INTEREST RATES AT HISTORIC LOWS

WEALTH TRANSFER OPPORTUNITIES AT HISTORIC HIGHS

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TOPICS

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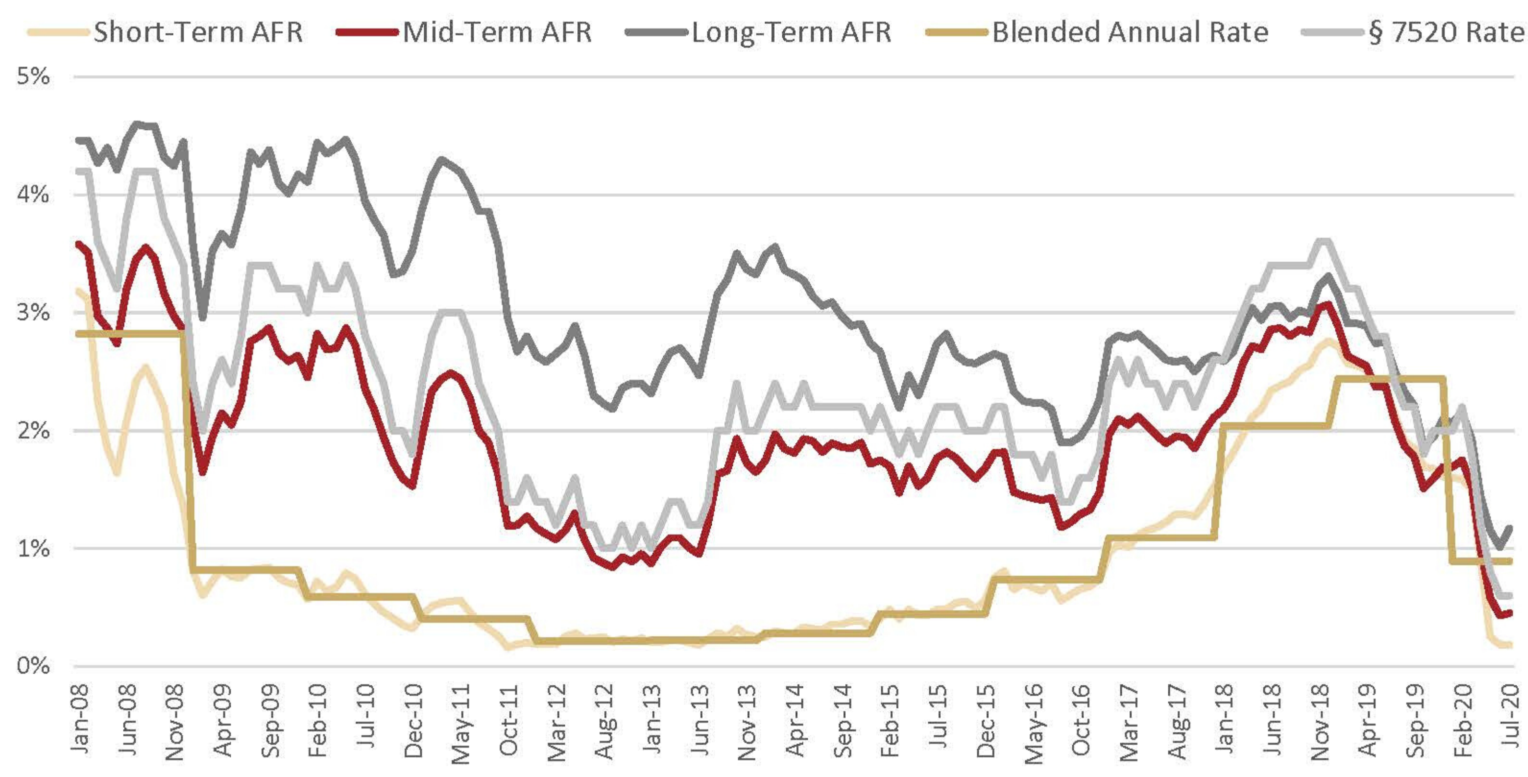
The Applicable Federal Rate (AFR) and § 7520 Rate have fallen to historic lows due to the Federal Reserve reducing short-term rates in response to the economic contraction caused by the COVID-19 pandemic and Treasury Bond yields following. Although COVID-19 has caused a great deal of upheaval and uncertainty, **low AFRs can increase the effectiveness of various estate freeze techniques, such as intrafamily loan, installment sale or certain gift strategies.** Moreover, the fair market value of assets held by high-net-worth individuals may have diminished due to economic or stock market volatility and, if expected to rebound in value with a subsequent recovery, these strategies can be **even more advantageous if assets with temporarily depressed values are thereby transferred to family members (or trusts therefor) and subsequent growth occurs outside the transferor's taxable estate.** For those able and willing to act, immense planning opportunity can be realized during this tumultuous time.

