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Thomas J. Pauloski, J.D.
Senior National Director

Bradley Gadomski, AAMS®, AWMA®
Vice President

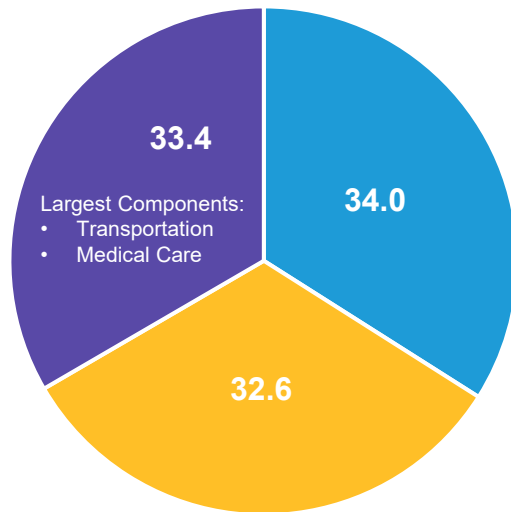
Over-Rated

**How Surging Interest
Rates and Slow
Growth May Radically
Change Wealth
Transfer Planning**

Has Inflation Peaked?

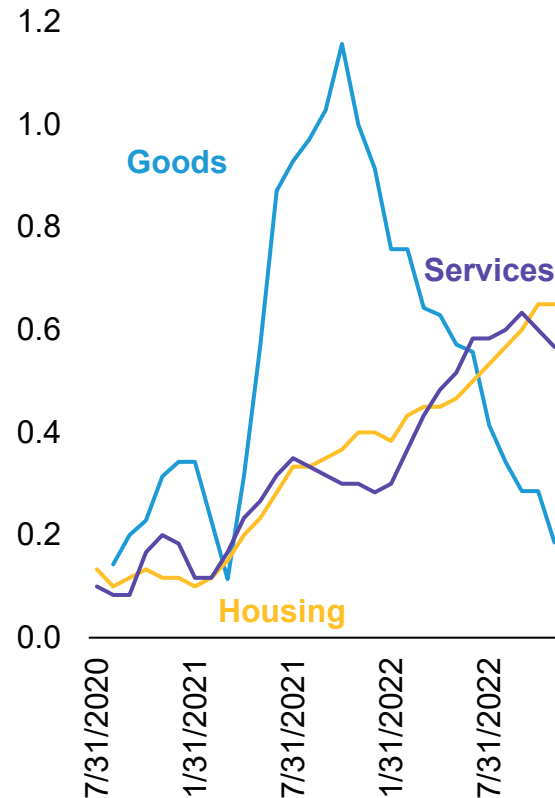
What's the Trend?

CPI Weights (%)



■ Goods ■ Housing ■ Non-Housing Services

MoM Percent Change in Core Inflation (6-Mo. Moving Avg. %)



Outlook

Housing

- Shelter inflation remains robust, accounting for nearly half of the total increase in core CPI.
- With house prices moving lower, we should expect shelter inflation to fall—though it is likely to be several more months before we see true relief.

Non-Housing Services

- We expect non-housing services inflation to be the Fed's focus moving forward.
- With the high correlation between service inflation and wages, a softening of the labor market will be central for pressure to ease on this front.

