

Low Interest Rates Ideal for Estate Planning

11/3/2010

[Carl W. Dufendach](#)

We are constantly reminded that interest rates are low. This may make you think about refinancing your mortgage. Another good idea is to take a look at estate planning. When interest rates are low, certain estate planning tools become especially attractive.

Coupled with the fact that the estate tax is currently scheduled to come back with a vengeance in 2011 (with top transfer tax rates of 55%), now is a good time to look for planning tools to reduce the estate tax burden on your family or business. Here are some options that you might want to consider.

Loans or Installment Sales

Loans or installment sales of assets may be made to children or grandchildren at very low interest rates. Multiple negative tax consequences (both income and gift tax) apply when related parties make interest-free loans. To avoid those consequences, related-party loans must be made at minimum (safe harbor) interest rates.

These safe harbors (known as applicable federal rates or AFR) vary based upon the duration of the loan and the timing of the required loan payments. The short-term rate and the mid-term rate hit historic lows in November, 2010. For example, short-term loans of three years or less requiring annual payments (which could be interest-only with a balloon payment at maturity) can now be made at 0.35% interest. These rates are low enough that your children or other intended beneficiaries can purchase low-risk, income-based investments such as insured CDs, T-Bills, top-rated bonds, etc., or other investments, through loans from you.

The spread between the income they receive and the interest they pay you passes without any gift taxes or the use of any gift tax exemption. Making these loans to children in lower income tax brackets (who are not subject to the kiddie tax) can also reduce overall family income taxes. Mid-term loans of 3 to 9 years may be made at an AFR rate of 1.59%, and long-term loans may use a still low safe harbor rate of 3.35%.

Grantor Retained Annuity Trust (GRAT)

A GRAT is structured with required fixed payments being made to you, the grantor, over a fixed period (the annuity payments). The payments are designed actuarially to be nearly equal to the amount that you put into the GRAT. The balance remaining after the annuity payments, if any, passes to the named beneficiaries. The annuity payments and their value are based upon a current calculated interest rate. That rate was at an all-time low in October and November at 2 percent, matching the February 2009 rate (the 7520 rate). This generally means that the combination of all income generated from and appreciation

of the assets placed in a GRAT, which together exceed the 7520 rate, passes to children without gift taxation.

Charitable Lead Annuity Trust (CLAT)

A CLAT is a gift to a trust that works a lot like a GRAT, but pays the annuity to charity. With one type of CLAT, you can receive a current charitable deduction for the value of the charitable annuity. The remainder then goes to or in trust for descendants. With a 2% 7520 rate, the value of the annuity is high, and if the performance is better than the assumed 2%, the remainder interest to the descendants could be significant. The CLAT is generally used by someone with current charitable desires, but with a desire to leverage potential excess future growth to family.

Intentional Grantor Irrevocable Trust (IGIT)

In some situations, you might be willing to sell to the children, but not desire to pay a capital gain tax on the sale. In that circumstance, a sale to an IGIT can be useful. You may again use the low interest rates mentioned in the "Loans" discussion above: 0.35% for up to 3 years, 1.59% for more than 3 and up to 9 years, and 3.35% for longer than 9 years.

Because the sale is to a grantor trust specially designed as such, the sale is not a current capital gain or loss transaction for you. The trust takes the property at your basis, but the asset in the trust is removed from your estate. If the income and appreciation on the asset purchased exceeds the applicable rate, then the excess growth again passes to future generations. The balance on the note you receive back from the trust or the payments on the note would be an asset of your estate.

Other Options

Other estate planning tools such as charitable gift annuities, charitable remainder annuity trusts and qualified personal residence trusts do not generally work quite as well when interest rates are low. The nature of the rate determinations under the AFR rules and Section 7520 generally means that month-to-month changes are not that dramatic. However, a few tenths of a percentage point may make a big difference in the effectiveness of a given tool that enables you to transfer assets to the next generation. See your Warner Norcross & Judd estate planning professional to determine if one of the low interest tools described above may be suitable for your objectives.