Below are the AFRs and § 7520 Rate for July 2020 and a chart showing historical rates:

	Period of Compounding			
	Annual	Semi-Annual	Quarterly	Monthly
Short-Term AFR (Term loans not more than 3 years)	**0.18%**	**0.18%**	**0.18%**	**0.18%**
Mid-Term AFR (Term loans over 3, not more than 9 years)	**0.45%**	**0.45%**	**0.45%**	**0.45%**
Long-Term AFR (Over 9 years)	**1.17%**	**1.17%**	**1.17%**	**1.17%**

2020 Blended Annual Rate (Demand Loans)	**0.89%** (average of January and July Short-Term AFRs for the year)
§ 7520 Rate (Present value of annuity, interest for life or term of years, or remainder or reversionary interest)	**0.6%** (120% of the Mid-Term AFR rounded to nearest 0.2%)



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ESTATE FREEZE TECHNIQUES, IN GENERAL

Generally speaking, estate freeze techniques are gift, loan or sale strategies that "freeze" or limit the value of property transferred in the transferor's taxable estate for federal estate tax purposes, allowing all or a portion of its subsequent appreciation or income to escape gift or estate tax with respect to the transferor.

An outright gift can be an estate freeze because the amount includible in the transferor's taxable estate is its fair market value (FMV) at the time the gift is made. All subsequent appreciation or income is not subject to gift or estate tax with respect to the transferor. Even gift taxes paid on an outright gift escape estate tax if the transferor survivors at least three years pursuant to IRC § 2035(b). Outright gifts are the baseline for evaluating other freeze techniques. If a technique does not outperform a gift, the tax and non-tax reasons for considering it should be evaluated by a professional estate planner.

A loan can be a freeze technique. Structured properly, the amount includible in the lender's taxable estate is limited to the FMV of the promissory note receivable and payments received. All excess appreciation from investment of the cash by the borrower from the date of the loan escapes estate or gift tax with respect to the lender.

An installment sale can be another freeze technique for similar reasons as a loan. The amount that is includible in the seller's taxable estate is limited to the FMV of the promissory note receivable and payments received. All excess appreciation on, or income from, the property sold from the date of the sale can escape estate or gift tax with respect to the seller if structured properly.

A Grantor Retained Annuity Trust (GRAT) can be an estate freeze should the grantor survive the trust term, in which case the amount includible in his or her taxable estate is limited to the portion of the initial transfer treated as a taxable gift plus the value of annuity payments received over the term. All appreciation and accumulated income in excess of the retained annuity payments can escape estate and gift tax with respect to the grantor.

A Charitable Lead Annuity Trust (CLAT) can also be an estate freeze because the amount includible in the transferor's taxable estate is the portion of the initial transfer that is treated as a taxable gift – the present value of the remainder interest. The rest of the initial transfer escapes gift taxation through the unlimited charitable gift tax deduction and the remainder value at the end of the trust term, if transferred to a third party, is not subject to gift or estate tax with respect to the transferor.

Leveraging the technique by freezing off a valuation discount can enhance the above techniques. If the FMV of the property gifted, loaned or sold can be legitimately discounted for gift tax purposes due to entity planning, economic recession and/or market volatility, the amount includible in the transferor's estate with respect to the transfer can be reduced and a greater amount of economic value due to subsequent appreciation on, and/or income from, the underlying property can be shifted to the recipient, escaping gift and estate tax with respect to the transferor.

Loans, installment sales, GRATs and CLATs, can become even more effective as wealth transfer strategies in lower interest rate environments and can be enhanced with life insurance, as discussed in detail below.

