HAWTHORN ESTATE PLANNING

Low Interest Rate Planning

LOW INTEREST RATE PLANNING OPPORTUNITIES

Recent significant declines in interest rates have created outstanding tax-advantaged wealth transfer opportunities. Three specific estate-planning tools are typically more attractive in a low interest rate environment.

Grantor Retained Annuity Trusts (GRATs)

A GRAT is an irrevocable trust involving the transfer of assets in return for fixed annuity payments to the Grantor (which come back into the grantor's taxable estate) for a specific term. The amount of the gift for federal gift tax purposes is based on the projected actuarial value of the remainder of the trust, which typically passes to family members outright or in further trust, at the end of the term of payments to the Grantor. The valuation of the remainder equals the value of the assets transferred less the projected actuarial value of the annuity payments to the Grantor.

The term and amount of the annuity payments can be set such that their actuarial value equals the value of the assets transferred to the GRAT, such that the value of the gifted remainder interest is zero (this is known as a "Zeroed Out GRAT").

The valuation of the retained annuity is based upon, among other things, the Section 7520 interest rate published by the IRS for the month the GRAT is established. This rate declines with prevailing interest rates. The lower this Section 7520 interest rate is, the higher will be the valuation of the fixed annuity payments to be made back to the grantor, thus significantly reducing the required annuity payment and term in order to create a Zeroed Out GRAT and increasing the likelihood of a substantial remainder interest passing to family beneficiaries at the end of the annuity term.

Charitable Lead Annuity Trust (CLAT)

A CLAT is identical to a GRAT, except that the fixed annuity payments are made to a charity or charities, which can be the Grantor's Private Foundation. Again, gift tax liability with respect to the remainder interest passing to family beneficiaries after the end of the annuity payment term to charity can be "zeroed out" if the actuarial value of the annuity payments equals or exceeds the value of the assets transferred to the CLAT, such that the remainder interest passes gift tax free to such family members.

Again, the value of the charitable annuity payments is determined based on the Section 7520 interest rate prevailing at the time of establishing the CLAT, and a lower rate increases that valuation, thus reducing the required annuity payment and term in order to create a Zeroed Out CLAT and increasing the likelihood of a substantial remainder interest passing to family beneficiaries at the end of the charitable annuity term.

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Sale of Assets to Family Trust

Another way to reduce or eliminate gift tax liability on transfers of assets to family members is to sell (rather than give) such assets to a Family Trust for their benefit. Typically, this is accomplished in large part through the Trust exchanging a promissory note for those assets. The required interest rate for this promissory note is determined in the month of the transaction under the Internal Revenue Code and corresponding published IRS rates, and that rate generally declines along with other interest rates.

A lower interest rate makes the required payments by the Trust back to the grantor/transferor of those assets under the promissory note lower, thus reducing the amount of payments that must be received back into the grantor's taxable estate. Accordingly, lower interest rates can dramatically increase the effectiveness of this type of wealth transfer strategy.

For further insight regarding these estate planning techniques, please contact your relationship manager or Martyn Babitz at (215) 585-5666 or email him at martyn.babitz@hawthorn.pnc.com.

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