



Wealth Planning Update

# The 2020 Wealth Transfer Trifecta

AUGUST 2020

**Elizabeth Jensen**

Senior Wealth Planning Strategist  
Wells Fargo Private Bank

**Aaron Waites**

Regional Wealth Planning Manager  
Wells Fargo Private Bank

**Key takeaways:**

- Why create a wealth transfer plan?
- What are some of the potential impacts of current estate and gift tax exemptions?
- How do depressed values and interest rates prescribed by the IRS play into this?

**What this may mean for you:**

The current Trifecta may be one of the best times in history to transfer wealth efficiently with minimal estate tax for generations, but the right approach for each family may vary. A comprehensive approach with a strong advisory team can help you decide what's best for your situation.

The Trifecta:

1. High estate and gift tax exemptions
2. Low values
3. Low interest rates

Election years often spur uncertainty in the economy and tax laws. 2020 is no exception as we entered the year with historically high wealth transfer exemptions and what many considered extremely low interest rates<sup>1</sup> prescribed by the IRS. Then came the coronavirus pandemic, driving interest rates even lower and creating extreme volatility in asset values. In this environment, it may be an opportune time to consider or revisit your wealth transfer plan.

The combination of historically high estate and gift tax exemptions, low values, and low interest rates prescribed by the IRS that are used for wealth transfer strategies creates a trifecta of favorable factors providing an opportunity to potentially increase the amount of wealth transferred to heirs for generations without estate and gift tax.

<sup>1</sup> Interest rates mentioned in this publication refer to the rates prescribed by the IRS that are used for Wealth Transfer Strategies

The opportunity to act on this trifecta, however, may not exist for long. By all accounts, the need for additional tax revenue increased substantially due to trillions in federal spending on the ongoing pandemic with more to come. These expenses, in addition to elections, could force tax changes to estate and gift tax exemptions earlier than scheduled. Even if tax laws remain unchanged, the low values and current interest rates that are tied to the economic uncertainty related to the pandemic, the length and full impact of which remains unknown.

## Why create a wealth transfer plan?

Wealth transfer planning is about creating a custom plan for the control and benefit of your wealth during your lifetime, in the event of incapacity, and upon your death. The personal decisions of who is in charge, who benefits, and how they benefit are entirely up to you. The more universal goals tend to be about ensuring the custom plan is carried out effectively and efficiently, that assets remain protected for the heirs, and that taxes can be kept to a minimum.

The estate and gift tax is a tax on the transfer of wealth during life and upon death. Under current law, each person may transfer a combined \$11.58 million of assets without tax. Every dollar transferred over this amount is subject to a 40% tax with general exceptions for transfers to a spouse or charity.<sup>2</sup>

Therefore, if you have a taxable estate and are seeking ways to potentially reduce your wealth transfer tax liability, you might want to consider:

- Keeping your taxable estate from growing by transferring growth
- Utilizing your exemptions efficiently

In many cases, lifetime transfers are necessary to help minimize transfer taxes. But many wealth creators are understandably hesitant to make substantial lifetime transfers due to concerns about loss of control, access to transferred assets and cash flow, next generation preparedness and dynamics, and lack of certainty around trust and tax laws. As a result, they may fail to make any, or enough, lifetime transfers to effectively minimize estate taxes. Addressing these common concerns is beyond the scope of this piece, but you should be aware of the various ways to handle them.

When lifetime transfers do make sense, making those transfers as efficient as possible is typically the next step. The trifecta of high exemptions, low values, and low interest rates can create what we view as an opportune planning environment for addressing that goal.

## High exemptions under current law

The Tax Cuts & Jobs Act of 2017 increased estate and gift tax exemptions to the highest level since inception. In 2020, the estate and gift tax exemption amount is \$11.58 million per person (\$23.16 million per married couple).

However, the current exemption is scheduled to expire on December 31, 2025 and revert to the pre-2017 number indexed for inflation (likely about \$6.75 million per person). Estate tax and gift tax rates have ranged between 40% and 55% over the last 20 years.<sup>2</sup>

*While 2025 may seem like plenty of time to plan, the 2020 elections and pandemic impact may bring change as soon as 2021.*

## Why now?

While a 2025 deadline may seem like you have plenty of time to plan, the 2020 elections and pandemic impact may bring change as soon as 2021. Congress could pass new legislation to reduce these exemptions at any time. A lower exemption rate of \$3.5 million has been proposed<sup>3</sup>, but even the current administration may revisit these exemptions and/or raise estate and gift tax rates to help cover costs of the recent pandemic stimulus packages.

*The exemption used when gifting to a trust may not be 'clawed' back even if exemptions are later reduced or eliminated.*

---

<sup>2</sup> [IRS: Estate Tax](#)

<sup>3</sup> [TaxFoundation.org](#)

Lifetime gifts generally utilize trusts to establish the desired controls and protections over assets while seeking to benefit heirs generationally. Once a gift to a trust is made and reported, the exemption used may not be 'clawed back' even if exemptions are later reduced or eliminated by Congressional changes. The higher exemptions facilitate greater funding if used.

Example: Today a married couple can transfer over \$20 million without estate or gift tax. If exemptions are cut in half, then the same couple can only transfer approximately \$10 million without estate or gift tax. At a 40% tax rate, the couple creates an approximate \$4 million savings by making a transfer at current exemptions. That means \$4 million more for the heirs instead.

