



Historically Low Interest Rates Create Incredible Planning Opportunities for Those Who Act Quickly

by Richard M. Morgan & Loraine M. DiSalvo

The major, but temporary, changes to the federal gift, estate, and generation-skipping transfer (“GST”) tax laws which were part of the December 17, 2010, tax act (the “2010 Tax Act”) have created a narrow window of opportunity for those who wish to have their hard-earned assets benefit them and their loved ones, rather than the tax man, creditors, and other unwanted outsiders. These opportunities were enhanced by the economic events of 2008 and more recent years which have generally lowered asset values well below the values seen prior to 2008. However, the recent trend toward lower and lower interest rates, combined with the changes made by the 2010 Tax Act and the low asset values, have made the opportunities offered by this narrow window truly incredible. This month’s newsletter will focus on these opportunities and explain why now is a great time to conduct significant estate planning transactions.

The 2010 Tax Act gave us a federal gift tax exemption of \$5 million per person, along with a federal GST tax exemption of \$5 million per person and a federal estate tax exemption of \$5 million per person. These exemptions alone represent a major change from prior years: in 2009, the estate and GST tax exemptions were \$3.5 million each and the gift tax exemption was a mere \$1 million, and these amounts were even lower for years before 2009. However, the 2010 Tax Act’s changes to the gift, GST, and estate tax exemptions are scheduled to expire at the end of 2012, and there is no guarantee that the laws will be changed to keep these high exemption amounts in effect past December 31, 2012. Just by combining these high exemption amounts with various estate planning techniques and the generally low asset values, we can help our clients reduce their potential estate and gift tax exposures while also helping protect their assets from creditors and predators. Many estate planning techniques, however, rely on a set of federally-determined interest rates, which include the “Applicable Federal Rate” (“AFR”) (which is actually a set of rates which apply to different situations) and a special rate generally referred to as the “Section 7520 Rate.” As of October 1, 2011, the AFRs and the Section 7520 rate will hit the lowest levels ever previously seen. As estate planners, all we could think when we saw the October 2011 rates was “Wow!”

For loans and promissory notes, you must use an interest rate no lower than the appropriate AFR. For October 2011, the AFRs range from 0.16%, which applies to short-term loans (which have terms of 3 years or less), 1.19% for mid-term loans (which have terms lasting between 3 and 9 years), to 2.91% - 2.95% for long-term loans (which have terms lasting longer than 9 years). **For certain planning strategies defined by statutes**, such as Grantor Retained Annuity Trusts (“GRATs”) and Charitable Lead Annuity Trusts (“CLATs”) and some others, you must use the Section 7520 rate, which will be 1.4% for October 2011. The lowest Section 7520 rate previously seen was 2.0%.



The reason that low AFRs and a low Section 7520 Rate are important is that these rates effectively set the minimum amount of return on investment that you have to recognize on assets used in an estate planning technique before you will realize any of the desired gift, GST, and estate tax benefits. **This rate is often referred to as the “hurdle rate.”** For example, if you wanted to transfer assets to a trust you created for the benefit of your loved ones without making a large, taxable gift, you could loan \$1 million to the trust, using a properly structured promissory note. The loan could have a nine-year term, which is considered a mid-term loan. In order to help avoid negative income tax and gift tax consequences, the loan would have to bear interest at a rate which is no lower than the AFR for a mid-term loan. Since the current AFR for a mid-term loan made in October 2011 is a mere 1.19%, you only need to beat this hurdle rate of return for the transaction to be successful. This means that, if the trust can earn a greater than 1.19% return on the assets you loan to it, the trust can use some of its returns to pay back the loan and accumulate the excess amount. This can allow the trust to keep the net profit sheltered from estate taxes and, with proper planning, from GST taxes, for your loved ones’ benefit. In addition, and especially if the trust already holds other assets as a result of previous transactions, you may be able to accomplish this transfer of wealth without using any of your available gift tax exemption.

As another example of how the ultra-low federal rates for October 2011 can produce amazing benefits, let’s assume you have a **closely held business** that you would like to eventually pass on to family members. However, you have been reluctant to begin transferring interests in the business due to the complications and potential tax burdens involved, and because you would still like to retain access to the wealth which the business represents. Under the current, very low rates, you can transfer smaller interests in the business as gifts, using either annual exclusion gifts or, if larger gifts are desirable, you can make taxable gifts and use some of your \$5 million gift tax exemption. You can then sell an additional interest in the business in exchange for a promissory note which bears interest at the appropriate AFR. As long as the business returns more than the necessary AFR in earnings and appreciation, the purchaser comes out ahead, and you should be successful in moving future appreciation on the transferred business interest out of your estate from a gift, GST, and estate tax perspective. You can also feel more comfortable than you might with a straight gift of the entire transferred interest, since you will receive assets in exchange for the sold portion.

For those who would like to take advantage of the current, incredible, opportunities but aren’t sure they feel comfortable shifting significant assets out of their direct control, there are **many techniques which can help reduce the pain of transferring assets and ensure that, if needed, assets may still be available.** You need estate planning attorneys who are well-versed in tax and estate planning, and who have the skill and knowledge necessary to make sure that transactions work as intended to accomplish your goals while maintaining as much flexibility as possible. At Morgan & DiSalvo, we have spent our careers and tremendous amounts of time working to develop a deep and detailed knowledge of the relevant law and concepts. Our goal is to offer our clients whatever level of planning they want and need, whether the goals are simple or the needed techniques are complex, creative, and cutting edge.



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Would you like to consider taking advantage of this incredible window of opportunity, or do you know someone who might? Call us at (678) 720-0750 or e-mail us at info@morgandisalvo.com to schedule an estate planning consultation with either Richard Morgan or Loraine DiSalvo. We can discuss your questions and determine what might be the best fit for you. But hurry - the window of opportunity is closing fast.