MANAGEMENT & *TAX CONCEPTS*

WHEN INTEREST RATES GO LOW, IT'S HIGH TIME FOR ESTATE PLANNING

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When interest rates go low, it's high time for estate planning

In a volatile economic environment, the idea of making substantial gifts may give you pause. But with interest rates at historic lows and the value of many assets depressed, now may be an ideal time to plan your estate. Current conditions present an opportunity to transfer substantial wealth to the younger generation while minimizing your exposure to estate and gift taxes. And many planning strategies provide you with an income stream, which can give you peace of mind in uncertain times.

WHY NOW?

Reducing the size of your estate may not seem like a pressing concern. After all, the federal estate and gift tax exemption is a staggering $11.58 million ($23.16 million for married couples). But even if your net worth is substantially lower than that, it's important to keep in mind that the exemption will likely shrink in the near future.

For one thing, the current exemption, which was established by the Tax Cuts and Jobs Act of 2017, is scheduled to be cut in half at the end of 2025. Plus, there's a strong possibility that the U.S. Congress will act sooner than that to boost tax revenues. One proposal, for example, would reduce the estate tax exemption to $3.5 million and the gift tax exemption to only $1 million.

So, regardless of the size of your estate, it's a good time to implement strategies that allow you to leverage low interest rates. Here are some estate-planning tools to consider.

ALL IN THE FAMILY

Lending money to your children or other family members is a simple — yet deceptively powerful — strategy for removing wealth from your estate with minimal transfer tax implications. It's critical, however, to structure the loan carefully to prevent the IRS from arguing that the transaction is a disguised gift. To avoid an IRS challenge, you should treat the loan as you would an arm's-length transaction with an unrelated party. That means, among other things:

- Charging interest at the applicable federal rate (AFR) or higher,
- Having a written loan agreement and
- Trying to collect the debt in the event the borrower defaults.

How does a loan reduce transfer taxes? The key is for the borrower to invest the funds in assets that outperform the AFR. That's a hurdle that's much easier to overcome when interest rates are low. For example, say you make a loan to your child when the AFR is 2%. And he or she invests the funds in a business, real estate or

Feeling charitable?

If charitable donations are important to you, you might consider a charitable lead annuity trust (CLAT). CLATs are similar to GRATs, except that, instead of making annuity payments to you, these payments are made to one or more charities of your choice.

At the end of the trust term, as with a GRAT, the remaining assets are distributed to your children or other noncharitable beneficiaries. For tax purposes, the value of the gift to your noncharitable beneficiaries also is determined in essentially the same manner as a GRAT. Thus, the lower the Section 7520 rate when you establish a CLAT, the larger the potential tax-free gift.

If you're contemplating a CLAT, be sure to discuss the income tax implications with your advisors. Typically, a CLAT is designed as a nongrantor trust, which prevents you from taking charitable deductions for contributions to the trust. However, it can offer other tax advantages down the road.

other assets that earn a 7% return. Then the difference between the loan payments and the returns earned by the borrower's investment is, in effect, a tax-free gift.

GRATEFUL FOR GRATS

A grantor retained annuity trust (GRAT) is another estate-planning tool that is particularly effective in a low-interest-rate environment. When you establish a GRAT (which is irrevocable), it pays you an annuity (a fixed dollar amount, typically paid annually) during the trust term. After that, the remaining assets are distributed to your children or other beneficiaries.

Here's the secret to the GRAT's tax-saving power: Funding the trust is considered a taxable gift to your beneficiaries, but the amount of the gift is based on the projected value of their remainder interests at the end of the trust term. And this value is calculated by assuming that the trust assets will grow at the "Section 7520" rate — a conservative rate of return set monthly by the IRS.

So long as you survive the trust term, any earnings that exceed the Section 7520 rate (at the time the trust is set up) are transferred to the beneficiaries tax-free. Again, this is a fairly easy hurdle to overcome when interest rates are low. In addition, by funding the trust with assets that have declined in value, you can minimize the tax impact even further.

HOW DOES YOUR PLAN RATE?

This article offers two examples of estate-planning strategies that benefit from low interest rates. There are other possibilities. Your advisors can help you identify strategies that are appropriate for your financial situation and goals. •

Does the pandemic make you think about an earlier retirement?

