WILMINGTON TRUST

MEMBER OF THE M&T FAMILY

New Year, New Administration: What Does this Mean for Gifting Under Your Wealth Plan?

With the runoff election in Georgia now complete, the state of the Senate is now clear. The Democratic party has control of both chambers of Congress with a slim margin, with Vice President Harris as the tie breaker. Although still not the "blue wave" previously projected, the potential impact of a Democratic Congress under a Biden administration will likely be significant in terms of tax legislation. Therefore, it is more important than ever to revisit your planning especially since tax legislation may be retroactive. For those who took a "wait and see" approach at year end, the time to evaluate and put a plan in place may be now.

Key points:

- After many recounts and court challenges, Joseph R. Biden Jr. has been inaugurated as President of the United States
- With the potential for a considerably reduced federal gift tax exemption, now is the time to make significant gifts

Consider making significant gifts to take advantage of the disappearing gift tax exemption

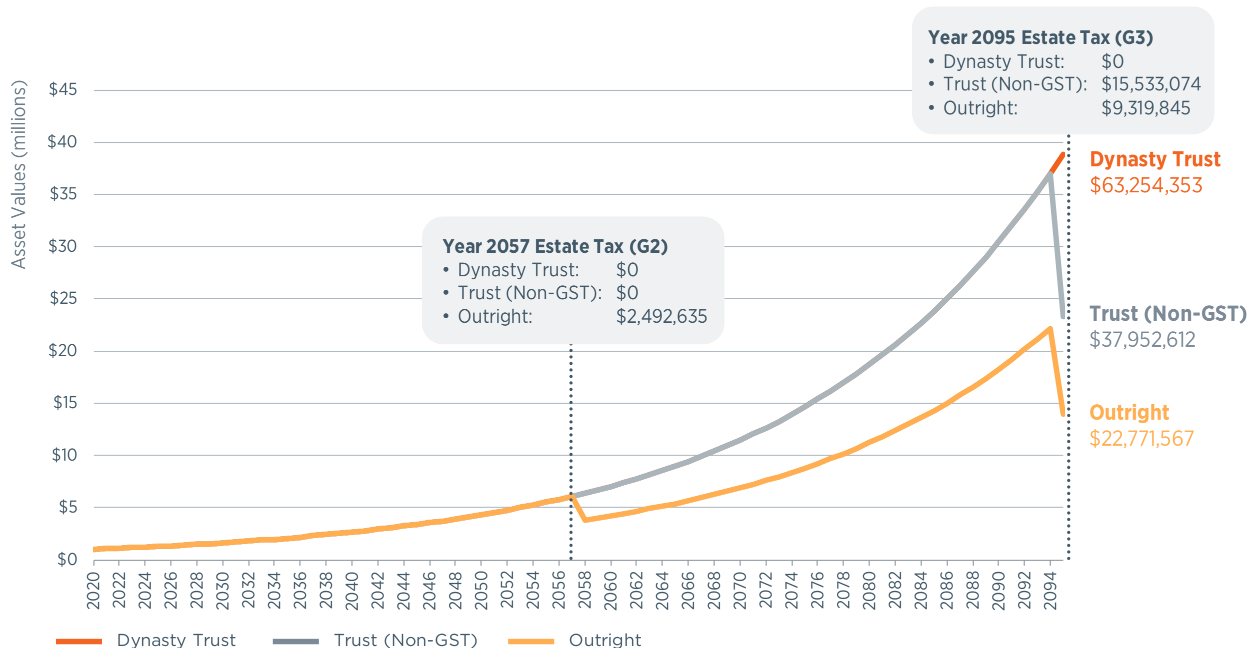
For those whose assets are significant enough to have a taxable estate, planning will be even more important now. One result of the comprehensive tax reform enacted in 2017 was a significant increase in the gift, estate, and generation-skipping transfer (GST) exemption. Indexed for inflation, the amount exempt from federal gift and estate tax in 2021 is $11.7 million per person ($23.4 million for a married couple), which means that you may give up to this amount during your lifetime, free of gift tax, with any unused amount applied against federal estate taxes at your death.

Continued

 ©2021 M&T Bank Corporation and its subsidiaries. All rights reserved.

Figure 1
Example of benefits of gifting to a dynasty trust

Assumptions: Initial investment of $1,000,000 | Net rate of return of 5% | Each generation holds assets for 37.5 years | Estate tax of 40%



This chart is for illustration purposes only and does not reflect the actual performance of any specific investment. The illustration is hypothetical and is intended solely to depict the benefits of a dynasty trust.

