A PANDEMIC PERSPECTIVE ON THE FUTURE OF ESTATE PLANNING

We thought as a generation we had weathered everything life could throw at us. We endured the Cold War, Vietnam, Watergate, two Gulf Wars, 9/11, and a Great Recession. We were ready to relax and enjoy retirement. Then, from nowhere, came the Covid-19 pandemic.

As estate planners, we now have a new and complicated impact on the decisions we need to make about our lives and deaths. Although we may be unsure as to precisely where this pandemic will take us, it's not too soon to take note that it has already influenced future planning and elder care. This article reviews my initial thoughts on changes in these fields, both for the immediate future and longer term.

1. As has been the case throughout our lives, life is accelerating the pace of change. As I write this, it's hard to calculate all the ways that Covid-19 has changed our lives in just a few short months. Foremost, the pandemic is accelerating the pace at which decision impacting changes occur. A life-threatening disease has rapidly spread worldwide, leaving economies in its widening wake that will take years to recover. The disproportionate effects of this disease on different segments of our society have highlighted premature complacency with racial inequity and how we care for our vulnerable populations. Addressing these challenges will require immediate response, even while we face the looming prospect of impacts on our economy and workforce posed by artificial intelligence and 5G internet.

Based largely on the pace at which families change, we have generally recommended that clients use a planning cycle of three to five years to review and update their estate planning. For many, that has translated into an eight to ten-year cycle. However, given the societal changes discussed below, that is likely too long a period to wait. Effectively updating your estate planning will likely require constant review and changes over much shorter periods.

2. We are all becoming increasingly reliant on digital resources. Digital access to information can no longer be solely the realm of the young. Digital dinosaurs beware! The ease and convenience of Zoom and videoconferencing are likely to be the norm in the future. The sooner we all invest in digital technology and become comfortable with online information access and communication, the better we will be able to participate in this digital discourse. Those who do not do so will become increasingly isolated.

3. The cost of elder assisted living is likely to increase. No segment of society has been hit harder by Covid-19 than our elderly living in senior living facilities. From the onset of the pandemic, over 50% of all coronavirus deaths have been persons over age 75 and over 40% of all deaths from Covid-19 are related to long-term care facilities. This disproportionate effect will have a number of ramifications. First, long-term care facilities will be forced to increase future protections for their populations by choice, litigation, liability insurers, or market protection of their reputations. The cost of those additional protections will find its way into the rates charged. Second, assisted living facilities will likely face substantially increased government regulation to prevent widespread disease in the future. Such increased regulation will also cause increased long-term care facility rates. At the same time, investment returns for insurers have decreased as a result of the changes in the economy since the pandemic started. These factors will in and of themselves have a number of impacts:

a. Older adults will need to devote a larger share of their respective net worths to elder care and will have less left to leave to their families after death.

b. Currently owned long-term care insurance will need to be reevaluated to determine sufficiency to pay these increased costs.

c. Rates for both current long-term care policies and new ones are likely to increase to provide for the increased coverage that will be necessary or to purchase new coverage.

4. The increased cost of long-term care, decreased savings, and the greater economic divide in the country means that more people should think about Medicaid planning. Medicaid is the nationwide but state-administered program that, among other things, provides affordable health care and assisted-living coverage for elderly Americans. Eligibility for the program is means tested on both income and available assets bases. Planning for such eligibility involves taking steps to ensure that income and available resource limits are not exceeded, often by making gifts to trusts and/or other family members. Because of applicable penalty periods during which the applicant is deemed to continue to have resources previously gifted to others, such planning should, if possible, be done well in advance of when the assistance will be needed.

The economic effects of the pandemic will likely cause more elderly Americans to have inadequate resources to pay for the increased cost of extended assisted living. To obtain Medicaid assistance and at the same time preserve resources as much as possible, planning ahead to achieve these goals will become a larger part of mainstream estate planning.

5. The value of closely held businesses and real estate has decreased and will require an uncertain period to return. With fewer people spending money, contracting business demand, and increased safety and restart costs, business earnings are suffering and not projected to return for some time. Rents are declining as more tenants are faced with insolvency or request rent concessions to stay in business. As such, the fair market values of business assets are declining. Without sufficient databases indicating how values have changed, even recent appraisals are suspect. In these circumstances, new loan applications are slower to close, and uncertainty causes increased valuation discounting. While publicly traded stock markets do not seem to reflect these trends when compared to private markets, what will happen to public markets if and when the Federal Reserve Board stops pumping money into the economy while depressing interest rates and/or inflation force interest rates higher?

Bottom line: Less is available to pay for retirement years and long-term care. On the other hand, for wealthy individuals faced with the prospect of federal or state estate taxes and declining estate tax exemptions, estate sizes and the value of potential gifts have at least temporarily been reduced.

