Barley Snyder

Low Interest Rates Offer Intriguing Estate Opportunities

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While we are all very eager for things to return to normal, some rather interesting estate planning opportunities are now available as a result of the COVID-19 pandemic and its extraordinary effect on prevailing interest rates.

This might be an excellent time to consider the use of a Grantor Retained Annuity Trust (GRAT), a Charitable Lead Annuity Trust (CLAT), an intra-family loan or sale to a grantor trust as a way to transfer wealth to heirs in a highly tax-efficient manner. These strategies, and others like them, take advantage of the exceptionally low Applicable Federal Rate (AFR) or Section 7520 interest rate, which will be as low as 0.8% for the month of May. These rates determine the tax consequences of certain wealth transfer strategies and there are many strategies that are much more tax efficient when the AFR and Section 7520 rates are as low as they are now.

A GRAT is one of these strategies, a trust to which an individual transfers assets while retaining the right to periodic payments (an annuity) for a term. The transfer to the trust is a taxable gift to the trust beneficiaries, but **only** to the extent that the value of the assets transferred exceeds the present value of the retained annuity. The present value of the retained annuity will be higher in a low-interest rate environment (all other factors remaining constant) and that reduces the taxable gift. If the GRAT's assets grow at a rate better than the Section 7520 rate, the tax-efficient transfer of wealth to the GRAT's remainder beneficiaries is greatly enhanced. With low interest rates, that goal is much easier to meet. The same concept applies to a CLAT, though the initial payments are made to a charity, with the remainder coming back to the grantor or to another beneficiary designated by the grantor.

An individual also might consider lending money to their child for the purchase of an asset or for the child's investment activities. That loan must bear interest at the prevailing AFR, at a minimum, to avoid unanticipated tax consequences. If the child's return on the investment of the loaned funds is higher than the interest rate on the loan, the spread represents a transfer of wealth from parent to child without gift or estate tax. This strategy works well when the interest rate on the loan is permitted to be low, as is the case now. A sale to a grantor trust is an even more tax-efficient variation of the intra-family loan example and tends to work well for the transfer of business interests and certain other assets in a low-interest-rate environment.

Members of the Barley Snyder Trust & Estates Practice Group are prepared to discuss these strategies with you and suggest others that may allow you to take advantage of extraordinarily low prevailing interest rates. Please reach out to any member of the group if you have any questions.

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