Goods

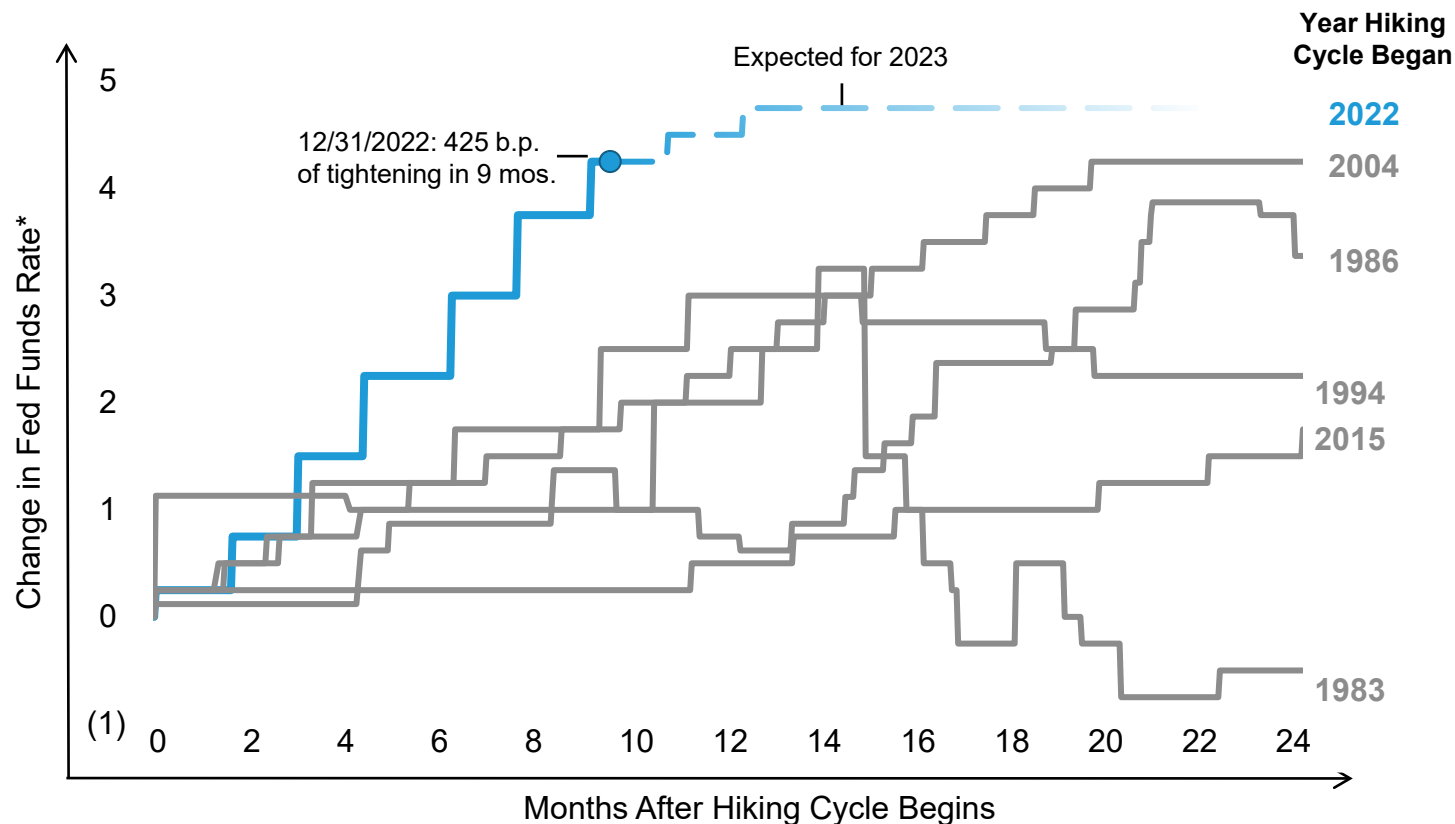
- Goods prices have significantly normalized, nearing the Fed's 2% YoY target, reflecting substantial healing in the global supply chain.

As of December 31, 2022. Historical analysis is not necessarily indicative of future results. There is no guarantee that any estimates or forecasts will be realized.

Source: Bloomberg, BLS, and Bernstein analysis

Assuming Inflation Trend Continues, Fed Close To Pausing

Change in Fed Funds Rates During Previous Hiking Cycles



2022 has seen the **most rapid** increase in rates at the **largest magnitude** in the past 40 years.

Further, we expect the Fed **to hold rates elevated** for the better part (if not all) of 2023, in an attempt to **definitively quell inflation**.

Rate cuts are possible, though, late in the year.

