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Estate Planning Strategies to Consider in a Bear Market

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April 2025

Market volatility provides opportunities to make wise estate planning decisions.

After an auspicious 2024 campaign, the S&P 500 entered bear market territory right after the end of Q1. Adding insult to injury, last year's most universally loved sectors of the market are telling most of the S&P 500 companies, to "hold my beer." Case in point: As of the end of the quarter, not only was the technology heavy NASDAQ kissing the bear, but the ubiquitously popular "Magnificent 7," stocks were engaged in a full-fledged affair. To highlight the concentration of destruction in 2025 – as of April 4th, the "Magnificent 7" was down close to 30% as a group. This carnage among seven companies represented roughly $1 trillion dollars of market capitalization loss out of $6 trillion dollars total.[1]

With the frenetic pace of U.S. policy vis-a-vis global tariffs – not to mention upcoming congressional tax and budget bills - it is possible that market volatility may continue unabated for a while. However, rather than being frozen in fear, down markets do provide investors opportunities to make proactive and strategically wise decisions. In late 2022, amid massive inflation along with the Federal Reserve's dizzying pace of rate hikes, I wrote an article: "Making smart moves in a down market." Many of these investment strategies are still relevant in today's volatile environment (i.e. taking RMDs with stock vs. cash, accelerating Roth conversions, exercising ISOs up to AMT breakeven).

In addition to making smart investment decisions, today's turbulence also provides an opportunity to make wise estate planning moves as well.

ACCELERATE ANNUAL GIFTING

If you haven't already, consider making your annual gifts in a down market. The current annual gift exclusion won't change until 2026 (for 2025, the annual gift amount is $19,000 per individual per beneficiary). However, with large price fluctuations, it is possible to transfer a much greater number of shares out of your taxable estate for each fixed $19,000 gift.

For example, let's say that Maria and Jay McFagan traditionally "split gift" $38,000 ($19,000 x 2) to each of their children on an annual basis. At the end of 2024, a stock candidate traded at $100 per share, meaning that this $38,000 gift would have translated to a transfer value of 380 shares at the time.

Let's go forward to 2025. As of mid-April, of the current year, let's assume that the stock is down 25% and is now trading at $75/share. With such a large sell off, Maria and Jay can now gift 507 shares ($38,000/$75 per share) to each of their children. While the stock price has gone down 25%, as a couple, they are able to give 33% more in the number of shares (out of their taxable estate) without breaching the annual exclusion. Once the price of the stock rebounds, not only is this additional capital appreciation outside of their own taxable estate, but it is in the hands of their beneficiaries who were gifted a greater number of shares per gift tax exclusion dollar.

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FRONT-LOAD "LIFETIME EXEMPTION"

The current "lifetime exemption" is $13.99M per individual. Much has been written about whether the 2017 Tax Cuts and Jobs Act (TCJA) will sunset or be extended by the end of 2025. If the law sunsets, the lifetime exemption is set to drop to $7M per individual (about 50% of the current amount). If it extends, it will stay at $13.99M (adjusted for inflation).

With Republicans currently controlling both chambers of congress, it is fair to surmise that an extension is more likely than it was as little as 1 year ago. With an extension of the estate tax exemptions ($13.99M per individual), very few American households will owe estate taxes. In fact, as recently as 2019 (post TCJA passage) and according to the Institute on Taxation and Economic Policy, only 8 estates of every 10,000 would have owed estate taxes that year (0.08%)![2] The number is likely smaller in 2025.

However, if your overall estate is already well over the current lifetime exemption of $13.99M per person, the TCJA extension will be reduced, but it <u>won't</u> eliminate your estate tax burden (40% on the value of assets > exemption).

Therefore, for investors with a taxable estate well over the current estate tax exemptions, a bear market presents an opportunity to accelerate a large irrevocable gift out of a taxable estate and against the total lifetime cap. There are a few caveats to this: First, the individual should be comfortable with the gift being irrevocable. Second, sufficient financial planning should be done to make sure that the large gift doesn't sacrifice one's lifestyle, cash-flow, etc.

Let's look at an example. Let's assume that the same fictional couple, Maria and Jay, still have $3M left of their uniform lifetime exemption total – they have used $24.98M of the $27.98M cap. Let's also assume that they own 10,000 shares of concentrated stock in their living trust account valued at $300 per share, equivalent to $3,000,000. The total value of the position is recently down 25% (from a high of $400 per share), but the stock still has an exceedingly low cost basis due to the length of time it has been held. For the dual purpose of reducing concentration risk and taking advantage of the bear market, Maria and Jay decide to make a $3,000,000 irrevocable gift out of their estate and up to the lifetime cap. The following year, the stock rebounds 33% (up to $400 per share) and the irrevocable trust now has a position valued at $4,000,000. This growth of $1,000,000 has taken place outside of the McFagan's taxable estate. Further, the future appreciation represents an estate tax savings of $400,000, which is 40% of $1,000,000 sheltered by estate tax.