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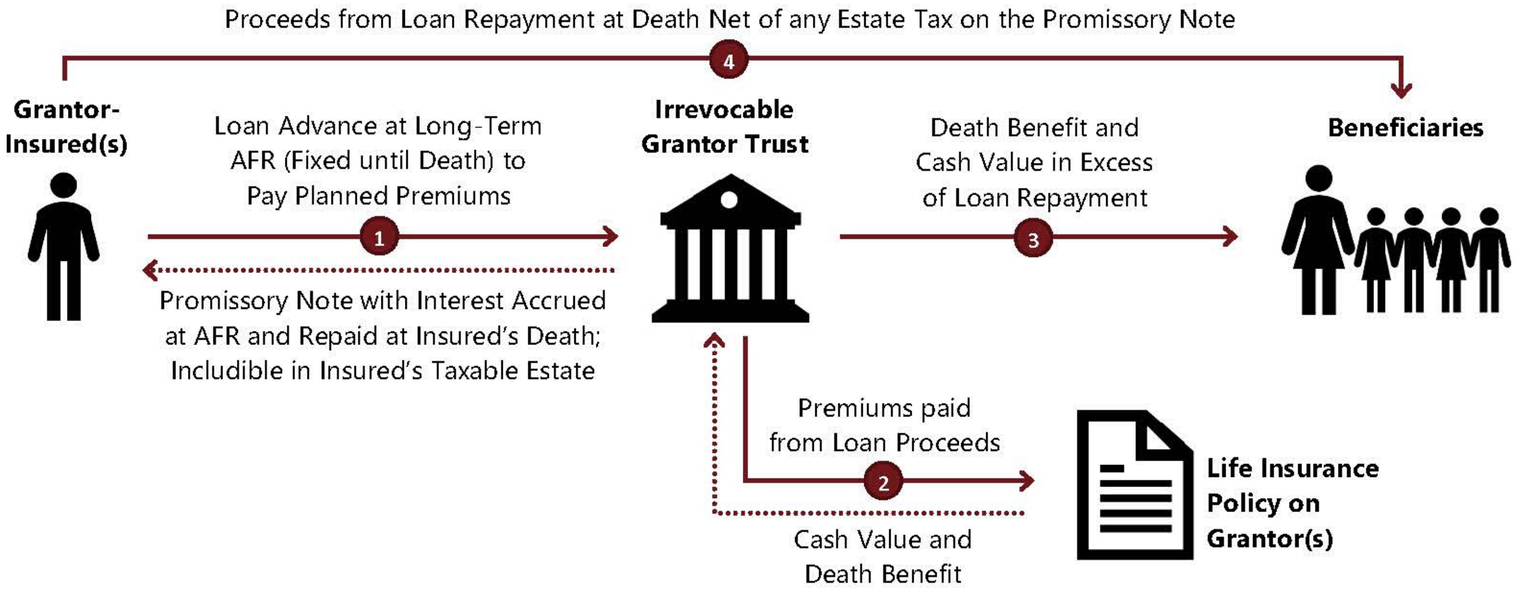
STRATEGY 1 INTRAFAMILY SPLIT DOLLAR LOAN ARRANGEMENT

HOW IT WORKS



1. **Grantor-Insured makes one loan advance to the Trust, repayable upon his or her death, of enough to pay all planned premiums locking in the current long-term AFR (1.17% for July 2020) on the entire loan for life. [1]**

   Loan advances can alternatively be made annually as premiums come due, in which case each advance will be subject to the AFR in effect the month the loan is made. The promissory note is generally non-recourse and, to avoid taxable gifts, the annual interest can be accrued at the AFR.[2]

2. **Trustee pays the first premium and can invest the balance of additional loan proceeds for premiums in years 2+, if any, in a side fund or the carrier's premium deposit account, if available, at his or her discretion.**

   Paying premiums over multiple years can avoid classification as a Modified Endowment Contract (MEC), thus preserving tax-favorable treatment of distributions during the Insured's lifetime, if necessary. The Grantor is generally treated as the owner of Trust property for income tax purposes and responsible for taxes payable on the Trust's taxable income. There should not be any taxable income generated by the life insurance if structured and managed properly.[3]

3. **Proceeds in excess of the loan repayment amount are transferrable to Beneficiaries estate tax free and the death benefit proceeds received are generally not includible in the Trust's taxable income.[4]**

   Withdrawals or loans from cash value could alternatively be taken during life income tax free (assuming the policy stays in force until death and never becomes a MEC) by the Trustee to accelerate the loan repayment or make distributions to Beneficiaries.[5]

4. **Loan repayment proceeds received by Grantor-Insured's estate at death, net of estate and income tax on the note, is transferrable separately to Beneficiaries.**

   The only portion of the interest that is taxable income to the estate should be only the amount that specifically accrues as OID in the year of death when grantor trust status ends (all prior years interest is disregarded under the grantor trust rules).[6] The promissory note could alternatively be transferred to the Trust by the estate and terminated, which may require future availability and allocation of Generation Skipping Transfer (GST) Exemption to preserve GST exempt trust status, if applicable, or donated to charity to eliminate the taxes on it through the charitable deduction.