Barring any intervening legislation, the current exemption amount is slated to sunset on December 31, 2025, and effective January 1, 2026, the exemption reverts to $5 million per individual ($10 million for a married couple) as indexed for inflation. However, President Biden has indicated an intent to revert to 2009 limits, which include a $1 million lifetime gift exemption and a $3.5 million estate and GST exemption. With this drop in the gift exemption, high-net-worth individuals could lose more than 90% of their ability to efficiently transfer wealth if there is new legislation.

Consider creating a trust and gifting assets to it sooner rather than later

The earlier a gift is made, the more time it will have to grow outside of your estate, and this is particularly true where a large gift is made to a trust rather than outright. In addition to benefits of a trust such as professional management, tax mitigation, and creditor protection, a trust structured as a grantor trust would effectively allow the trust assets to grow income tax free, as all income tax obligations would be paid by the grantor. The grantor trust structure also benefits the grantor in that all payments for taxes further reduce the grantor's taxable estate and yet are not subject to gift tax. If structured and administered properly, the trust may serve multiple generations with significant tax benefits. Using the dynasty trust as an example (see Figure 1), if you gift $1 million to this type of long-term trust, that gift could grow to almost three times its value in just two generations as compared to an outright gift.

Continued

 ©2021 M&T Bank Corporation and its subsidiaries. All rights reserved.

Perhaps the biggest roadblock for many is having to give up control over the trust assets. While an irrevocable trust, by its nature, necessitates some limits and restrictions over control, the directed trust structure allows for greater flexibility.

Overcome common "roadblocks"

Although the inherent value of gifting is understood by many, the mental roadblock of parting with such significant assets can be daunting, and there are some strategies that can help you get past them. Like many, you may feel that you are being rushed into this decision and it may paralyze your ability to move forward. No one likes the feeling of being rushed. Here are three common roadblocks and strategies that may help you to get past them.

1. How can I maintain flexibility in a trust?

Create a spousal lifetime access trust (SLAT). These trusts are designed to take advantage of the gift tax exemption while allowing a way for your spouse (as a beneficiary of the trust) to continue to enjoy the benefits of the trust now and in the future, if needed. For example, if a husband were to create a trust for the benefit of his wife and children, because his wife is a beneficiary of the trust, she may request a distribution of the funds from the trustee. The trustee will exercise its fiduciary responsibility and make the distribution to the wife, as beneficiary, assuming it is appropriate and in accordance with the terms of the trust. If the wife wishes to then later share that distribution from the trust with her husband or use the distribution for their joint benefit (e.g., making improvements to the family home), she may do so without negative gift tax consequences. In some cases, it may make sense for the family to have two trusts: one where the husband creates a trust for the benefit of his wife and children, and one where the wife creates a trust for the benefit of her husband and children. This way, both spouses could potentially benefit from the trust assets should the need arise in the future. One thing to note is that these trusts must not be identical and need to contain enough variations so as not to run afoul of the "reciprocal trust doctrine."

Include a testamentary power of appointment. In the SLAT strategy described above, an additional feature than can offer further flexibility is a special power known as a "testamentary power of appointment." This would allow you to give your spouse a "second bite of the apple" because your spouse may, using this power in his/her will, redirect the trust assets to a pre-determined group of people or charity. For those who are concerned about deciding now about how their assets are to be distributed down the road, this is a great way to effectively delay that decision and allow your spouse to determine at a later time when the future becomes clearer.

Implement a directed trust. Perhaps the biggest roadblock for many is having to give up control over the trust assets. While an irrevocable trust, by its nature, necessitates some limits and restrictions over control, the directed trust structure allows for greater flexibility. A properly drafted directed trust under the right jurisdiction can allow traditional trustee responsibilities over distribution and investment decisions to remain with trusted family members, friends, or advisors.

Continued

 ©2021 M&T Bank Corporation and its subsidiaries. All rights reserved.

Gone are the days where trusts were created and operated in a black box. Modern trust law and drafting have evolved to allow for the family to remain involved and ensure flexibility for generations to come.

Essentially, the directed trust splits fiduciary responsibilities, allowing you as the grantor of the trust to name your own investment advisor to manage the assets, while the trustee is responsible for other aspects of administering the trust. The trustee can't be held liable for the investment advisor's actions unless the trustee engages in willful misconduct related to the investment process. This structure is particularly beneficial for business owners who do not wish to divest the business interests held in a trust.

The directed trust feature provides significant flexibility since it can be added to virtually any type of trust structure in Delaware. Having recognized a directed trust structure for over a century, Delaware's directed trust law provides:

- Freedom to engage in estate planning or asset protection planning using illiquid assets, such as stock in the family business, real estate, or hedge fund/private equity investments, when a trustee may otherwise be reluctant to hold these types of assets
- Flexibility for a trusted advisor or family member to retain control over a trustee's investment or distribution decisions so that they can do what is best for the family/beneficiaries

Gone are the days where trusts were created and operated in a black box. Modern trust law and drafting have evolved to allow for the family to remain involved and ensure flexibility for generations to come.