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*Change in fed funds rate vs. day prior to hiking cycle beginning

Source: Bloomberg, Board of Governors of the Federal Reserve System, and AB

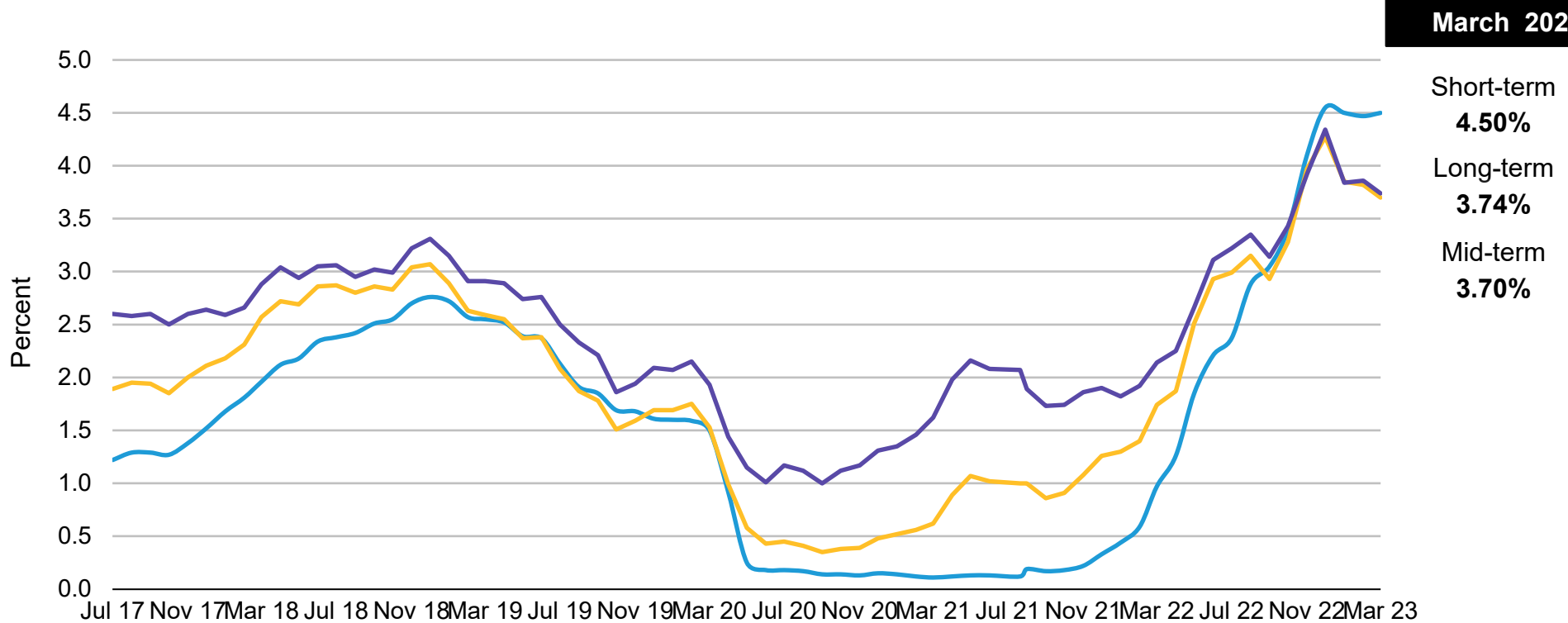
Skyrocketing AFRs

AFR	Mar 2023	All-time low (month/year)	Percentage increase
Short-term	4.50%	0.12% (Jul. 2021)	3,650%
Mid-term	3.70%	0.35% (Sep. 2020)	957%
Long-term	3.74%	1.00% (Sep. 2020)	274%

Source: www.irs.gov

Rising Interest Rates, and a Flat, “Inverted” Yield Curve, Present Challenges ... And Perhaps Opportunities