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STRATEGY 1: INTRAFAMILY SPLIT DOLLAR LOAN ARRANGEMENT

HOW IT BENEFITS FROM LOW INTEREST RATES

1. **Locking in a low AFR for life helps reduce taxable gifts needed to help the trustee pay interest to the Grantor-Insured; or**
2. **With accrued interest designs that avoid taxable gifts, it can minimize the loan receivable includible the Grantor-Insured's taxable estate allowing more policy proceeds to transfer to Beneficiaries estate and gift tax free; and**
3. **Reduces the pressure on policy performance to generate cash value or death benefit proceeds to repay the loan.**

HYPOTHETICAL ILLUSTRATIVE EXAMPLES

Although annual loan advances are typically made as premiums come due, making one term loan payable on death of enough to fund all planned premiums can lock in the AFR on the entire loan for the insured's lifetime, as shown below.

Assumes a Female, age 55 and Standard Nonsmoker, Whole Life Policy from a Highly Rated Carrier, 33 Year LE, $50MM other estate assets growing at 3%. See full sample analysis downloadable below for additional details and assumptions.

1 Year	2 Annual Loan to Trust	3 Loan Receivable at 1.17% AFR Includible in Grantor-Insured's Taxable Estate	4 Annual Gift Taxes Payable by Grantor-Insured	5 Income Taxes Payable by Grantor-Insured on Trust Taxable Income	6 Grantor-Insured's Outlay	7 Annual Premiums Paid	8 Premium Reserve Assuming No Interest Earnings	9 Total Death Benefit	10 Columns 9 + 10 Less Estate & Income Tax on Loan Receivable	11 Income and Estate Tax Equiv-alent ROI on Column 6 & 10
1	7,000,000	**7,081,900**	-	-	**7,000,000**	1,000,000	6,000,000	19,908,819	**24,162,558**	551.46%
2	-	**7,164,758**	-	-	-	1,000,000	5,000,000	19,925,371	**23,149,942**	164.80%
3	-	**7,248,586**	-	-	-	1,000,000	4,000,000	19,952,477	**22,147,975**	91.63%
4	-	**7,333,394**	-	-	-	1,000,000	3,000,000	19,988,481	**21,154,042**	61.79%
5	-	**7,419,195**	-	-	-	1,000,000	2,000,000	20,013,707	**20,148,930**	45.64%
6	-	**7,506,000**	-	-	-	1,000,000	1,000,000	21,628,162	**20,161,712**	39.78%
7	-	**7,593,820**	-	-	-	1,000,000	-	24,174,730	**21,674,693**	35.36%
8	-	**7,682,668**	-	-	-	-	-	19,612,896	**17,079,067**	25.29%
10	-	**7,863,494**	-	-	-	-	-	20,448,916	**17,846,387**	20.63%
20	-	**8,833,505**	-	-	-	-	-	25,414,023	**22,440,203**	11.77%
33	**-**	**10,275,567**	**-**	**-**	**-**	**-**	**-**	**34,826,171**	**31,295,102**	**8.58%**
40	-	**11,147,258**	-	-	-	-	-	42,094,132	**38,224,154**	7.81%

Click here for the full sample analysis of the above illustration and here for the whole life policy illustration.

Below is an illustration of the benefit of reducing the amount subject to estate tax and increasing tax-equivalent ROI at LE that a lower AFR can have on loan regime split dollar based on the above policy values and assumptions.