Due to the COVID-19 crisis, many employees who're able to perform their duties remotely have transitioned to working from home. This has offered a glimpse of what retirement might look like for them — minus the work load, of course.

For example, many remote employees are enjoying more free time since they no longer have to commute back and forth to an office. And they have more flexibility to take care of routine tasks and chores that arise throughout the day, whether it's meeting a repairman at their home or helping their kids with remote learning.

CHANGING VIEWS OF RETIREMENT

These new work-from-home experiences are changing the way some employees view retirement. Here's one example: In a June survey of approximately 300 individuals age 55 and over conducted by investment strategist Wes Moss, who hosts a radio show about personal finances, a quarter of respondents said they plan to keep as much of their lockdown lifestyle as possible after the pandemic ends.

Some corporations are offering employees early retirement packages in an effort to cut costs and align their workforce with lower, pandemic-era demand for their products and services. Such a package may serve as an added incentive for an employee who's nearing retirement to make the leap now.

FOUR FACTORS TO CONSIDER

If you're thinking about accelerating your retirement date, there are several different factors to consider, including:

1. Do you have enough savings to support an early retirement? Without adequate financial resources, you could deplete your retirement savings early and possibly have to return to the workforce later. Be sure to factor all sources of retirement income into the equation, including your IRA or 401(k), Social Security, a company pension plan (if you have one), real estate holdings, anticipated inheritances and an early retirement package if you're offered one. But remember: You typically can't start receiving Social Security retirement benefits until you turn 62, and it is often wise to delay the start date to increase the monthly benefit.

2. Are you emotionally prepared for retirement? Nonfinancial aspects of retirement, such as emotions, can be just as important as financial considerations. For example, does your social life revolve around friendships and relationships at work? And how closely are you defined by your job? Some retirees struggle with their identity after they leave the workplace, so give this some careful thought.

3. Have you pictured what retirement looks like for you?

How do you envision your retirement lifestyle? For example, do you want to travel to exotic locations or spend time with your children and grandchildren? Or are there hobbies and interests you'd like to pursue? It's important to plan for how you'll spend your days in order to stay busy and mentally sharp. This includes replacing the socialization you experienced while you were in the workforce.

4. Do you want to work part-time in retirement? This can not only help you stay busy after you retire, but it can also generate extra income that could help your retirement savings last longer. Retiring earlier than you originally planned might also allow you to launch that new business you've always dreamed about but never could squeeze in while you were working full time.

TALK TO YOUR LOVED ONES

Accelerating your retirement date is a big decision that will have major repercussions on every area of your life. Be sure to discuss it with your spouse, other close family members — and your financial advisors — before taking the leap. •

Put procedures in place to avoid "past due" situations

COVID-19 has caused many businesses and individuals to be strapped for cash and experiencing difficulty paying their bills. If you're running your own business, outstanding invoices can play havoc with *your own* cash flow.

Some businesses are offering payment extensions to their customers. But if your financial situation isn't, or is no longer, allowing you that courtesy, there are steps you can take to help ensure you get paid.

IN THE BEGINNING

Before your transaction with the customer, share a written summary of the project's scope and fee. Capturing the terms in writing helps minimize future disagreements that can delay payment.

For larger projects, try to negotiate that installment payments be made after you complete specific stages of the work. This offers some assurance that even if some difficulty occurs — such as the customer running into financial trouble or the project being canceled before completion — you'll at least receive something for your efforts.

INVOICE TIME

Invoice your customers promptly. It's easy for this important task to get pushed aside by the crunch of ongoing business. Many businesses are backed up because of COVID-19–related closures or delays last spring or summer. But the more quickly you invoice, the more quickly you'll be paid.

Invoice accurately. Ensure that you're sending the invoice to the right person at the right address. Sending it to the wrong addressee will delay payment until it lands in the correct inbox. Double-check arithmetic, as errors also can lead to delays. If your customer requires a purchase order number to issue payment, obtain one and include it on the invoice.

Break out the charges. Provide enough detail on the invoice that the customer can easily identify the services or products for which he or she is being charged.

Offering payment options is perhaps more important now than in "normal" times. Customers may pay more quickly when they can use the method they find most convenient — whether they prefer paying by credit card, by check or via an online payment platform.