Applicable Federal Rates (AFR)
100% annual compounding



Source: www.irs.gov

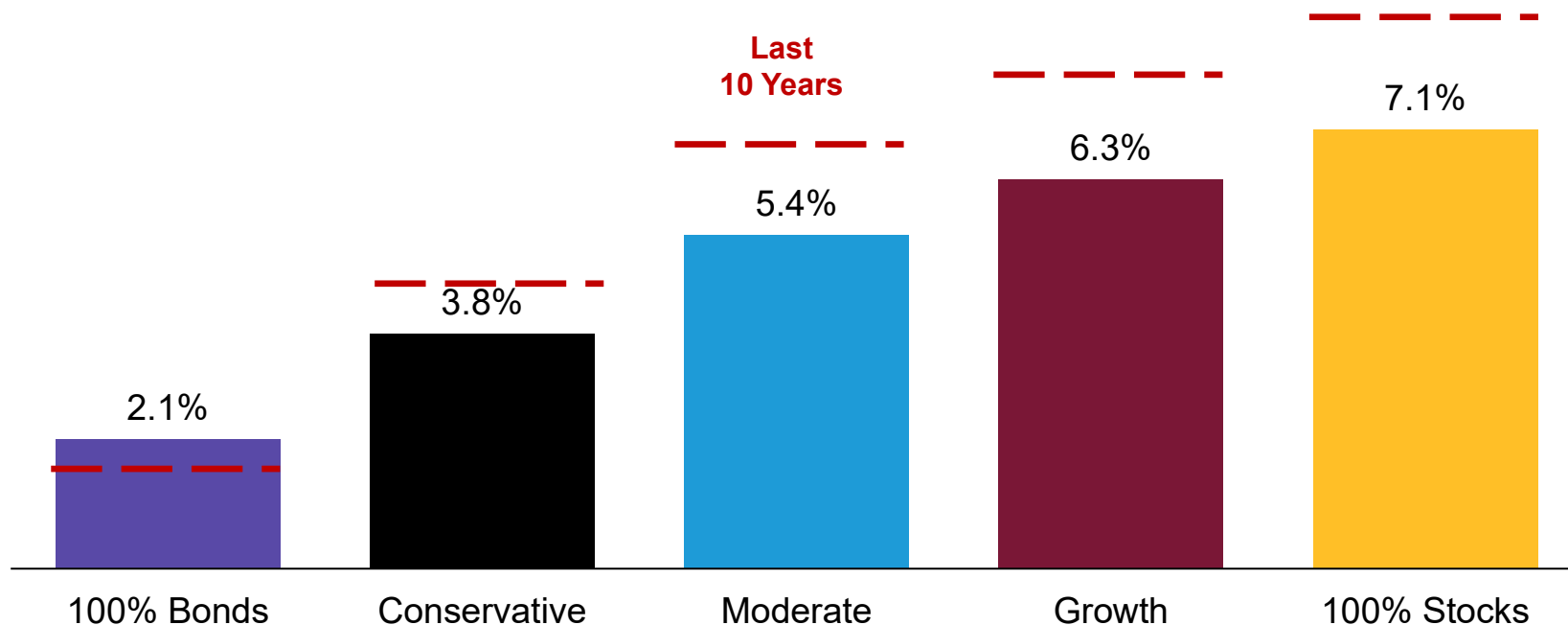
Cost of Capital Example

- Assume loan (or sale) to irrevocable (“intentionally defective”) grantor trust (IGT)
 - July 2021
 - Principal amount = \$11.7 million
 - Loan term = 3 years
 - Short-term AFR = 0.12% (all-time low)
 - Annual interest (cost of capital) = \$14,040
 - March 2023
 - Principal amount = \$11.7 million (apples-to-apples)
 - Loan term = 3 years + 1 day
 - Mid-term AFR = 3.82% (due to inversion, mid-term AFR currently is lower than short-term AFR)
 - Annual interest (cost of capital) = \$432,900 (nearly 31x more per year than in July 2021)
- The cost of capital is no longer zero
 - Until recently, a grantor promissory note might be thought of as a “free option” to complete a large gift
 - That option is no longer free

Bernstein does not provide tax or legal advice; please consult professionals in these fields prior to making any decisions regarding strategies modeled in this analysis.
Source: AB

Future Investment Returns Are Likely to Be Below Normal

Median Return Projections (Next 10 Years)*



Past performance is not necessarily indicative of future results. There is no guarantee that any estimates or forecasts will be realized.