	1.17% Long-Term AFR	2% Long-Term AFR	3% Long-Term AFR	4% Long-Term AFR	5% Long-Term AFR
One-Time Loan for All Planned Premiums	7,000,000	7,000,000	7,000,000	7,000,000	7,000,000
Accrued Loan at LE Subject to Estate Tax	**10,275,567**	**13,455,620**	**18,566,347**	**25,538,668**	**35,022,320**
Death Benefit Net of Estate Tax on Loan Receivable at LE	31,295,102	30,140,268	28,250,859	25,619,326	21,960,220
Income and Estate Tax-Equivalent ROI at LE	**8.58%**	**8.40%**	**8.10%**	**7.65%**	**6.94%**

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ADDITIONAL POTENTIAL ADVANTAGES WHEN COMBINED WITH OTHER COMMON ESTATE PLANNING TECHNIQUES

- **Due to the avoidance of taxable gifts via accruing interest, the Grantor-Insured's Basic Exclusion Amount (BEA) can be allocated to gifts of other assets or preserved for other income tax basis or estate planning purposes.**

- **Because death benefit proceeds are not includible in the beneficiary's taxable income, life insurance is generally the only asset that receives a basis step-up outside one's taxable estate, making it an efficient asset to fund via gifts or loans, help offset capital gain tax exposure in other trust assets or provide estate tax liquidity.[7]**

- **Trustee can repay the split dollar loan low-basis trust property (previously transferred using Grantor-Insured's BEA, an installment sale, or otherwise) during life without recognizing taxable income on the gain, thus transferring it into the Grantor-Insured's taxable estate to receive a basis step-up at death and reduce post-mortem capital gain tax exposure for Beneficiaries.[8]**

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DOWNLOAD STRATEGY 1 PDF

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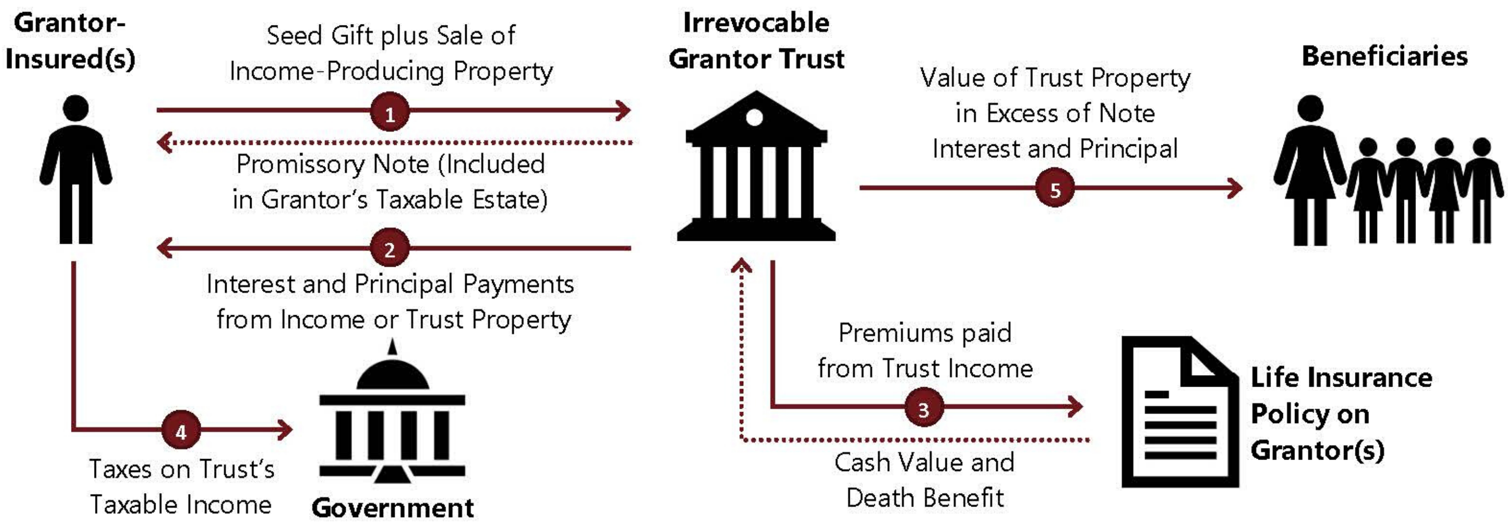
STRATEGY 2 INSTALLMENT SALE TO AN IRREVOCABLE GRANTOR TRUST

HOW IT WORKS



1. **Grantor-Insured makes a seed gift and then sells an interest in an asset or entity to the Trust as an installment obligation with an interest rate equal to the AFR for the note's term (0.18%, 0.45% or 1.17% for July 2020).** [9]

   By selling minority, non-managing or fractional interests, valuation discounts may be applied in calculating the fair market value (FMV) of the property interests sold due to lack of marketability and control which can reduce the promissory note's face value and required interest payments, thus transferring additional discounted economic value.[10]

2. **Interest is typically paid annually to the Grantor from the income produced by the asset or entity sold, or other Trust assets, with the balloon principal payment being made at the end of the note term.**

   Payments can be made from Trust income or other property, including interests in the property sold. The grantor trust rules cause the transaction to be "disregarded" for income tax purposes and there is no income recognized by Grantor on the payments received whether in cash or appreciated property.[11] If valuation discounts are applied to the FMV of the property interests sold then any payments made with such property should reflect such discounts.

