



# Why Now Is a Good Time to Explore Trusts

By Carla Wigen



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In my more than 20 years advising on trusts and estate planning, I have seldom seen a better time to explore setting up a trust. The two key variables of multi-generational wealth planning – tax rates and interest rates – are both starting to look as if they might be significantly less favorable in the coming years.

The prospect of higher taxes -- on estates/inheritance, capital gains, and high ordinary income – is increasing, given rising federal and state budget deficits and ambitious new spending programs. At the same time, interest rates – including the “hurdle rate” that determines distributions from some trusts – has started to rise from historical lows. These developments make the benefits of a trust potentially more valuable for high-net-worth households.

**#1. POTENTIALLY HIGHER ESTATE TAXES.** Currently, an individual during their lifetime can transfer up to \$11.7 million to heirs (over \$23 million for a married couple) without paying federal estate or gift taxes; this is double the amount allowed prior to 2018. The current estate tax exclusion will expire at the end of 2025 if not renewed by Congress, but Congress could lower it much sooner (perhaps even halving it) as part of the Biden administration’s proposals to increase taxes on the wealthy.

**Trust solution:** Transferring assets to a trust (up to \$11.7 million per person) can take that amount out of an estate permanently without the grantor or the heirs owing gift taxes on that. What’s more, a 2019 determination from the IRS preserves this higher exclusion for those who use it before the law changes it, in essence grandfathering it in. This has created a use it or lose it situation. The “use” means giving assets away – directly to beneficiaries or to a trust — up to the full exclusion (\$11.7 million per person), which is enough to fund a trust that can benefit children, grandchildren and/or charities over a long period of time.

Say you have a sizable estate that has grown significantly in value, is likely to keep appreciating, and you want to provide for future generations of your family, not just your children. A Generation-Skipping Trust (sometimes called a Dynasty Trust) could currently be funded with up to \$11.7 million in assets (roughly \$23 million for a couple). In Washington State, trusts can last for up to 150 years, so this would allow many generations to benefit from the trust. Another great benefit: assets transferred to a trust reduce or eliminate WA State estate taxes (see box).



## DON'T FORGET WA STATE ESTATE TAX

If your primary residence is in Washington State and you have a net worth higher than \$2.19 million, there is also the WA State estate tax to consider (see chart at right). The good news is that any lifetime gifts you make, either outright or through a trust, reduce your WA estate and thus the WA estate tax. (NOTE: Many other states, including IL and MA, do not allow this; they add back all gifts in calculating your taxable estate at the state level.)

WA Estate Value Above \$2.19 Million	Estate Tax Marginal Rate
\$0 to \$1 million	10.0%
\$1 million to \$2 million	14.0%
\$2 million to \$3 million	15.0%
\$3 million to \$4 million	16.0%
\$4 million to \$6 million	18.0%
\$6 million to \$7 million	19.0%
\$7 million to \$9 million	19.5%
Over \$9 million	20.0%

**#2. POTENTIALLY HIGHER CAPITAL GAINS TAXES.** In the past decade, many assets have seen tremendous price gains – stocks, real estate, private businesses, etc. Proposals put forth by the Biden administration and some members of Congress would significantly increase capital gains taxes in different ways and times – annually, upon sale, or when the owner dies. Among the proposals:

- Taxing capital gains as income for households with \$1 million or more in income from all sources. If you're in this category, capital gains would be taxed as ordinary income up to the highest rate, which could revert back to 39.6%. For everyone else, long-term capital gains would continue to be taxed at the usual beneficial rates of 0%, 15% and 20%, depending on income level.
- Ending "stepped-up" basis at death. Currently, assets owned at death transfer to heirs at the prevailing market price, referred to as "stepped-up tax basis." This means your heirs can inherit, sell immediately, and not pay any capital gains tax. An apartment building bought for \$500,000 in 1984, for example, can be inherited and sold for \$5 million in 2021 without any capital gains taxes owed. If stepped-up basis is eliminated, however, the estate could owe \$1.78 million in taxes (39.6% top rate on \$4.5 million in gains).

**Trust solutions:** Assets transferred to a trust are out of the estate and can continue to gain in value without capital taxes being recognized. When and how to pay capital gains taxes can then be decided by the trustee or ultimately the trust beneficiaries. One strategy is to sell assets to a trust over a set period of time in exchange for a promissory note, whose rate would be based on Applicable Federal Rates, which are relatively low compared with market rates (see chart). The assets would then be out of the estate and can continue gaining in value over time.