*This information is hypothetical and is provided for illustrative purposes only. It is not intended to represent any specific strategy, nor is it indicative of future results.*

## Low values

How do you choose which asset to use with your exemptions?

Unlike the typical investment strategy of "buy low" and "sell high", when it comes to wealth transfer, the philosophy could be seen as a bit different - transfer assets when value is "low" and capture the potential opportunity to let it "grow".

The thinking is that - if exemptions could allow for transfer with minimal estate or gift tax impact - the more assets that could potentially be transferred, the bigger the impact of the exemption on the taxable estate. Lower values allow you to transfer more if they perform well by the time you pass.

*When it comes to wealth transfer...*

*"Transfer low and let it grow."*

Example: Assume a business owner has a \$20 million business that is expected to grow to \$40 million by her date of death. If her exemption is \$10 million, then she can only gift 50% of the business value out of her estate without incurring gift tax. If instead, she makes the transfer during uncertain economic times when the business may be valued much lower (let's say \$15 million) although she still expects it to be worth \$40 million by her date of death, she can transfer 75% of the business outside of her taxable estate without paying gift tax. The lower value at the time of transfer is better. By moving a greater percentage of the business out of her estate today, she may move more growth out of her estate. On her date of death, \$30 million of the business value is out of her estate instead of only \$20 million. At a 40% tax rate, this is a potential \$4 million tax savings that increases the amount her heirs receive by the same amount.

*This information is hypothetical and is provided for illustrative purposes only. It is not intended to represent any specific strategy, nor is it indicative of future results. Note that transferring a lower valued asset expected to appreciate after the transfer may result in the recipient paying more in the capital gains taxes than if he/she received it on the business owners' death.*

The tax code permits valuation discounts applied where there is lack of marketability, control, or other restriction that lowers the value of the interest at the time of transfer – think partial interests in closely held businesses and real estate assets. In 2017, the current administration shelved proposed regulations intended to limit this technique, but they still exist and a new administration could revive them to increase tax revenues. We believe that the ability to apply valuation discounts combined with low valuations make now a favorable time to transfer assets.

## Low interest rates

Gift tax exemptions are not the only way to transfer wealth. Families can freeze the value of their estate by loaning or selling assets to trusts or heirs using the IRS Applicable Federal Rate (AFR) to address estate and wealth transfer planning goals. The AFR set by the IRS each month establishes a minimum rate for intra-family loans and a discount rate to value certain interests. The rates act as a kind of hurdle – if your investment surpasses the AFR, your family can save estate taxes. Current rates are at a historic low, potentially making the hurdle easier to beat. The long-term AFR for August 2020, for example, is only 1.12% compared with 4.58% in August 2008, the last major crisis. If the asset transferred appreciates more than 1.12% annually, you have achieved your financial goal because you have reduced your taxable estate and your family's estate tax

liability.<sup>4</sup> Of course, in 2020 we have seen valuations fluctuate, with uncertainty regarding the growth of assets given that businesses and individuals are changing how they operate. Therefore, assets that once may have felt like a “sure thing”, such as commercial real estate, may not grow at the pace anticipated, or could lose value in years to come.

For more details on various techniques using low interest rates to reduce estate taxes such as renegotiating existing related party note terms, see the [3 Wealth Transfer Strategies in a Low Interest Rate Environment](#) Wealth Planning Update.

## Moving forward

This trifecta may be one of the best times in history to transfer wealth efficiently with minimal estate tax for generations, but the right approach for each family may vary. A comprehensive approach with a strong advisory team including your tax and legal professionals can help you decide:

- Whether to transfer assets
- How much to transfer
- Which assets
- Amount of exemption to use
- When to transfer

Consider setting up a virtual meeting with your local Wealth Planning team to discuss your specific situation and goals.

## Disclosures

Wells Fargo Private Bank provides products and services through Wells Fargo Bank, N.A. and its various affiliates and subsidiaries. Wells Fargo Bank, N.A. is a bank affiliate of Wells Fargo & Company.

**Wells Fargo Bank, N.A. offers various advisory and fiduciary products and services including discretionary portfolio management. Wells Fargo affiliates, including Financial Advisors of Wells Fargo Advisors, a separate non-bank affiliate, may be paid an ongoing or one-time referral fee in relation to clients referred to the bank. The bank is responsible for the day-to-day management of the account and for providing investment advice, investment management services and wealth management services to clients. The role of the Financial Advisor with respect to the Bank products and services is limited to referral and relationship management services.**

Brokerage services are offered through Wells Fargo Advisors. Wells Fargo Advisors is a trade name used by Wells Fargo Clearing Services, LLC and Wells Fargo Advisors Financial Network, LLC, Members SIPC, separate registered broker-dealers and non-bank affiliates of Wells Fargo & Company.

Wells Fargo & Company and its affiliates do not provide legal or tax advice. Please consult your legal and/or tax advisors to determine how this information may apply to your own situation. Whether any planned tax result is realized by you depends on the specific facts of your own situation at the time your tax return is filed.

©2020 Wells Fargo Bank, N.A. All rights reserved. Member FDIC. CAR-0820-00417

---

<sup>4</sup> IRS: [Index of Applicable Federal Rates \(AFR\) Rulings](#)