Trusts, Estates & Legacy Planning Updates

Spring 2020

Newsletter from the Trusts, Estates & Legacy Planning Practice Group at Lathrop GPM

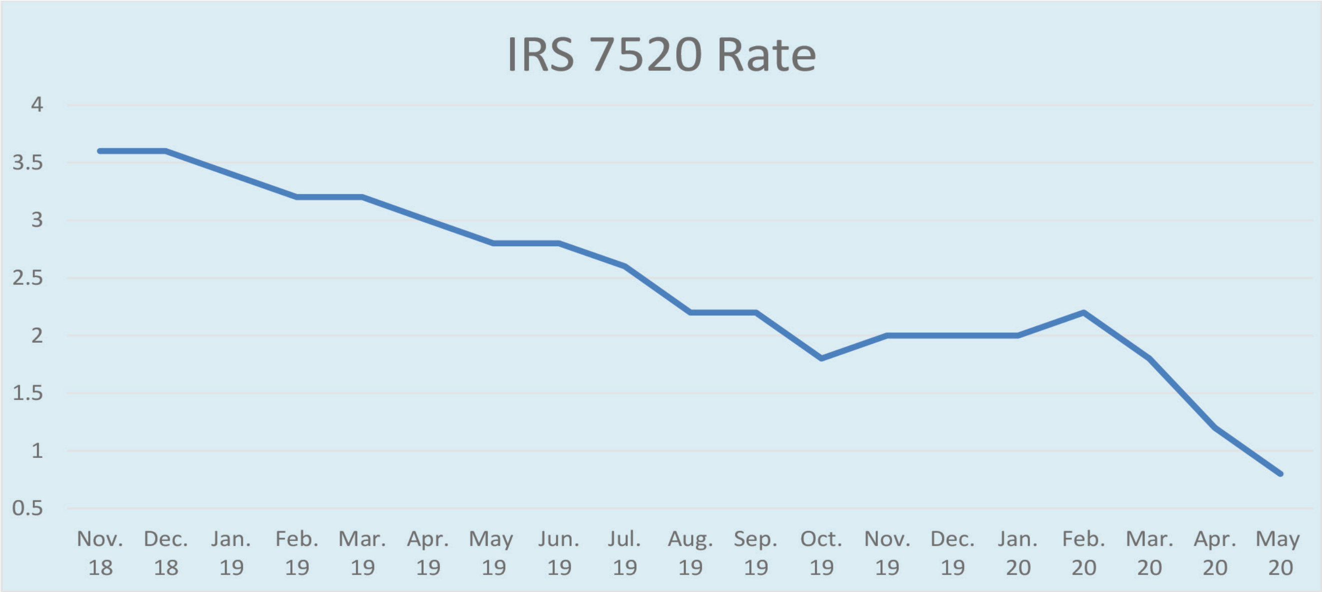
Lathrop GPM's Trusts, Estates and Legacy Planning Practice Group hopes this newsletter finds you and your loved ones safe and healthy during this difficult and unprecedented time. Although we have moved to a remote working environment due to the COVID-19 pandemic, please know that we are still available and able to assist you with all of your estate planning needs.

Estate Planning Opportunities with Historically Low Interest Rates

Many of the sophisticated estate planning strategies designed to reduce gift and estate tax exposure are tied to interest rates of the month in which the strategy is implemented and, generally, are more effective in a low interest rate environment.

Each month the IRS publishes a 7520 rate, a short-term AFR rate, a mid-term AFR rate, and a long-term AFR rate. The 7520 rate is used for actuarial calculations in valuing interests in some estate planning strategies and the AFR rates are minimum safe-harbor interest rates that must be applied to related party transactions (e.g., transactions between family members or family trusts) to avoid adverse tax consequences. The short-term AFR rate applies to a transaction with a term up to three years, the mid-term AFR rate applies to a transaction with a term greater than three years and up to nine years, and the long-term AFR rate applies to a transaction with a term greater than nine years.

The May 2020 7520 rate is 0.8 percent, which is the all-time low 7520 rate and is significantly less than the historic average 7520 rate of 5.0 percent. As shown on the below chart, over the past eighteen months the 7520 rate has been in a steep decline and has plummeted the past couple of months due to the COVID-19 pandemic.



The current AFR rates are also at historic lows. For May 2020, the short-term AFR rate is 0.25 percent, the mid-term AFR rate is 0.58 percent, and the long-term AFR rate is 1.15 percent. These interest rates present a significant and unprecedented opportunity to tax-efficiently transfer wealth to the next generation through the implementation of an estate planning strategy.