For larger projects, try to negotiate that installment payments be made after you complete specific stages of the work.

Another helpful strategy is to consider early payment discounts. You can motivate some customers to pay more quickly by offering to shave a percentage from the invoice total if they pay before the agreed-upon due date.

FOLLOWING UP

A polite email reminder, sent before payment is due, can nudge customers who may have overlooked your invoice. Some software programs can be programmed to send reminders automatically.

Follow up right away. Contact the customer once you notice a payment is late. A polite email or text reminder asking the customer to correct the oversight often is enough to prompt action. But if you've sent several texts or emails and still haven't received payment, a phone call may be in order. Many people find it harder to ignore or evade questions over the phone.

Throughout the payment process, remain polite. Especially in larger companies, it's possible the person with whom you're talking isn't aware your invoice is overdue. Polite assertiveness can help you both get paid and maintain a good relationship with the customer.

PROCEDURES ARE KEY

Create an inhouse collection policy. Put steps, such as the ones described above, in writing. Your staff (and you) will be more successful in getting customers to pay their bills promptly if you have procedures in place and follow them. •

Remote work can be taxing

The COVID-19 pandemic has required many people to work remotely, either from home or a temporary location. One potential consequence of remote work may surprise you: an increase in your state tax bill.

During the pandemic, it's been fairly common for people to work remotely from another state — across state lines from the employer's place of business or even across the nation. If that describes your situation, you may need to file tax returns in both states, potentially triggering additional state taxes. But the outcome depends on applicable law, which varies from state to state.

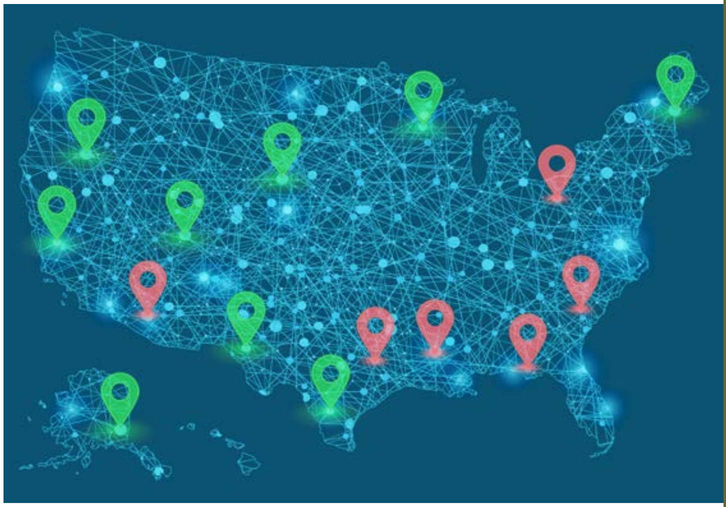
WATCH OUT FOR DOUBLE TAXATION

Generally, a state's power to tax a person's income is based on concepts such as domicile and residence. If you're domiciled in a state — that is, you have your "true, fixed permanent home" there — the state has the power to tax your worldwide income. A state also may tax your income if you're a "resident." Usually, that means you have a dwelling in the state and spend a minimum amount of time there.

It's possible to be domiciled in one state but a resident of another, which may require you to pay taxes to both states on the same income.

It's possible to be domiciled in one state but a resident of another, which may require you to pay taxes to both states on the same income. Many states offer relief from such double taxation by providing credits for taxes paid to other states.

But it's still possible for remote work to result in higher taxes — for example, if the state where your employer is based, and where you usually live, has no income tax but you work remotely from a state with a high income tax.



A state also may be able to tax your income if it's derived from a source within the state, even if you aren't a resident or domiciliary. Several states have so-called "convenience rules": If you're employed by an organization in the state, but live and work in another state for your convenience (not because the job requires it), then you owe income tax to the state where the employer is based.

If that happens, you also may owe tax to the state where you reside, which may or may not be reduced by credits for taxes paid to the other state. Some states have agreed not to impose their taxes on remote workers who are present in their state as a result of the pandemic. But in many other states there's a risk of double taxation.

KNOW YOUR OPTIONS

If you've been working remotely from out of state, consult your tax advisor to determine whether you're liable for taxes in both states. If so, ask if there are steps you can take to soften the blow. •

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