3. **Trust income in excess of that needed to make note payments can be used to pay life insurance premiums.**

   Life insurance can provide liquidity to help repay the note if Grantor-Insured dies during the term, pay estate taxes on the value of the note or other assets includible in his or her estate, or mitigate capital gain tax on post-death dispositions of Trust assets.

4. **The Grantor is treated as the owner of Trust property for income tax purposes under the grantor trust rules and personally responsible for taxes payable on the Trust's taxable income.**[12]

   Payment of the Trust's income taxes has the effect of an additional gift to the Trust but is not treated as such, which reduces the Grantor's taxable estate and allows more wealth to accrue to the Beneficiaries.[13]

5. **Trust property appreciation and reinvested income in excess of note interest and principal payments can be shifted away from the Grantor's taxable estate and is transferrable to Trust Beneficiaries estate tax free.**

   The value of the asset sold can be "frozen" in the Grantor's taxable estate for estate tax purposes at the face value of the promissory note plus the future value of payments received during the note term.

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HOW IT BENEFITS FROM LOW INTEREST RATES

1. **Locking in a low AFR for the note's term can reduce the amount of interest the Trustee must pay to the Grantor;**
2. **Create a lower wealth transfer "hurdle rate" allowing more Trust asset appreciation and reinvested income to be shifted outside the Grantor's taxable estate and transferrable to Beneficiaries estate tax free; and**
3. **Increase Trust income available to pay life insurance premium or reduce the corresponding sale amount required.**

HYPOTHETICAL ILLUSTRATIVE EXAMPLES

Many installment sales for estate planning purposes are structured with a note term of nine years or less to use the mid-term AFR as compared to the long-term AFR, between which there had been a noticeable spread, and as interest-only with a balloon payment of principal upon maturity, as the below example illustrates.

Assumes 5% income and 2% growth, 37% Grantor marginal tax rate, no valuation discount for simplicity's sake and the following design parameters:

1	2	3	4	5
$9,000,000 Asset or Entity Sale	**9 Years** Promissory Note	**0.45%** Mid-Term AFR	**$1,000,000** Taxable Seed Gift	**$10,000,000** Total Asset Transfer

Year	Trust Growth	Trust Income (Taxable to Grantor)	Interest Payments to Grantor at 0.45% AFR	Principal Payments in Kind to Grantor	Ending Trust Value	Note Receivable Subject to Estate Tax	Trust Equity Not Subject to Estate Tax	Grantor's Tax Due on Trust Income
1	200,000	500,000	**-40,500**	-	10,659,500	9,000,000	**1,659,500**	**-185,000**
2	213,190	532,975	**-40,500**	-	11,365,165	9,000,000	**2,365,165**	**-197,201**
3	227,303	568,258	**-40,500**	-	12,120,227	9,000,000	**3,120,227**	**-210,256**
4	242,405	606,011	**-40,500**	-	12,928,142	9,000,000	**3,928,142**	**-224,224**
5	258,563	646,407	**-40,500**	-	13,792,612	9,000,000	**4,792,612**	**-239,171**
6	275,852	689,631	**-40,500**	-	14,717,595	9,000,000	**5,717,595**	**-255,163**
7	294,352	735,880	**-40,500**	-	15,707,327	9,000,000	**6,707,327**	**-272,276**
8	314,147	785,366	**-40,500**	-	16,766,340	9,000,000	**7,766,340**	**-290,586**
9	335,327	838,317	**-40,500**	**-9,000,000**	8,899,484	-	**8,899,484**	**-310,177**
Total	**2,361,138**	**5,902,845**	**-364,500**	**-9,000,000**	**8,899,484**	**-**	**8,899,484**	**-2,184,053**

Click here for a sample of a more detailed analysis illustrating the economics of a 9-year installment sale with life insurance (a separate example, not reflecting the values above).

