

## ABOUT THE AUTHOR



Terry LaBant leads our Wealth Strategies team. Terry has 20 years of experience consulting with clients in six core

areas that influence the creation, preservation and protection of family wealth. They include: tax planning, business planning, succession planning, estate planning, retirement planning and asset protection.

## Estate Planning Benefits During Periods of Low Interest Rates

The Federal Reserve has continued to lower interest rates to encourage economic growth. As rates have become historically low, our clients may have one last chance to consider the following planning techniques that work so well in this environment.

### Family Loans

Parents often gift assets to their children; however, large taxable gifts first will reduce the parents' estate tax exemptions and then will trigger payment of gift taxes over time. To avoid these large gifts, parents instead may choose to make loans to their children for a variety of reasons. For example, parents may loan their children funds to purchase a home or to invest in a business.

If parents charge at least the minimum applicable federal rate ("AFR") of interest on these loans, they can avoid having the loan reclassified as a gift. While the AFR of interest remains low, parents can make loans to their children at these lower rates. If the child can invest loan proceeds and grow them at a rate that exceeds the loan interest rate, the parents effectively can shift asset appreciation out of their estates without making any gift.

Depending on available circumstances, parents currently also can forgive part of the loan over time at the annual rate of \$13,000 per parent or \$26,000 per married couple. This will enable them to reduce the loan balance that otherwise could be included as an asset of the parents' estates upon death.

### Grantor Retained Annuity Trust ("GRAT")

Another means to transfer assets with low or no gift tax cost involves the creation of a GRAT. A GRAT is a type of gift trust that allows a parent to transfer property while retaining the right to receive an annuity payment for an initial term of years. Thereafter, the remaining assets of the

GRAT will be held for the benefit of other family members. The value of the parent's gift to family for these purposes will equal the difference between the property's value and the parent's retained annuity value.

Family businesses that are expected to appreciate in value are perfect candidates for gifting to a GRAT. This is especially true when the business generates significant income annually.

The minimum annuity rate for a GRAT must equal at least a rate of interest published by the IRS. When your gifted assets either grow or produce income that exceeds the GRAT's annuity payment obligation, it shifts tremendous wealth to your family. This is especially true if the total annuity payments equal the value of the original trust assets. While interest rates remain historically low, there is a greater chance that a GRAT will succeed in this fashion.

*“Federal interest rates remain low and present a variety of planning techniques to benefit your family.”*

The most famous example of GRAT planning involved the transfer of Walmart stock within the family of Sam Walton. Sam Walton created a series of aggressive GRATs funded with Walmart stock, and his required annuity payments exactly equaled the value of the stock. This resulted in no initial gift by Mr. Walton to his family and ultimately removed all of the gifted stock from his estate (at no tax cost) as he survived each GRAT term.

As expected, the IRS challenged this technique; however, the IRS lost its case. Congress continues to propose legislation designed to minimize the wealth shifting advantages associated with GRATs. Current low interest rates coupled with this likely legislation provide a good window of opportunity to consider using this successful technique now.

## Installment Sales to “Intentionally Defective” Grantor Trust (“IDIT”)

An IDIT is a type of trust to which transfers are deemed complete for gift and estate tax purposes but incomplete for income tax purposes. An IDIT, therefore, enables parents to transfer assets out of their estates but retain the obligation to pay taxes on the income generated by the IDIT assets until a later date as they determine.

Why would parents want to give assets away but retain income tax liability related to them? The IRS has lost its cases that attempted to treat income tax payments by parents on behalf of IDITs as additional gifts. However, such payments by parents have the same economic effect of gifts in the sense that they are paid on behalf of the trust without using trust assets. Such payments also allow parents to remove assets from their estates that would be subject to future estate taxes as well.

The property transferred by parents to an IDIT is treated as a gift equal to the property's fair market value. However, if the parents sell assets to an IDIT for its fair market value, the sale is not subject to gift tax as long as the IDIT has a legal obligation to pay for the assets it purchases.

Does the sale trigger income taxes? Since the IDIT operates as the parents' alter ego for income tax purposes, the sale does not trigger income taxes (because you cannot be charged income tax for selling something to yourself).

What is the benefit of using IDITs while interest rates are low? While interest rates remain low, the AFR of interest associated with the purchase remains low. If the purchased assets appreciate faster than the IDIT's purchase payment obligation, the parent will shift all asset appreciation to the IDIT beneficiaries.

What types of assets may parents sell to an IDIT? Again, family businesses that are expected to appreciate in value are perfect candidates for selling to an IDIT. This is especially true when the business generates significant income annually.

### Charitable Lead Annuity Trust ("CLAT")

A CLAT operates similarly to a GRAT; however, a charitable organization will receive the annuity payments for the initial term of years while family members will receive the remaining trust benefits thereafter. A CLAT can be structured so that the gift to family members is not subject to gift tax, and the initial benefits to the charitable organization will be classified as charitable gifts.

While interest rates remain low, parents can contribute highly appreciating assets to a CLAT and generate significant tax planning benefits for their family if the assets appreciate faster than the required annuity payments. Gifts of business interests to a CLAT may not work as well if the charitable organization otherwise does not desire to own such interests.

### Remainder Gift or Sales of Residence

Parents may retain the right to live in their home for life (or a term of years) and either gift or sell the remainder interest to a trust for the benefit of their family. The value of the parents' right to live in the home will be based on the value of the home and their life expectancy.

While interest rates remain low, the value of this retained right will likewise be lower and the remainder benefits to family members will be greater. If structured as a gift to family members, parents will need to plan for the gift tax cost of the transaction or use lifetime exemption to cover it. If structured as a sale to family members, this structure will eliminate gift tax exposure if based on the property's fair market value. If the remainder is gifted to a charitable organization, the parents may qualify for an income tax charitable deduction while removing the value of their home from their estate.

Although parents may not all desire to give or sell their home during life, this planning technique highlights that a residence remains a viable tax planning option worthy of some consideration when appropriate. Elderly parents who otherwise have provided ample inheritance for the benefit of family members can benefit from this technique.

Federal interest rates remain low and present a variety of planning opportunities for clients. Please give some thought to how low interest rate planning can benefit your planning and let us know if we can discuss these techniques with you.

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