

Helping Clients Identify Estate Planning Opportunities in a Low Interest Rate and Depressed Value Environment



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Today's historically low interest rates and depressed asset values make this an excellent time to engage in various estate planning techniques. Current conditions present several planning opportunities for transferring wealth at little or no gift tax cost. The following summary highlights several estate planning techniques which could provide significant tax advantages in a low interest rate and depressed value environment.

ADVANTAGES OF LIFETIME GIVING IN A LOW INTEREST RATE ENVIRONMENT

Lifetime giving is especially advantageous in the current low interest rate environment. Lower interest rates can have a significant impact on the transfer tax values of many types of transfers. Lifetime giving techniques, such as the use of grantor retained annuity trusts and installment sales, are more attractive in a low interest rate environment. This is due to the fact that the value of such gifts is in part determined by the interest rate, and the lower the interest rate, the lower the value of the gift. Low interest rates enhance the benefits of the following planning techniques, all of which attempt to transfer assets at reduced gift tax values.

LOW INTEREST INTRA-FAMILY LOANS

Intra-family loans allow parents to transfer significant amounts of wealth to their children (or to trusts for their benefit) with relatively minor tax consequences to the parents. Such loans can be made at interest rates lower than those available on commercial loans and the payment terms of an intra-family loan can be fashioned to provide for the specific needs and circumstances of the child. There will not be any gift tax consequences to these loans as long as the parent charges interest at least equal to the "applicable federal rate" ("AFR"). The AFR is published by the IRS each month. The AFRs for March 2020 are:

Loan Term	Annual Payments	Semiannual Payments	Quarterly Payments	Monthly Payments
3 Years or Less	1.50%	1.49%	1.49%	1.49%
More than 3 Years and 9 Years or Less	1.53%	1.52%	1.52%	1.52%
More than 9 Years	CV	1.92%	1.92%	1.91%

If the loan is structured using a balloon note that provides only for the payment of interest currently, the child will receive the loan money without having to make substantial payments during the term of the loan. Intra-family loans are a good technique for parents to use if a child is in need of funds for buying a house or starting a business. Another beneficial use of intra-family loans is for the child to invest the funds obtained through the loan at a rate higher than that of the loan itself. Over the course of the loan's term, the funds will grow, and when the loan matures the principal will be returned to the parents, who will have effectively transferred the amount of the increase in the funds free of gift tax.

INSTALLMENT SALES

An installment sale of an interest in a closely held business or a family limited partnership offers significant transfer tax benefits in a low interest rate environment. This technique is especially attractive if the value of the business or partnership is temporarily depressed. The sale could be made to a trust or directly to a child (or other buyer). In an installment sale to an intentionally defective grantor trust, a parent sells appreciated assets to an irrevocable trust for the benefit of his child. In return, the trust gives the parent a promissory note based on the low interest rate. The trust is structured as a grantor trust for income tax purposes, which means that the parent does not recognize any gain on the sale of the appreciated assets to the trust and does not have to report payments of interest as taxable income. The parent is treated as the owner of the trust assets for income tax purposes but not for estate tax and legal title purposes.

In an installment sale to a child, a parent sells appreciated assets directly to a child. In return, the child gives the parent a promissory note based on the low AFR interest rate. Unlike an installment sale to an intentionally defective grantor trust, the parent will recognize gain on the sale of the appreciated assets to the child and will have to report payments of interest as taxable income.

There is a significant benefit to the buyer (the trust or the child), who does not have the immediate burden of substantial loan payments, due to the low interest rate and the structure of the promissory note, which can provide interest-only payments for the term with a balloon principal payment made at the end. Any post-sale appreciation in the value of the assets beyond the interest rate will accrue to the trust or child without being subject to gift or estate tax. Obviously, the lower the interest rate, the more beneficial an installment sale is because the trust's or child's payments will be reduced.

GRANTOR RETAINED ANNUITY TRUSTS

A grantor retained annuity trust ("GRAT") is a trust in which the grantor-parent retains an annuity interest for a specified term at the end of which the trust property passes to the grantor's child or other designated individual. The present value of the interest passing to the child is a taxable gift which can be "zeroed out," meaning that no part of the parent's lifetime gift tax exemption needs to be utilized. Any appreciation in the value of the trust assets beyond the IRS's assumed rate of return (1.8% for March 2020) will not be subject to gift or estate tax as long as the grantor survives the trust term. Interests in a closely held business or a family limited partnership and other assets that are expected to grow dramatically over a short period of time are ideal assets to transfer to a GRAT.

A typical GRAT is structured to maximize the value of the annuity interest and minimize the value of the remainder interest transferred to the child so that the remainder interest is transferred with little or no use of the grantor-parent's gift tax exemption. A lower interest rate helps achieve this objective because it increases the value of the retained annuity interest and thus reduces the value of the gift of the remainder interest.

CHARITABLE LEAD ANNUITY TRUSTS

With a charitable lead annuity trust ("CLAT"), a designated charity receives annual payments for a set term and the remainder interest passes to a noncharitable beneficiary, such as the grantor's child. The objective with a CLAT is to maximize the value of the annuity interest and minimize the value of the remainder interest transferred to the child so that the remainder interest is transferred with little or no use of gift tax exemption. Any appreciation in the value of the trust assets beyond the IRS's assumed rate of return (1.8% for March 2020) will pass to the child without being subject to gift or estate tax. Lower interest rates decrease the value of the gift of the remainder interest passing to the child and also increase the value of the charitable deduction for the annuity interest passing to the charity.

ADDITIONAL ESTATE PLANNING STRATEGIES

Private annuities and self-canceling installment notes ("SCINs") are two additional planning techniques which can provide significant benefits when implemented in a low interest rate environment. Private annuities and SCINs involve a parent transferring property to his or her child in exchange for an annuity or installment obligation, and both are used when the parent's actual life expectancy is likely to be substantially less than his or her actuarially predicted life expectancy. When the interest rates are low at the time of the private annuity or SCIN transaction, the payments made by the child to the parent are reduced, allowing for a greater transfer of wealth to the child.

CONCLUSION

Significant opportunities to transfer wealth on a tax-free basis exist in today's environment of historically low interest rates and depressed asset values. For assistance in evaluating the planning strategies discussed in this update please contact any of the members of Foley & Lardner LLP's Estate Planning Practice Group or your Foley & Lardner LLP attorney.