2. How do I know how much and what assets to gift to the trust?

It's one thing to talk about gifting in the abstract; it's quite another to make that a reality. One of the most common questions is: how much do I gift and what asset do I gift?

An experienced financial planner can help you answer this question by running detailed analyses and projections to quantify the impact of the gift against your future needs. A sustainability analysis is recommended to help determine how a gift that's removed from your balance sheet will impact your future cash flow and lifestyle needs. The sustainability analysis should also be stress tested to account for any future contingencies. Depending on your balance sheet and needs, gifting the maximum amount allowed under the current law might be too large a gift and could begin to erode your future cash flow or lifestyle needs. In that case, it may be wise to reverse engineer back to a more comfortable gifting amount.

Continued

©2021 M&T Bank Corporation and its subsidiaries. All rights reserved.

3. I am still not sure and may need more time, what strategies may give me more flexibility?

While the likelihood of tax legislation is still yet to be seen, having a gifting strategy in place that is ready to be executed is critical in case of any swift legislative changes. Here are some strategies that may help you buy a little more time.

Gift cash or marketable securities now to lock in the exemption and include a "swap" power

Like many, your most valuable asset with the highest appreciation potential (and hence the ideal asset to gift) is often also a complex asset that is hard to value. Many of these assets are also levered where a transfer of ownership implicates credit which can be challenging to restructure. In these cases, there may not be enough time to properly value the asset and work through the mechanics involved for a quick gift. A potential strategy is to utilize a "swap" power in the trust. This type of power allows you to substitute assets of equal value in and out of the trust at a later time. For example, let's say you wish to make a gift of $11 million consisting of your business interests and you are concerned that you cannot do this quickly in case there is a swift change in legislation. In this case, you may instead make a gift of cash or marketable securities (that are readily valued) of $11 million into a trust now to lock in the use of the gifting exemption. Then, some time later in the year, you, as grantor of the trust, can exercise your swap power and exchange the business interests for the cash/marketable securities. The result: the business interest is held in the trust, and you have the cash/marketable securities back. If cash flow is an issue, many banking institutions may be able to provide a short-term lending facility to accommodate and bridge the timing gap. If structured and implemented correctly, this kind of swap will not have any negative tax consequences.

Issue a promissory note now and cancel the note later if gifting is desired

If you are still uncomfortable with making a sizable gift and want a little more time to consider before making the final decision, one strategy is to lend the asset that may be potentially gifted to your beneficiary (or a trust for his/her benefit) and receive a promissory note in return. Pending any news on legislative action (and assuming changes are not retroactive), you can simply forgive the note, hence making the effective date of the gift prior to any legislative changes.

Continued

 ©2021 M&T Bank Corporation and its subsidiaries. All rights reserved.

There is often a mistaken notion that the death benefit from life insurance is tax free. While life insurance proceeds are income tax free, they are not estate tax free.

What if this kind of gifting is just not for me; what else should I consider for my estate planning before the gift exemption disappears?

Do not forget the existing trusts you've created. You may already have an existing estate plan that includes trusts. Many of these older existing trusts may not have been created properly with the right allocation of GST exemption. In some cases, you may be able to apply the current GST exemption and "protect" these old trusts and make them effectively GST trusts. This would not require additional asset outlay from you. You're simply using up your exemption in a smart way. Before implementing this strategy, you will want to work with your wealth advisor and attorney to ensure that the existing trusts are in the proper form, and if not, determine whether a modification is possible.

Consider a GRAT if you don't want to use your gift exemption. If you do not wish or are not ready to use your gift exemption, there are other strategies to consider. In this current low interest rate environment, a grantor retained annuity trust (GRAT) can be a valuable consideration. A GRAT is a popular strategy of transferring property that is expected to appreciate in value to a trust in exchange for an annual payment (or annuity) for a term of years. The amount of the annuity is determined by the length of the trust, the value of the property transferred, and current interest rates. As of January 2021, this interest rate, also known as the 7520 rate, is at a historic low of 0.6%.

The primary tax benefit of a GRAT is that any income or appreciation earned during the term, in excess of the stated interest rate, passes to the remainder beneficiaries (who are often children or family trusts) free of gift or estate tax. GRATs are a popular strategy because there is limited economic downside and you can effectively retain control of the property transferred. Moreover, GRATs may be designed (under current law) to pay back to you the entire value of the property plus the stated interest amount without any gift tax consequences. (This technique is often referred to as a zeroed-out GRAT.)

