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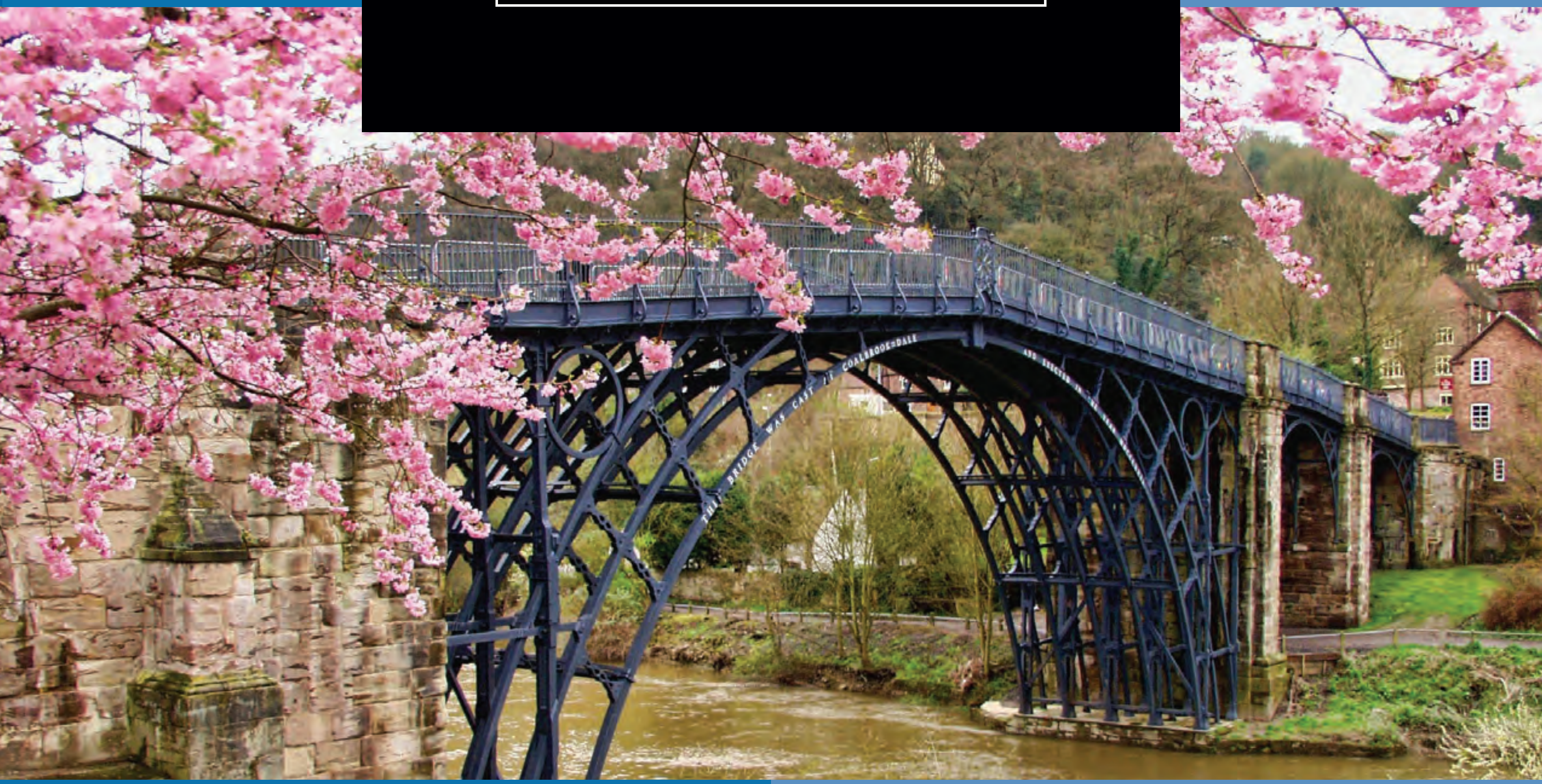
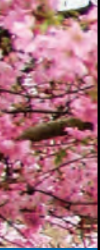


TRUST CONNECTION
CLIENT INSIGHTS

A Monthly Report on
Trust News and Information

APRIL 2020



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Trust Planning Techniques When Interest Rates are Low

Given world events during the past few weeks and the unprecedented actions by the Federal Reserve to drastically lower interest rates to near zero in an attempt to stimulate a shaken global economy, now is the time to discuss the trust planning opportunities that exist for families when interest rates are low. Here's why... interest rates influence how wealth transfers are valued for tax reporting purposes. There are several estate planning strategies that can be especially beneficial in a low interest rate environment, including GRATs (Grantor Retained Annuity Trusts), IDGTs (Intentionally Defective Grantor Trusts), CLATs (Charitable Lead Annuity Trusts), Intrafamily Loans, and FLPs (Family Limited Partnerships). This article will focus on GRATs and CLATs, two of the more popular options for those who want to take advantage of today's low interest rates in the future.

GRATs - Grantor Retained Annuity Trusts

A GRAT is an irrevocable trust into which the grantor transfers assets and receives payment of a fixed dollar amount (the annuity) for a specified number of years. At the end of the GRAT term, the remaining assets in the trust, minus the interest, then pass tax-free to the designated beneficiaries.

The GRAT works great in a low interest rate environment because the IRS sets an interest rate at which it believes the GRAT will grow at the time the trust is established (in low interest periods these rates are low). The IRS does not consider the actual growth of the assets, so any appreciation above the IRS set interest rate is passed on to trust beneficiaries free of gift and estate taxes. The lower the interest rate, the larger the potential tax-free gift.

Another benefit of a GRAT is that it is a "grantor trust." The grantor is considered the owner of the trust from an income tax perspective, so all the income tax is paid by the grantor. The payment of income taxes by the grantor allows the trust assets to grow tax free and becomes a tax-free gift to the trust beneficiaries. A GRAT can be an especially great wealth transfer strategy when interest rates are low.

CLATs - Charitable Lead Annuity Trusts

CLATs are similar to GRATs, except, instead of the annuity payment being made to the grantor, it is made to a charity. Like the GRAT, the CLAT annuity payment must be paid at least annually for a specified number of years. At the end of the CLAT term, the remainder interest must be distributed to one or more non-charitable beneficiaries. These remainder beneficiaries are most often family members.

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The assets contributed to a CLAT are assumed to grow at a rate equal to the IRS established rate in effect at the time of the transfer of asset into the trust. A CLAT works best in a low interest rate environment because any investment performance in excess of the hurdle rate passes tax-free to the family members at the expiration date of the CLAT. The lower the interest rate, the larger the potential tax-free transfer.

Another feature of a CLAT is that the grantor (donor) can take a charitable deduction on the value of the annuity payments paid to the charity. Only the calculated remaining assets when the CLAT terminates are subject to a gift tax. When a CLAT is structured to be zero at termination, there is little to no gift tax.

Based on what you are trying to achieve, there are many trust planning options that can be employed when interest rates are low. This is just an overview of GRATs and CLATs. There are many more details and items to consider with each option. Please consult your financial planner to determine which path is best for your family.

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