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**Shift Large Wealth before a Possible Dem Victory in 2020: Guarantees and Guarantee Fees**



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So, this one’s a tad complicated, but for people with wealth, complexity and comprehensive planning may be important to complete before the 2020 election. No one knows what the election will bring, and no predictions are made here (my Ouija Board long ago burnt out). But one statement might be certain. If the Dems win enough control any one of substantial means should expect much harsher estate and other taxes. There may be a big emphasis on “other” this go round in Washington given the continued talk about a possible wealth tax. While a wealth tax seems costly and complex to administer, who knows what might occur. So, folks of wealth should be considering transferring assets to irrevocable trusts to remove them from their estates. Gifts to spousal lifetime access trusts and domestic asset protection trusts should be growing like Tribbles (you’re a Trekkie right?). While no one can assure any of today’s plans will work under a new tax regime, it certainly seems worth taking a shot.

For the real wealth, making gifts of the $11.4 million exemption will not suffice to transfer enough wealth. So, more is necessary. There are lots of techniques to consider (your estate tax attorney will no doubt have a bag of acronyms to toss at you) one of the popular tools has been the so-called note sale to a grantor trust. In simple terms (and it is really much more complex) you sell say 45% of an interest in a family business to a trust and the trust gives you a note back for much of the purchase price. You lock in today’s value of the business. If the business keeps growing in value that growth will be shifted out of your estate, and if you’re lucky (who knows what the new laws will be) that growth might escape a new harsher estate tax, and perhaps even a new wealth tax. Also, since you sold a non-controlling slice of the business under current law that value will be discounted to reflect that that interest is not controlling. More wealth shifted. By the way, Bernie Sander’s estate tax bill proposed earlier this year would zap most of this planning. So, you may want to try to get it while you can (again, not knowing what will or won’t work under a new administration).

So that’s the background, now let’s get to the meat of the discussion, guarantees and seed gifts. Many folks believe that if you sell a valuable asset to the trust that trust must have a reasonable net worth or cushion to make the sale real so that the IRS will respect it. Somewhere somehow someone suggested that you should have a 10% seed gift. If you sell $100 million in stock to a trust the trust should have $10 million of assets to support the sale. Others calculate the numbers somewhat differently. Much of this is as mythical as a Chimera but alas, so many have talked about it as being real, that perhaps you might want to treat this fiction as a reality. So, what if you’ve used up your exemption or are selling a much larger asset and cannot just gift assets to the trust to hit this 10% hurdle? In some cases, family members, other family trusts, beneficiaries or even family entities might guarantee a portion of the buying trust’s note. According to many, perhaps most experts, that should suffice.

So, have the buying trust’s beneficiaries, your adult children guarantee the trust’s note. Or perhaps have a family entity or trust do it. Simple? Nope. Nothing in the tax world seems to ever be simple. Lots of issues arise. First, whoever is giving the guarantee must have sufficient net worth that the guarantee is viable. So, you might want to get financial data together for the guarantor to support it. You’ll also need a guarantee agreement. Your advisers will have to assure that all the documentation on the deal (your sale of stock or other assets to the trust which would include say a stock purchase agreement, note, security and perhaps an escrow agreement should you have title documents held in escrow pending repayment of the note, etc.) coordinate with the guarantee.

To make this all work you’ll need to have your advisers address a bunch of other issues. Do you have to have a fee paid for the guarantee? Assume your kids, who are beneficiaries of the trust buying the business interest, guarantee part of the note the trust used to buy the business. Do they have to get paid a guarantee fee? Most experts would say no since as beneficiaries they are really securing their interest in the trust. What if a different family entity gave the guarantee? That would seem to require a guarantee fee since a business entity would not normally provide an economic benefit without a return. Consider the income tax implications of all of this too. With the elimination of most itemized deductions if a fee flows through to an individual income tax return there may be no income tax deduction. If the fee is received by a business entity that would seem to trigger taxable income. There could actually be a whipsaw for tax purposes (one taxpayer reports income and no one gets a deduction). So, this should be factored into how the guarantee is structured to either eliminate the fee altogether if feasible, and if not to mitigate the possible adverse income tax results.

Does giving a guarantee constitute a gift (especially if no arm’s length fee is paid)? The IRS has suggested that giving a guarantee is a gift and that that gift might be measured by the reduction in borrowing costs. Some suggest that a gift might be considered to have occurred only when the guarantee is triggered (i.e., the guarantor makes a payment on the note that was guaranteed).

There other facets to this. What if a trust makes a guarantee? If the guaranteeing trust has the same beneficiaries as the buying trust benefiting from the guarantee perhaps no fee is required as the guaranteeing trust is making the guarantee to benefit its beneficiaries. However, might the payment of a fee for a guarantee be necessary to demonstrate that the fiduciaries of the trust providing the guarantee are meeting their fiduciary obligations? Will the provision of benefit to the beneficiaries suffice?

When a guarantee is provided, and a fee is determined to be paid, how is that fee to be calculated? Should the guarantee fee be set at a commercially reasonable rate (e.g., what a financial institution might require in terms of a fee for a similar transaction)? Should that fee be reduced if there is a benefit, e.g. to the beneficiaries of a trust providing the guarantee?

If a fee is to be paid, a factor to consider is the anticipated cash flow from the business interests or assets held by the buyer/borrower trust. If the cash flow (a reality of sale construct) is and will be adequate to service the note, how much of a fee is really necessary, if any?

Consider all these and other factors with your advisers in planning a note sale transaction, but in all cases get into the planning ring and determine what steps might be appropriate.