An example of an estate planning strategy where the success is tied to the 7520 rate is a grantor retained annuity trust (GRAT). A GRAT is an irrevocable trust created by a settlor. The settlor transfers assets to the GRAT in exchange for the right to receive a fixed annual payment (an annuity) from the GRAT for a term of years. The present value of the annuity payments is determined based on the 7520 rate at the time of the transfer. At the end of the term of years, the remaining trust property is distributed to one or more remainder beneficiaries (e.g., the settlor's children or trusts for their benefit). Consequently, to the extent the assets transferred to the GRAT appreciate in value at a rate that exceeds the 7520 rate, the excess appreciation is transferred to or for the benefit of the remainder beneficiaries gift tax-free.

Below is an illustration that shows how the 7520 rate can affect the success of a GRAT.

7520 Rate:	**5.0% (historic average)**	**3.6% (18 months ago)**	**0.8% (May 2020)**
Assets to GRAT:	$1,000,000	$1,000,000	$1,000,000
Term of GRAT:	4 years	4 years	4 years
Growth Rate of Assets held by GRAT:	8.0%	8.0%	8.0%
Total Annuity Payments to Settlor:	$1,140,600	$1,100,400	$1,021,900
Remaining Assets to Beneficiaries:	$97,800	$142,300	$229,200
Percentage of Assets to Beneficiaries:	**7.9%**	**11.5%**	**18.3%**

It is also important to note that a GRAT is a relatively "risk-free" strategy, which means that if the GRAT fails to perform (i.e., the assets transferred to the GRAT appreciate at a rate less than the 7520 rate), there are no adverse tax or economic consequences other than the loss of the transaction costs (i.e., attorney fees and other expenses incurred to create and fund the GRAT).

This strategy works especially well when the GRAT is funded with easy to value assets (e.g., marketable securities) or closely held assets that have significant growth potential.

A GRAT is just one of the several estate planning strategies that can be implemented to take advantage of the current low IRS interest rates. Other strategies include: (1) intra-family loans; (2) charitable lead annuity trusts; and (3) installment sales to intentionally defective grantor trusts.

We recommend that you contact an attorney in Lathrop GPM's Trusts, Estates and Legacy Planning Practice Group if you are interested in learning more about a GRAT or any other estate planning strategy that is designed to take advantage of the current low interest rate environment.

Now is a Good Time to Consider a Roth IRA Conversion

The COVID-19 pandemic is changing how we all live and has caused tragic health and economic results for many. However, it has also created some advantageous tax-planning opportunities. One potential tax-planning opportunity available to those with a traditional IRA is to convert that traditional IRA to a Roth IRA.

Advantages of a Roth IRA as compared to a traditional IRA include:

- You do not pay income tax on withdrawals from your Roth IRA in retirement. If you believe your effective income tax rate will be higher in retirement than it is now, a Roth IRA conversion could reduce your income tax exposure.

- You do not have to take required minimum distributions from your Roth IRA when you reach age 72. Therefore, the assets held by the Roth IRA can continue to grow tax-free for the remainder of your life, which is a significant benefit to your designated beneficiaries (e.g., your children) following your death.

- Roth IRA conversions allow high earners who are not eligible to contribute directly to a Roth IRA, or who are limited in how much they can contribute, to convert their traditional IRA to a Roth IRA regardless of their income level at the time of the conversion.

The main disadvantage of a Roth IRA conversion is that you are required to pay income tax on the value of the traditional IRA for the year of the conversion. If you do not have the liquidity to pay the resulting income tax on the converted IRA assets, this planning opportunity is likely not right for you.

Because the value of most retirement accounts experienced significant loss due to the economic fallout from COVID-19, now may be a good time to consider a Roth IRA conversion. Additionally, your income may be less this year as compared to normal years – possibly resulting in a lower effective tax rate that would be applied to the converted IRA assets. Consequently, you may be able to convert your traditional IRA now with substantially less income tax exposure than you would have had just a couple of months ago.

We recommend that you contact an attorney in Lathrop GPM's Trusts, Estates and Legacy Planning Practice Group if you are interested in learning more about a Roth IRA conversion and the potential resulting income tax benefits.

Passing of Clinton Schroeder

We are very saddened to announce the recent passing of our legendary former partner of almost 60 years, Clinton Schroeder. Our firm's thriving nonprofit and estate and charitable giving practice rests on the foundation Clint built with his nationally-recognized legal expertise and tireless work in tax, estate planning, and philanthropy. Clint was also a valued leader in the nonprofit community, serving on and leading many of the Twin Cities' notable charities. His far-reaching legacy is found in federal tax laws his advocacy created, a regional planned giving council formed through his mentoring and educating efforts, countless gifts he created to support charities and give meaning to donors' legacies, and the deep and lasting relationships he forged with clients and others. We, and the many communities in which Clint worked, volunteered, and advised, will miss him terribly. Clint was our friend, mentor, and inspiration. We cherish the privilege we had to know him and the privilege to honor his legacy through our work to create meaningful impact with our clients and in our communities.

