Strategic Estate Planning Opportunities in a Low Interest Rate Environment

Apr 21, 2020

Categories:

Blogs
Coronavirus Response Team
Tax Law Defined™ Blog

Authors:

M. Todd Lewis

"When written in Chinese, the word crisis is composed of two characters – one represents danger and the other represents opportunity. In a crisis, be aware of the danger but recognize the opportunity." ~ John F. Kennedy

While we hope that everyone is staying healthy and safe from the danger imposed by the COVID-19 pandemic, we feel it is important to bring to your attention the following strategic estate planning opportunities that can be especially advantageous in this current low interest rate environment.

Grantor Retained Annuity Trusts

A Grantor Retained Annuity Trust (GRAT) is an irrevocable trust, which the creator of the trust transfers appreciating assets while retaining annuity repayments of the principal over the term of the trust (two years or more) that add up to the transferred asset's original value, plus an assumed rate of return set forth by the Internal Revenue Service for tax purposes, i.e., the "7520 rate." GRATs work best when the 7520 rate is low because the transferred assets need only to outperform the 7520 rate in order to remove such growth from the GRAT creator's estate and to transfer a tax-free gift to the remainder beneficiaries of the GRAT at the end of the term. Simply put, the lower the 7520 rate, the greater the potential tax-free transfer. The 7520 rate for GRATs funded in April 2020 is 1.2%, and the 7520 rate for GRATs funded in May 2020 is 0.8%.

Charitable Lead Annuity Trusts

A Charitable Lead Annuity Trust (CLAT) is an irrevocable trust almost exactly like the GRAT except the annuity payments are made to charity rather than back to the creator of the trust, which

2026 FBT Gibbons LLP. All rights reserved. ADVERTISING MATERIAL.

FBT Gibbons

provides the creator with a charitable deduction. Any growth of the transferred assets over the 7520 rate (also known as the "hurdle rate") will be distributed to one or more noncharitable beneficiaries of the GRAT (often the creator's descendants, or trusts for such descendants) at the end of the term.

Intrafamily Loans

The Internal Revenue Code requires that loans must have a minimum amount of interest even if the loan documents charge a lower interest rate or no rate at all. The interest that should have been charged is imputed, and the lender must pay taxes on such imputed interest. These minimum interest rates are referred to as the Applicable Federal Rates (AFRs) and, similar to the 7520 rate, are set each month by the Internal Revenue Service, but unlike the 7520 rate, are based on the term of the loan (short-term AFR for less than three years, midterm AFR for three to nine years, and long-term AFR for over nine years). Using these AFRs, intrafamily lending can be a good way to assist family members without incurring gift tax or reducing estate tax exemption. Further, the interest expense paid over the term of the loan stays within the family (rather than paid to an institution), and the lender may also forgive part of the loan each year up to the annual exclusion amount without a gift tax consequence. The AFR for loans established in April 2020 are 0.91% for short-term, 0.99% for midterm and 1.44% for long-term. The AFR for loans established in May 2020 are 0.25% for short-term, 0.58% for midterm and 1.15% for long-term.

Installment Sales to Intentionally Defective Grantor Trusts

An intentionally defective grantor trust (IDGT) is an irrevocable trust typically established as a perpetual trust for the benefit of the grantor's children and future descendants to which the grantor sells cash-generating assets in return for a promissory note. Similar to intrafamily loans, the interest rate that must be charged on the promissory note is the AFR as of the month of the sale. As long as the property sold earns a higher rate of return than the AFR, the excess represents a tax-free transfer to the IDGT. The IDGT is

2026 FBT Gibbons LLP. All rights reserved. ADVERTISING MATERIAL.

purposely structured to be "defective" for income tax purposes in order to receive "grantor trust" treatment; that is, (i) the grantor pays the income taxes of the IDGT to allow its assets to grow tax-free, (ii) such payment of income taxes is not considered a gift for gift tax purposes, (iii) there is no capital gain recognized upon the sale, and (iv) the interest payments to the grantor are not considered taxable income. The IDGT is purposely structured to be "effective" for estate tax purpose; that is, the assets in the IDGT will be excluded from the grantor's gross estate upon death if the grantor outlives the term of the note, or if the grantor dies during the term of the note, only the outstanding balance of the note is includible in the grantor's gross estate.

For more information, please contact M. Todd Lewis or any attorney in Frost Brown Todd's Estate Planning & Administration practice group. For more tax-related updates, view our Tax Law Defined Blog.

To provide guidance and support to clients as this global public-health crisis unfolds, Frost Brown Todd has created a Coronavirus Response Team. Our attorneys are on hand to answer your questions and provide guidance on how to proactively prepare for and manage any coronavirus-related threats to your business operations and workforce.

© 2026 FBT Gibbons LLP. May be considered attorney advertising in some jurisdictions.

2026 FBT Gibbons LLP. All rights reserved. ADVERTISING MATERIAL.

FBT Gibbons