*Based on Bernstein's estimates of the range of returns for the applicable capital markets over the next 10 years as of June 30, 2022.

Projected pretax 10-year compound annual growth rate. Conservative is 30% stocks/70% bonds; moderate is 60% stocks/40% bonds; growth is 80% stocks/20% bonds. Stocks are represented by the following allocation for a 100% stock allocation: 16.2% US value, 16.2% US growth, 12.0% US diversified, 6.0% US small-/mid-cap, 23.7% developed foreign markets, 7.3% emerging markets, 9.6% US Low Vol Equity, 9.0% high-risk international. Equity geography weights may shift in proportion to total return-seeking allocation. Bonds are represented by diversified intermediate-term municipal bonds in the proportions noted. Additional details regarding allocation available upon request.

See Assumptions and Notes on Bernstein Wealth Forecasting System in Appendix for further details.

Source: Lipper, MSCI, Russell, S&P, and AB

Estate Planning Arbitrage

- Estate planning equivalent to the “equity risk premium”
- Equals the difference between
 - Expected return; and
 - Cost of capital
- Example: Loan (or sale) to IGT
 - Expected annual return = 6%
 - Grantor bears any income tax consequences, so IGT keeps return, net of any debt service
 - July 2021
 - Cost of capital = effectively 0%
 - IGT keeps all 6%
 - March 2023
 - Annual cost of capital is around 4%
 - IGT keeps about 2%

Grantor needs to transfer ~3x more to achieve the same outcome

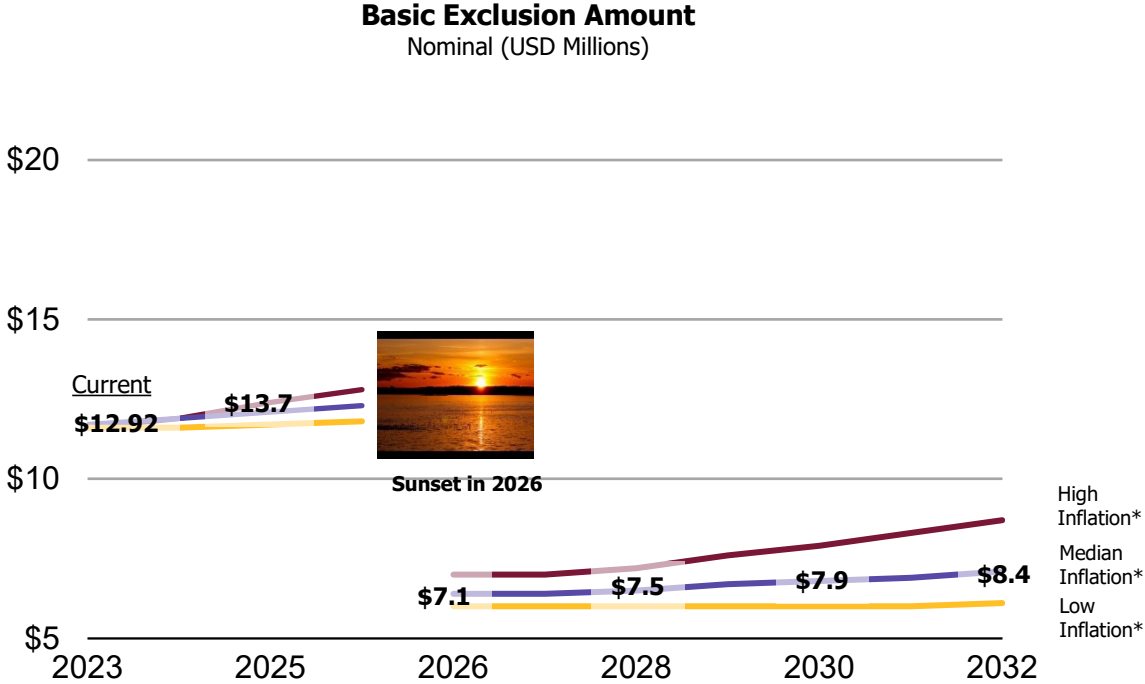
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Source: AB