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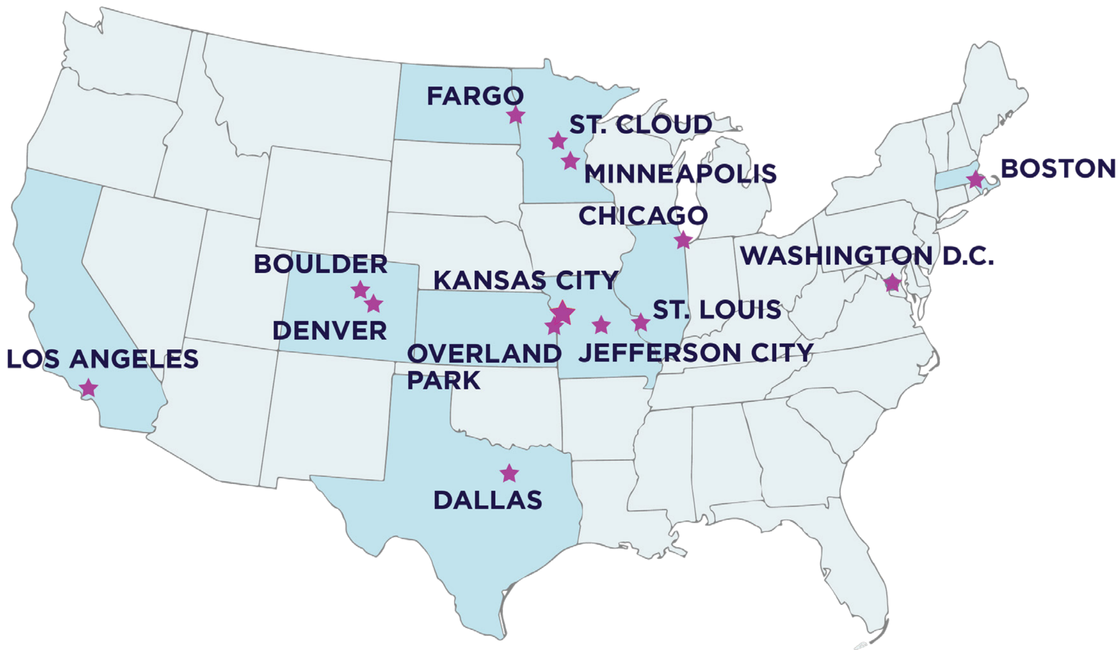

Lathrop GPM Trusts, Estates & Legacy Planning Attorneys:

Jim B. Betterman	913.451.5102	Bennett S. Keller	314.613.2806	Marya P. Robben	612.632.3010
Benjamin O. Bonestroo	612.632.3244	Kerstine B. Kerner	314.613.2816	Erik M. Rome	913.451.5117
Ruth J. Brackney	913.451.5104	Abbi H. Kirchner	314.613.2516	Nancy S. Roush	816.460.5820
Peter W. Brown	913.451.5165	James D. Lamm	612.632.3404	Mary S. Shafer	816.460.5415
Ann B. Burns	612.632.3402	Brian N. Lynn	816.460.5847	Matthew J. Shea	612.632.3428
Courtney M. Conrad	913.451.5171	Scott H. Malin	314.613.2807	James R. Thomson	612.632.3251
Krista L. Durrwachter	320.202.5318	Karen E. McMahon	612.632.3254	Douglas J. Traeger	720.931.3260
Julie A. Frommelt	612.632.3068	Richard A. Moore Jr.	612.632.3265	Edward H. Tully	612.632.3445
Gretchen M. Gold	816.460.5410	Beth T. Morrison	612.632.3322	Justin G. Vaughn	720.931.3230
Sally S. Grossman	612.632.3007	Sheryl G. Morrison	612.632.3376	Joel B. Voran	816.460.5625
Joseph D. Growney	913.451.5105	Maurice O'Sullivan	816.460.5626	Justin W. Whitney	913.451.5183
Lee W. Hanson	320.202.5313	Amy E. Papenhausen	612.632.3480	Alison E. Zinn	720.931.3255
Phillip K. Johnson	816.460.5854	Lyle D. Pishny	913.451.5101		

For more information on our Trusts, Estates & Legacy Planning Practice Group, visit our website at https://www.lathropgpm.com/services-practices-trusts-estates-legacy-planning.html.