Do not forget about your life insurance. There is often a mistaken notion that the death benefit from life insurance is tax free. While life insurance proceeds are income tax free, they are not estate tax free. In other words, life insurance owned outright by you is includable in your estate and subject to the estate tax. Many individuals have substantial life insurance policies, which may be structured incorrectly, as they are not held in a trust. This may be a good time to gift those policies into an irrevocable life insurance trust (ILIT) for the benefit of your family. If structured and administered properly, the death benefit received by the ILIT could be free of both income and estate taxes. The gift of certain policies can be a taxable gift, and this would be a good way to use the gift exemption without any additional cash outlay. Before implementing this strategy, it is important to work with your advisor to conduct a careful analysis of the nature of the insurance policies to see if this strategy is appropriate.

Continued

 ©2021 M&T Bank Corporation and its subsidiaries. All rights reserved.

I already made year-end gifts, should I do more?

For those who created year-end trusts to take advantage of the 2020 gift exemption, note that the allowable exemption amount has increased by $120,000 per person (or $240,000 for a married couple) for this year. You may wish to gift this additional amount into a previously created trust in order to maximize the use of the remaining gift exemption in 2021 early in the year. For many, a year-end gifting strategy included utilizing a SLAT. Given the potential of tax law changes later in the year, you may consider creating another SLAT where the beneficiary includes the other spouse and gift assets equal to any remaining gift exemption amount into the second SLAT. As previously discussed, care should be taken to ensure that the second SLAT does not contain the same terms as the first SLAT so that it runs afoul of the "reciprocal trust doctrine." The fact that the SLATs are created in different calendar years could be helpful in that regard.

As always, we are here to help you navigate through any potential legislative changes, and to help position your wealth plan to best capitalize on opportunities while being prepared for the unknown.

Continued

©2021 M&T Bank Corporation and its subsidiaries. All rights reserved.

Alvina H. Lo
Chief Wealth Strategist
Wilmington Trust, N.A.

212.415.0567
alo@wilmingtontrust.com

As part of the Wilmington Trust and M&T Emerald Advisory Services® team, Alvina is responsible for wealth planning, strategic advice, and thought leadership development for Wilmington Trust's Wealth Management division. She oversees a national team of wealth strategists, financial planners, and thought leadership experts, who together, serve as advisors to high-net-worth individuals and families, business owners, entrepreneurs, and foundations and endowments.

Alvina 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 has been recognized by Crain's New York Business as one of their Most Notable Women in Financial Advice in 2020. She was also recognized as one of Worth's Groundbreakers 2020: 50 Women Changing the World. She is a published author on estate planning matters and has lectured at the American Bankers Association, American Bar Association, Delaware Trust Conference, Hawaii Tax Institute, and *Barron's* Top Women Advisors Summit. She has been quoted in the *New York Times, Barron's, Bloomberg,* and *Business Insider.*

This article is for informational purposes only and is not intended as an offer or solicitation for the sale of any financial product or service or as a determination that any investment strategy is suitable for a specific investor. Investors should seek financial advice regarding the suitability of any investment strategy based on their objectives, financial situations, and particular needs. This article is not designed or intended to provide financial, tax, legal, accounting, estate planning, or other professional advice since such advice always requires consideration of individual circumstances. If professional advice is needed, the services of a professional advisor should be sought.

Wilmington Trust is not authorized to and does not provide legal, accounting, or tax advice. Our advice and recommendations provided to you are illustrative only and subject to the opinions and advice of your own attorney, tax advisor, or other professional advisor.

There is no assurance the any investment, financial, or estate planning strategy will be successful. These strategies require consideration for suitability of the individual, business, or investor.

The information in this article has been obtained from sources believed to be reliable, but its accuracy and completeness are not guaranteed.

Note that a few states, including Delaware, have special trust advantages that may not be available under the laws of your state of residence, including asset protection trusts and directed trusts.

Investing involves risks and you may incur a profit or a loss. Asset allocation/ diversification cannot guarantee a profit or protect against a loss.

Wilmington Trust and M&T Emerald Advisory Services are registered trademarks and refers to these services provided by Wilmington Trust, N.A., a member of the M&T family.

Wilmington Trust is a registered service mark used in connection with various fiduciary and non-fiduciary services offered by certain subsidiaries of M&T Bank Corporation including, but not limited to, Manufacturers & Traders Trust Company (M&T Bank), Wilmington Trust Company (WTC) operating in Delaware only, Wilmington Trust, N.A. (WTNA), Wilmington Trust Investment Advisors, Inc. (WTIA), Wilmington Funds Management Corporation (WFMC), and Wilmington Trust Investment Management, LLC (WTIM). Such services include trustee, custodial, agency, investment management, and other services. International corporate and institutional services are offered through M&T Bank Corporation's international subsidiaries. Loans, credit cards, retail and business deposits, and other business and personal banking services and products are offered by M&T Bank, member FDIC.

©2021 M&T Bank Corporation and its subsidiaries. All rights reserved. 24709 210120 V8