### Applicable Federal Rates (AFR) April 2021

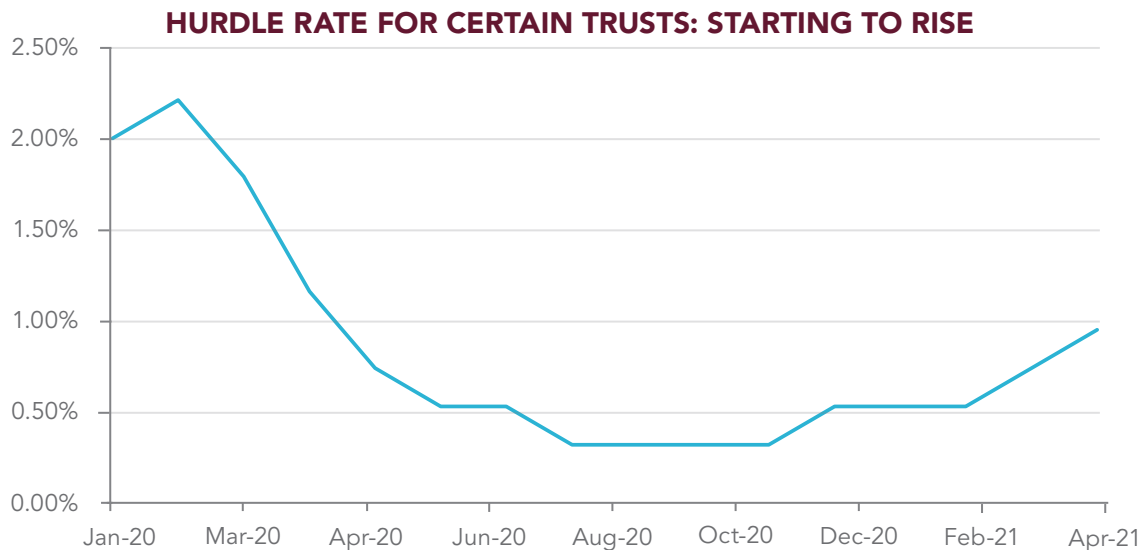
Term	Applicable Interest Rate (Annualized, Fixed)
<b>0 to 3 years</b>	0.12%
<b>From 3 to 9 years</b>	0.89%
<b>More than 9 years</b>	1.98%

Source: IRS Rev. Rul. 2021-7.



For business owners, a Grantor Retained Annuity Trust (GRAT) can help revitalize the business by transferring ownership shares to younger generations, including bringing in family members not currently involved with the business. After the business is transferred to the GRAT, the current owners would get back a series of annual payments that over time add up to the value of the business when transferred. In the meantime, the business could continue to increase in value for the benefit of the new owners.

**#3. HISTORICALLY LOW “HURDLE RATE.”** For two major types of trusts – the GRATs mentioned above and also Charitable Lead Trusts (CLTs) – the IRS sets a “hurdle rate” (officially known as the Section 7520 rate) at which trust assets are expected to grow. Any growth above that rate can go to heirs estate-tax-free after the trust expires. In April 2021, the hurdle rate is 1%, about half what it was Jan. 2020, although on the rise (see chart below). The relatively low hurdle rate currently makes trusts an even more effective wealth transfer tool, assuming assets in the trust can gain more than 1% annually in value.



Source: Internal Revenue Service.

Say you transfer a portion of a stock portfolio to a Charitable Lead Trust (CLT), which can then hold the shares or sell them and reinvest. The CLT would make annual distributions to your favorite charities for a specified period or for the lifetimes of you and/or your spouse. You could get an upfront income-tax deduction depending on how much control you retain over the trust and your willingness to pay tax on the trust’s income. Any growth in trust assets above 1% annually — the current hurdle rate — would go estate-tax-free to your children or other heirs when the term of the trust ends.

### THE BOTTOM LINE

My colleagues and I at LNWM are closely watching the progress of tax proposals at both the federal and state level so we can advise clients accordingly should some of these become law. Keep in mind that trusts are set up for many reasons, and they are definitely not for everyone. Still, what a trust can do for you and your family is worth exploring given the potential changes noted above. Because each situation is different, we advise that you get in touch with your LNWM advisor to learn more. We can also work closely with your existing attorney(s) and accountant(s) to analyze the benefits and pitfalls of specific trusts in context of your priorities and finances.



## ABOUT THE AUTHOR

**Carla Wigen**, JD, CPA, is chief operating officer at Laird Norton Wealth Management. In this key role, Carla works to ensure that the full strength of LNWM's services is being applied strategically to achieve the goals of each client, and to develop new connections, resources and programs that help clients thrive in all aspects of their lives. To her work, Carla brings 25 years of experience as an industry leader in comprehensive wealth management, including investments, planning, trusts and estate strategies, and tax law. Carla earned a Juris Doctorate at the Seattle University School of Law and a Master's of Law at the University of WA School of Law. She has a Bachelor's in Business Administration from the University of WA and is a Certified Public Accountant.

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