Strategies that May Struggle in the Current Interest-Rate Environment

- Loan or installment sale at AFR: As previously discussed
- Single-term grantor retained annuity trust (GRAT)
 - March 2023 Section 7520 rate is 0.70% higher than the mid-term AFR
 - But consider:
 - No adverse transfer tax consequence to economic failure
 - Consider funding with high-risk, high-reward assets (e.g., venture capital)
- Charitable lead annuity trust (CLAT)
 - Always zero-out a grantor CLAT
 - Immediate charitable income tax deduction, notwithstanding higher possibility of “failure”
 - If CLAT runs dry, “make-up” contributions to charity may generate additional deductions
 - Up to two-month “look-back” for Section 7520 rate is not currently favorable (i.e., March 2023 rate is lower than the January and February rates)

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Source: AB

One Way or Another, the Basic Exclusion Amount Is Likely to Be Reduced



*Based on projected increases in "chained" CPI-U, rounded to the nearest \$100,000 in this display. Basic exclusion amount shown is for an individual, based upon 10th ("high"), 50th ("median"), and 90th ("low") percentile outcomes for the inflation-adjusted basic exclusion amount.

Based on Bernstein's estimates of the range of returns for the applicable capital markets. **Data do not represent past performance and are not a promise of actual results or a range of future results.** See Appendix, Notes on Wealth Forecasting, for details.

Source: AB

Strategies that May Thrive in the Current Interest-Rate Environment

- Gift: As previously discussed
- Valuation discount
 - When cost of capital is low or zero
 - Forgo the audit risk of a discount
 - Instead, use leverage (e.g., loan, sale, or GRAT) and “overstuff” the strategy
 - If discount can be defended: Immediate benefit (no mortality risk, unlike leveraged strategies)
 - Discount may be thought of as reducing the cost of capital
 - Despite GOP control of the House, keep an eye out for possible regulatory action by the Treasury Department
- Preferred (aka “frozen”) limited partnerships and limited liability companies
 - Popular in the 1990s, before installment sales to IGTs became widely popular
 - Avoids perceived “note risk”
- Qualified personal residence trust (QPRT)
 - Higher interest rates reduce the gift tax value of the remainder
 - Recent interest rate increases more than offset the recent surge in residential real estate prices
 - But consider:
 - Client must pay fair rental value to continue to live in the residence after the income term
 - Who wouldn’t want their kids to be their landlords?!

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Source: AB

Strategies that May Be Impervious to the Current Interest-Rate Environment

- Series of short-term, “rolling” GRATs funded with marketable stocks
 - Stock volatility is offset by “heads I win, tails I don’t lose” feature that is unique to GRATs
 - Not looking for a series of modest wins
 - Rather, looking for a few spectacular wins that crush even a high Section 7520 rate

- Charitable remainder unitrust (CRUT)
 - “Optimal” payout percentage isn’t affected much by the Section 7520 rate
 - Particularly interesting when selling a business than is not structured as an S corporation
 - When properly managed, income tax recognized upon sale is spread out over the grantor’s lifetime
 - If the business is structured as a C corporation, arguably may qualify as a separate taxpayer for purposes of Section 1202 (“qualified small business stock”)

- Private placement life insurance (PPLI)
 - Often funded with alternative investments that have
 - High, interest-rate-neutral return potential, but
 - Punitive near-term income tax consequences
 - Keep an eye on:
 - Fallout of recent rhetoric from Sen. Wyden (D-OR)
 - Controversial strategy involving private options deposited with an offshore insurance carrier

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Source: AB