CONSIDER A GRAT (GRANTOR RETAINED ANNUITY TRUST)

What is a GRAT? A GRAT stands for "Grantor Retained Annuity Trust" and it can be incredibly impactful as a method to "freeze" the future growth of assets out of an estate.

Further, this power can be magnified during a bear market. When *distressed* assets are transferred out of a taxable estate, their future appreciation (post bear market) is unencumbered by would be estate taxes.

Before I discuss the mechanics, let's first dive into the basics. Who are the players and what is the process? The "grantor" (owner) drafts an irrevocable trust with the help of an estate planning attorney. The grantor then selects and transfers select assets to the GRAT for a particular term of years. The grantor is also the "annuitant"- the individual who receives a series of fixed payments from the trust for the duration of the term. Upon the end of the term, the "beneficiary" (often the grantor's children) receives the remainder interest estate tax free.

The IRS assumes that the assets in the GRAT will earn a return of at least the Sec. 7520 IRS rate in place for the month the assets were transferred to the trust. As of April 2025, the rate is 5%. In short, any growth more than the Sec. 7520 rate (i.e. 5%) passes to the beneficiaries free of gift tax. For example, assuming the current 5% rate, if the assets in the GRAT grow at 12%, the excess of 7% of annualized growth accrues to the beneficiaries free of estate tax. If assets grow less than the 5%, no harm no foul - the value of the GRAT would simply be folded back into the estate but with a likely very low taxable value.[3]

The good news: In a bear market, the grantor-annuitant can have their cake and eat it too! They can transfer discounted assets into the GRAT and receive an income stream. The goal is that the undervalued assets will ultimately rebound (post bear market) and appreciate over the long-term without estate tax.

For example, let's say that our favorite fictional couple, Jay and Maria, have decided to fund a 10-year GRAT with $5,000,000 of high growth stocks. The positions are down 30% for the year, however the Investment Team posits that the companies are fundamentally sound with good future upside and especially over the next decade. After the GRAT is funded, they will receive $500,000 per year over a term of 10 years. At the end of the 10 years, the remainder will be distributed to their children.

With a traditional GRAT, there is an immediate taxable gift to consider due to the annuity income. The taxable gift would be calculated by subtracting the present value of the grantor's retained interest (discounted at the IRS Sec. 7520 rate) from the fair market value of the assets transferred into the GRAT. For the $5,000,000 GRAT, and using the IRS' current 5% discount rate, the annuity stream is valued at $3,860,867, and the remainder interest is valued at its present value of $1,139,133. This remainder interest is a taxable gift.

However, let's assume that the Investment Team is correct, and the growth stocks appreciate significantly (post bear market), or at 12% per year. When deducting the same stream of payments, the beneficiaries will receive $6,754,874! However, only the present value of the remainder interest at the initial funding, or $1,139,133, would be subject to gift tax.

The estate tax savings are calculated by multiplying 40% (estate tax rate) by the difference in remainder interest due to growth. The final tax savings are: 40% x ($5,615,741) = $2,246,296!

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Like most estate planning strategies, there are downsides to the GRAT which can include the following: the grantor passes before the term, the assets don't appreciate as expected, or the funding results in a taxable gift. That said, solutions exist for these three risks. First, the grantor can always shorten the term. Second, assets that appreciate less than the Sec. 7520 rate simply fold back to the estate at a lower taxable value. Third, a "zeroed out GRAT," can actually eliminate the taxable gift of a GRAT altogether, although for brevity not mentioned in this article.

Stock market turbulence can be challenging to navigate. But bear markets also present opportunities to consider smart estate planning strategies. As always, before implementing any strategy, please consult your estate planning attorney and CPA in addition to your Wealth Counselor. ■

[1] CNBC (3 April 2025). Magnificent 7 Relinquishes More Than $1 trillion as Tech Drives Stock Market Nosedive, https://www.cnbc.com/2025/04/03/mag-7-relinquishes-more-than-800-billion-as-tech-drives-stock-market-nosedive.html. Accessed 11 April 2025.

[2] Institute on Taxation and Economic Policy (7 December 2023). The Estate Tax is Irrelevant to More Than 99 Percent of Americans, https://itep.org/federal-estate-tax-historic-lows-2023/. Accessed 11 April 2025.

[3] IRS (Page last updated 21 March 2025). Section 7520 interest rates, https://www.irs.gov/businesses/small-businesses-self-employed/section-7520-interest-rates. Accessed 11 April 2025.