Client Alert

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Estates, Trusts
& Tax Planning

January 5, 2009

Lower Interest Rates Can Mean Additional Estate and Gift Tax Savings

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*Our Client Alert from November 18, 2008—*Recessionary Pressures and Market Volatility*—described how lower asset values, coupled with increased volatility in the stock market, are reducing the gift tax cost of transferring family business interests to beneficiaries. Two techniques in particular—the Grantor Retained Annuity Trust ("GRAT") and a Sale to Grantor Trust—pass assets to beneficiaries at little or no gift tax costs. The new development in the mix is historically low interest rates.*

With the Federal government under heightened pressure to make cheap credit available, interest rates for transactions in January 2009 are at historically low rates. Compare those rates with "safe harbor" interest rates for transactions occurring in November 2008:

	January 2009	November 2008
Short-term rate (for loans up to three years):	0.81%	1.63%
Mid-term rate (for loans between three and nine years):	2.06%	2.97%
Long-term rate (for loans over nine years):	3.57%	4.24%
Section 7520 rate (for use with GRATs):	2.40%	3.60%

With interest rates between 15% to 50% **cheaper** than in November, GRATs and Sales to Grantor Trusts make even more sense than before; the "hurdle rate" that investments must exceed before wealth is transferred to the beneficiaries is **lower**, meaning investments can produce mediocre returns and still pass assets to the next generation free of transfer taxes. We have said this is an opportune time for estate planning, now the climate is even more favorable.

Suggested Technique

In addition to GRATs and Sales to Grantor Trusts, some clients are opting for even simpler estate planning techniques, including the most basic: **a very simple, low interest loan to a child, grandchild, or other**

beneficiary. Because the transaction is a loan, not a gift, it requires no use of a client's $13,000 annual gift tax exclusion or $1,000,000 lifetime gift tax exclusion. Documentation is minimal: a promissory note and, if the loan is to be secured, a deed of trust (on real property) or other collateral agreement. Two examples:

1. Granddaughter finally has completed grad school and has landed a promising job in San Francisco. With real estate prices depressed, Grandfather thinks this is a good time to help her buy a "starter condo" as her new home and is willing to lend the $600,000 purchase price. Grandfather can lend Granddaughter $600,000 for 30 years, fully amortized, with payments at only $2,235.76 per month. If the condo appreciates at a 3% annual rate, Granddaughter will have over $206,000 in equity after 10 years, at no gift tax cost to Grandfather.

2. Father wants to help Son build a portfolio of marketable securities to provide long-term financial stability. Father is willing to lend Son $100,000 on an interest-only basis for nine years, with a balloon payment due at the end. Upon receipt of the loan proceeds, Son would invest them in a well-diversified portfolio. Son would pay Father $171.67 per month for nine years, then make a $100,000 balloon payment in 2018. If Son is able to achieve a 5% return each year, the portfolio would then be worth over $129,000 before taxes and repayment of the loan principal. Son would enjoy the financial benefit of all appreciation in the portfolio in excess of 2.06% per year, at no gift tax cost to Father.

As an added benefit in either case, if the lender dies before the beneficiary pays off the note, a good argument can be made to support a discount of the promissory note for estate tax purposes.

In summary, a combination of ultra-low interest rates and depressed stock and housing prices make low-interest rate loans an unbeatable technique for combining simplicity with gift tax benefits.

Live Link

Recessionary Pressures and Market Volatility: An Opportunity to Save Estate and Gift Taxes, Pillsbury Client Alert, 18-Nov-2008 (PDF, 4 pages)

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