

Gifting Strategies

As you are aware, interest rates have reached historic lows. However, the interest rates for August 2020 offer a once in a lifetime opportunity to transfer wealth with little or no gift tax cost.

The IRS requires the use of certain published interest rates, called the applicable federal rates ("AFRs"), to value estate planning vehicles. Each month the Internal Revenue Service publishes short-, mid- and long-term rates (the Applicable Federal Rates, or AFRs) and the §7520 rate. The AFRs reflect the minimum interest rate that must be charged for loans between related parties; the §7520 rate, which is 120% of the mid-term AFR, is used to calculate the present value of an annuity, a life interest, an interest for a term of years, or a remainder or reversionary interest. For August 2020, the long-term annual AFR rate is 1.12%, the mid-term AFR rate is .41% and the short-term rate is .17%; the Section 7520 rate for August 2020 is .4%.

While no one can predict with certainty the results of the 2020 congressional and presidential elections, we know that many Democrats have expressed their support for dismantling the Tax Cuts and Jobs Act of 2017, including lowering the gift and estate tax exemption to somewhere in the range of \$3.5 million, a nearly 70% reduction from the current \$11.58 million exempt amount, and Joe Biden, the presumptive democratic nominee for president, has advocated for, among other things, eliminating the step-up in basis for capital gains. Given the low federal interest rates, the reduction in value of many assets due to the COVID crisis, the high estate, gift, and generation-skipping transfer tax exemption available now but scheduled to be reduced at the end of 2025 under current law but more likely to be reduced as early as 2021 either due to a change in administration or the need for additional revenue as a result of spending trillions to combat COVID and the economic downturn, it is an ideal time to consider the following strategies as well as gifting in general:

Grantor Retained Annuity Trusts

A grantor retained annuity trust ("GRAT") is an irrevocable trust to which a grantor gifts property but retains the right to receive annuity payments for a term of years. At the end of the annuity

term, the trust property passes to the named beneficiaries (or trusts for their benefit). The annuity payments made to the grantor reduce the value of the gift of the remainder interest, determined when the GRAT is established. Thus, only the present value of the remainder interest is subject to federal gift tax. The GRAT yields estate and gift tax savings if the grantor survives the term (so it is excluded from the grantor's estate) and the trust property generates a return (net income and appreciation) greater than the Section 7520 rate of .6% (if the GRAT is created in August 2020).

Sales to Grantor Trusts

Under this technique, the grantor makes an installment sale of, for example, a business interest, to an irrevocable trust in exchange for a promissory note. The trust is structured as a separate entity for federal estate and gift tax purposes, but the trust income is taxed to the grantor for income tax purposes (known as a "Grantor Trust"). The AFR used for this type of transaction is usually the mid-term rate (term of nine years or less), *currently .43%*, or the long-term rate (loan term of more than nine years), *currently 1.01%*. Appreciation in the value of transferred assets after the sale to the trust does not result in federal estate or gift tax to the grantor. To the extent the promissory note has an outstanding balance at the grantor's death, the balance is included in the grantor's estate.

Intrafamily Loans

A low-interest loan to family members might also be a useful strategy. A parent or grandparent can lend assets to a child or grandchild at the appropriate AFR. The loan payment terms must be respected as if the loan were between unrelated parties. If an adequate interest rate on the loan (AFR) is not charged, interest will be deemed to be charged for income tax and gift tax purposes at the AFR. If the assets appreciate in value over the course of the loan, the return in excess of the AFR rate benefits the borrower and is outside the estate of the senior family member lender.

Charitable lead annuity trust (CLAT)

The CLAT is similar to a GRAT, except a charity, not the grantor, receives the annuity payments for a term of years. The value of the annuity is determined based on the value of the property

gifted to the CLAT and the 7520 rate at that time. At the end of the term, whatever is left in the CLAT (the remainder) passes to individual beneficiaries selected by the client (presumably the client's family members). CLATs work particularly well in periods of low interest rates (as we obviously are experiencing now) because the low rates increase the value of the income streams and thus reduce the value of the taxable gifts. Thus, CLATs allow clients to transfer significant wealth at reduced gift tax cost, as a result of the gift tax deduction

If the CLAT is structured as a grantor trust, the grantor may receive a charitable income tax deduction upon funding for the gift of the annuity interest, but in such case, the grantor is taxed on trust income. If instead, the grantor chooses to structure the GRAT as a non

grantor Trust, the grantor does not receive an immediate income tax deduction for the contribution, but the trust is taxed during the term of the trust and will receive a charitable deduction for the annuities that are being paid to the charities. After the trust term ends, the remaining trust property passes to the beneficiaries free of federal estate or gift tax. Not only may this strategy assist in meeting the needs of charities during these trying times, it allows wealth transfer to the non-charitable remainder beneficiaries free of estate and gift tax.

If you are interested in exploring any of the strategies described above and the specific tax benefits to you, or you wish to discuss gifting in general, please contact me Rona Fingold at rona@lex-life.com.