

PUBLICATION

Estate Planning to Take Advantage of Low Applicable Federal Rates

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For those with significant assets, the current economic environment, although scary, is also an estate planning opportunity. The applicable federal rate (AFR), which is used to determine the minimum interest rate for related party loans, is 0.91 percent for short-term loans and 0.99 percent for mid-term loans in April 2020, and is set to go down to .25 percent for short-term loans and .58 percent for mid-term loans in May 2020. This is an especially good time for transfer techniques that are keyed to AFR. Some examples of possible strategies:

- **Sale to Intentionally Defective Grantor Trust.** One strategy that may be especially attractive is the creation of an Intentionally Defective Grantor Trust followed by the sale of assets or an ongoing business to the trust in exchange for a note. The grantor gets to keep the value of the asset at the time of the gift in the form of a note (usually done as a "demand" note) but, when done properly, the underlying assets are no longer includable in the grantor's taxable estate. This "estate freeze" technique is especially attractive for certain assets and businesses right now, specifically those that may be depressed in value for the short term but are expected to regain value. Because AFR is low, the note back to the grantor is expected to bear relatively little interest. The grantor will continue to pay income tax on the assets in the trust (although with careful drafting the grantor can also later change their mind on this as well) and thereby will make additional nontaxable gifts to the beneficiaries of the trust.
- **Grantor Retained Annuity Trust.** A Grantor Retained Annuity Trust (GRAT) is a trust where the grantor retains an annuity interest for a period of years. At the termination of the period the remainder of the trust goes to the beneficiaries designated by the grantor. The minimum annuity must be at least AFR. GRATs are most successful as transfer strategies where the growth of the assets is greater than the annuity payments and where interest rates are low, this strategy is more likely to be successful.
- **Sales and Gifts Generally.** The current economy also provides an opportunity for outright gifts to a trust or otherwise, as well as sales and loans to beneficiaries. One word of warning: you do not want to gift an asset where you have a loss (the fair market value is lower than your basis) as the gift recipient will not be able to use the loss.

These are just a few examples of techniques that may be beneficial to you and your family. If you are interested in learning more about transfer tax savings opportunities, need an estate plan, or need to update your estate plan, please contact one of our estate planning attorneys.