6. Estate and capital gains taxes are likely to increase. At the end of fiscal year 2019, our total federal debt was $22.8 trillion. As of June 5, 2020, the Congressional Budget Office projects that federal pandemic financial relief enacted to that date will result in a projected federal deficit of some $3.7 trillion in 2020 and another $2.1 trillion next year. Additional pandemic relief is now being negotiated in Congress totaling between $1 trillion and $3 trillion. At some point, this rapidly increasing federal debt will need to be addressed. And, on top of federal deficits, state and local governments without authority to rely on deficit spending are now confronted by decreased revenues and drastically increased costs of providing Covid care. Given this situation, additional tax increases at the federal, state, and local level appear to be inevitable. However, the greater economic divide between Americans resulting from the current crisis means that at least for the immediate future, we will have a narrower effective progressive tax base for revenues to pay for pandemic economic relief and debt repayment.

Some tax increases are already built into current law. In 2026, the personal tax cut measures included in the federal 2017 Tax Cuts and Jobs Act will automatically expire and be replaced by the law that existed prior to 2017. Included in this roll-back will be a reduction in the federal estate tax exemption from $10 million per person (plus an inflation adjustment from 2010) to $5 million per person (plus inflation adjustment). After 2025, personal income tax brackets will also revert to their previous higher levels.

Prior to the pandemic, Democratic party proposals called for additional tax increases on wealthy taxpayers to address pressing infrastructure and environmental concerns. A current bill before the U.S. Senate would reduce the federal estate tax exemption to $3.5 million per person and increase the federal estate tax rate to 45% for estates up to $10 million. Larger estates would pay estate taxes at rates ranging from 50% (for estates up to $50 million) to their historic high at 77% (for estates larger than $1 billion). In addition to not waiting until 2026 to raise the top income tax bracket from 37% to 39.6%, presidential candidate Joe Biden has proposed to increase capital gains taxes by subjecting capital gains to ordinary income tax rates for households earning more than $1 million per year and by eliminating the "step-up" that eliminates capital gains on assets passing at death. This latter proposal would affect inheritances from all decedents and not just those from the wealthy.

These proposals may very well be precursors to tax measures to come. For those affected by such changes, the time may be now to use the existing $11.58 million gift tax exemption to avoid additional estate taxes in the future.

7. Millennials, members of Generation X, and older persons without an adequate retirement safety net have just been hit by another disaster that will impede future savings. For younger individuals and families who started out burdened by education debt and Great Recession investment downfall, lower employment, stock market losses, and decreased financial reserves caused by the pandemic further interrupt necessary savings for retirement and the future. For older Americans, the low interest rates necessitated by underpinning the economy mean that future saving and investment growth will be much more difficult. And lurking just over the horizon is the prospect that artificial intelligence, while providing increased productivity for those who can take advantage of it, may mean reduced employment opportunities for even middle-class family members.

Impeded prospects to save for retirement and the future will probably mean that younger generations will need to work longer and better provide for their families and themselves with life, disability, and long-term care insurance. To afford such permanent coverage, they will need to initiate policies earlier than prior generations. As noted above, where such coverage is not available, planning for Medicaid qualification will become much more important. In addition, inheritances and the protection of inherited assets will become more significant for future personal and family security. To the extent that such inheritances can be structured to avoid being counted as an available resource for Medicaid qualification purposes, they will become all the more valuable.

8. Asset protection for family members is becoming more important, not less. Clients are often unaware of the creditor risks faced by their family successors. They know that we live in a litigious society, but, aside from the potential for divorce, they are confident that this will not be a problem for their well-educated, sensible children. Often, they prefer to avoid the future additional administrative annoyances of asset protection trusts in favor of the simplicity of outright inheritances.

Our pandemic-flattened economy is showing us that even well-educated, sensible children can face credit threats not of their own making. The Federal Reserve is worried that a large number of large and especially small businesses face failure during the coronavirus pandemic. Those business failures will represent millions of intelligent people who have taken on originally unexpected risks associated with business investments and personal loans and guarantees for commercial mortgages and leases. Even if their businesses don't actually fail, members of the succeeding generation will face an increasing likelihood of litigation with employees and/or customers alleging liability for failure to prevent Covid sickness exposure. In addition, personal stress associated with layoffs and other economic worries may augment interpersonal relationship difficulties and the potential for family dissolution. As a result, the asset protection features of inheritance trusts have become much more compelling in spite of the additional potential paperwork associated with their administration.

We no doubt still have much to learn as we confront the impacts of Covid-19. Challenges, however, are opportunities for meaningful change. Being forewarned may give you an important leg up on being prepared. I hope that this article has provided some helpful considerations to guide you with your planning as we face these challenges together.

— Richard T. Wright