BALLENTINE PARTNERS

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Sophisticated Wealth Planning for a Hollywood Ending: Down market strategies and their cult film counterparts

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Hindsight is always 20/20, and there's no question the investment markets have been challenging in 2022. Investment losses don't have to be the whole story, though. Just like a good plot twist or unexpected movie ending, there are a few planning strategies that, if implemented properly, could provide a material impact and ease the pain of investment losses. These strategies go beyond tax loss harvesting and help you, maximize benefit where you can in an otherwise tumultuous market.

Strategy #1: GRAT swap and roll – Trading Places (1983)

The good news is that you decided to embark on the path of transferring wealth with minimal gift tax cost by using a grantor retained annuity trust (GRAT). You picked an asset you expected to appreciate significantly, but then the bad news: the market dropped off sharply, jeopardizing a successful outcome. Your GRAT is now Louis Winthorpe (Dan Aykroyd), starting off successful, only to be torn down and hitting rock bottom. You could wait and see, hoping for the best, or you could take action and turn tragedy into success.

Typically, language will be included in the GRAT document allowing the grantor to substitute assets of equal value. When this right is exercised, the underperforming asset is removed and used to fund a new identical GRAT, creating a fresh start. The initial GRAT success is sacrificed, as there is a much higher probability of overall success when starting over. Quick hypothetical example - a GRAT was funded with $5 million of Amazon stock in January 2022 at $170/share. Today, Amazon trades around $98/share, down 41% (about $3 million of value), meaning even if the stock rebounded by 70% by the end of the term, it would be a failure as you'd be back where you started. Instead, the grantor substitutes the stock by taking back the shares and replacing them with $3 million of cash or other assets. The stock could then be immediately contributed to a new GRAT, thus creating a new starting value of $3 million. If the stock price then increased by 70% by the end of the term, it's possible that close to $2 million would pass gift tax free to the beneficiaries after satisfying the annuity requirements. That type of win would get you invited to the tropical beach along with Louis and Billy Ray (Eddie Murphy).

Strategy #2: Fashionably late with GST – Brewster's Millions (1985)

Monty Brewster (Richard Pryer) was tasked with spending $30 million in 30 days in order to inherit $300 million. I expect after he blew through the $30 million, he would do whatever he could to protect the $300 million. If multi-generational wealth preservation is your goal, then effective use of the generation-skipping transfer tax (GST) exemption can be one of the most powerful tools. Have you made gifts into an irrevocable trust in the past and didn't take advantage of the exemption? No problem, as the tax code allows for late allocation.

GST exemption essentially shields assets from tax on both current gifts and in future estates. If used in states that allow perpetual “dynasty” trusts, assets could be shielded from these taxes forever while in trust. So how can you take advantage? Circling back to the Amazon stock gift example in Strategy #1 (but using a typical irrevocable trust instead of GRAT), the tax code does not require the use of GST exemption when the initial gift tax return is filed. Instead, a subsequent return can be prepared and exemption calculated based on the current fair market value of the assets at the time of the new filing. Sticking with the Amazon details, $2 million of GST exemption could be saved by using this strategy (i.e., allocating exemption on the decreased $3 million value instead of the initial gift of $5 million). Was GST exemption already used on a prior return, or is the trust subject to automatically allocated exemption? Using the strategy may still be possible, so your professional advisors should carefully review all details.

Strategy #3: Location, location, location – The Great Outdoors (1988)

While it’s starting to cool across the country, the real estate market has experienced quite a boom in recent years. Covid drove prices even higher, especially in areas where second homes are highly desirable. Some families beat the appreciation to the punch and gifted their homes to irrevocable trusts. They had visions of family gatherings for generations hoped to provide a lasting legacy. Then they got a bit squeamish after watching the disasters (albeit comical) endured by Chet Ripley (John Candy) and his family after his brother’s family crashed their vacation. Luckily there’s another article in this newsletter to help address shared home ownership, but if the regret is already too great, it doesn’t mean you have to sell the home and take a large income tax hit on the price appreciation. Similar to Strategy #1, you can go back to the substitution well (assuming the language is included in the trust) and layer on a step-up in basis strategy. Under current law, when an owner of an appreciated asset dies, the basis (i.e., what the owner paid) gets “stepped up” to the fair market value at death. If, however, the asset (such as a home) is owned in an irrevocable trust, the step up would not apply. To avoid an unfortunate tax consequence on an unbearable ownership strategy, the original owner can remove the home from the trust by substituting assets of equal value. They’ll maintain the home until death and then let the beneficiaries sell it with minimal or no tax consequence, allowing them to relegate at the misfortunes of Chet Ripley to the movies, rather than live it themselves.

Enjoy your time with family and friends as the year comes to a close, and maybe turn on an entertaining movie. Then call your advisors and ensure you’re not leaving anything on the table. Roger Ebert once said, “A film is a terrible thing to waste,” and the same could be said for a powerful planning strategy.

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Stephen is a Senior Wealth Advisor on the High Net Worth Team, which serves families with $3.5 million or more of investable assets. He joined the team in 2018 after spending 13 years in our family office practice where he worked on complex client engagements and rose to help lead and manage the firm's Wealth Advisory Operations. Stephen consults with families on all aspects of their financial affairs, including investment, estate, tax, insurance, philanthropy, retirement, debt and liquidity planning. His experience already has proved invaluable on the High Net Worth Team. Stephen is a CERTIFIED FINANCIAL PLANNER™ practitioner. Prior to joining the firm in 2005, Stephen received a Master of Science in Financial Planning (MSFP), with distinction, from McCallum Graduate School of Business at Bentley University and a BS in Finance, Magna Cum Laude, from Bentley University. While at Bentley, he was a member of Beta Gamma Sigma International Honor Society, and was actively involved in community outreach programs. Stephen resides in Andover, MA, with his wife and three young daughters. When he's not becoming well versed in Disney characters, Stephen enjoys following New England sports and being involved in local community events.