. For instance, Joe Biden’s tax plan proposes reducing the gift tax exemption to $3.5 million per individual and increasing the tax rate to 45%.

Asset Values

Business owners seeking to gift shares of ownership in their company (or companies) may benefit from the declines in fair market value; however, this may depend on the company’s industry and size.

While the major stock indices are at or approaching all-time highs (or, in the case of the NASDAQ, setting new all-time highs almost daily), the truth behind that picture is not as rosy. Those indices are comprised of some of the largest, most well capitalized companies in the world. Smaller businesses have not been as fortunate and are hoping to recover from the significant negative effects caused by the coronavirus.

The industry in which a company operates has been a significant driver in the pace of recovery. Many owners of businesses in the technology industry have been able to bounce back to pre-COVID levels or better. For most industries, however, COVID-19 has had a negative impact on valuations, and this means that the giftor will be able to either gift more of their assets or use less of their exemption.

Valuation Considerations

The timing of a gift requires consideration of how COVID-19 has affected the subject asset and its long-term recovery prospects.

For operating businesses, the income approach and market approach are the most relied upon indicators of value. The income approach considers the present value of the company's projected future cash flows. If future projections have declined due to COVID-19, the value of the business likely declined as well. With the market approach, the value of the subject business likely declined if either the relevant multiples (e.g., 1x revenue, 5x EBITDA) within the industry declined and/or the subject company's expected metric (revenue, EBITDA, etc.) declined. Therefore, in many instances, gifting post COVID-19 takes advantage of deceased values and as such, a larger percentage of the interest can be gifted.

Possible Strategies

In a depressed economy, there are many potentially beneficial gifting strategies to consider. For example, the depressed assets can be used to fund an irrevocable trust. If the value of assets rebound, you will have used only a portion (equal to depressed value) of your available exemption to provide an outsized gift for your beneficiaries. Other possible strategies include grantor retained annuity trusts (GRATs), charitable lead annuity trusts (CLATs), note sales to intentionally defective grantor trust, intra-family loans, and more.

For many business owners, the two things largely beyond their control—exemption size and asset values—are temporarily aligned in a way that is potentially favorable for estate planning. If you are considering making a gift or employing any of the strategies above, we highly recommend you talk to a financial adviser.

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