Installment sales can be used to help fund Trust-owned life insurance premiums with reduced taxable gift exposure. Below is an illustration of the increase in the affordable face amount per $10MM of sale/gift amount (at 9/1 ratio) based on available Trust income in the first year at lower AFRs. See the example below.

Assumes a male age 55 and standard plus non-tobacco, solve for maximum guaranteed face amount to age 120 with a no-lapse guarantee policy paid up after 9 years, rounded to nearest 1,000, first premium paid from the seed gift.

Life Insurance Premium Funding:	**0.45%** **Mid-Term AFR**	**1.00%** **Mid-Term AFR**	**2.00%** **Mid-Term AFR**	**3.00%** **Mid-Term AFR**
Affordable Face Amount of Policy based on Initial Trust Income Available for Premium from a $9MM Asset Sale + $1MM Seed Gift	**$13,793,000**	**$12,292,000**	**$9,580,000**	**$6,899,000**

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STRATEGY 2: INSTALLMENT SALE TO AN IRREVOCABLE GRANTOR TRUST

Due to the historically low long-term AFR, and small spread over the mid-term, it could advantageous to structure Installment Sales for longer durations to lock in a very low wealth transfer hurdle rate for a longer period, allowing more long-term appreciation potential to be transferred away from the Grantor's taxable estate and gift tax free.[14] See below.

Assumes 5% income and 2% growth, 37% Grantor marginal tax rate, no valuation discount for simplicity sake and the following design parameters:

1	2	3	4	5
$9,000,000 Asset or Entity Sale	**20 Years** Promissory Note	**1.17%** Long-Term AFR	**$1,000,000** Taxable Seed Gift	**$10,000,000** Total Asset Transfer

Year	Trust Growth	Trust Income (Taxable to Grantor)	Interest Payments to Grantor at 1.17% AFR	Principal Payments to Grantor	Ending Trust Value	Note Receivable Subject to Estate Tax	Trust Equity Not Subject to Estate Tax	Grantor's Tax Due on Trust Income
1	200,000	500,000	-105,300	-	10,594,700	9,000,000	1,594,700	-185,000
2	211,894	529,735	-105,300	-	11,231,029	9,000,000	2,231,029	-196,002
3	224,621	561,551	-105,300	-	11,911,901	9,000,000	2,911,901	-207,774
5	252,809	632,022	-105,300	-	13,419,964	9,000,000	4,419,964	-233,848
10	342,466	856,165	-105,300	-	18,216,642	9,000,000	9,216,642	-316,781
15	468,216	1,170,539	-105,300	-	24,944,229	9,000,000	15,944,229	-433,099
20	644,585	1,611,464	-105,300	-9,000,000	25,380,019	-	25,380,019	-596,242
Total	**7,567,434**	**18,918,585**	**-2,106,000**	**-9,000,000**	**25,380,019**	**-**	**25,380,019**	**-6,999,877**

Click here for a sample of a more detailed analysis illustrating the economics of a 20-year installment sale with life insurance (a separate example, not reflecting the values above).

Below is another analysis of the affordable face amount per $10MM of sale/gift amount (at 9/1 ratio) at various AFRs based on the available Trust income in the first year if used to fund Trust-owned life insurance premiums.

Assumes a male age 55 and standard plus non-tobacco, solve for maximum guaranteed face amount to age 120 with a no-lapse guarantee policy paid up after 20 years, rounded down to nearest 1,000, first premium paid from the seed gift.

Life Insurance Premium Funding:	1.17% Long-Term AFR	2.00% Long-Term AFR	3.00% Long-Term AFR	4.00% Long-Term AFR
Affordable Face Amount of Policy based on Trust Income Available for Premium from a $9MM Asset Sale + $1MM Seed Gift	**$19,301,000**	**$15,608,000**	**$11,242,000**	**$6,825,000**

ADDITIONAL POTENTIAL ADVANTAGES IN THE CURRENT ENVIRONMENT

- **Many privately held business interests or income-producing assets may have experienced temporary declines in fair market value (FMV) due to the economic impact of the COVID-19 pandemic; and**
- **If such assets are expected to substantially rebound in value as the economy recovers over the next couple years, now may be an opportunistic time to consider selling such assets to a Trust using this technique; because**
- **The temporarily reduced FMV can help reduce the face value and payments owed by the Trust under an installment sale and subsequent growth can be shifted outside the Grantor's taxable estate, thus transferring significant amounts of wealth to Beneficiaries gift and estate tax free.**

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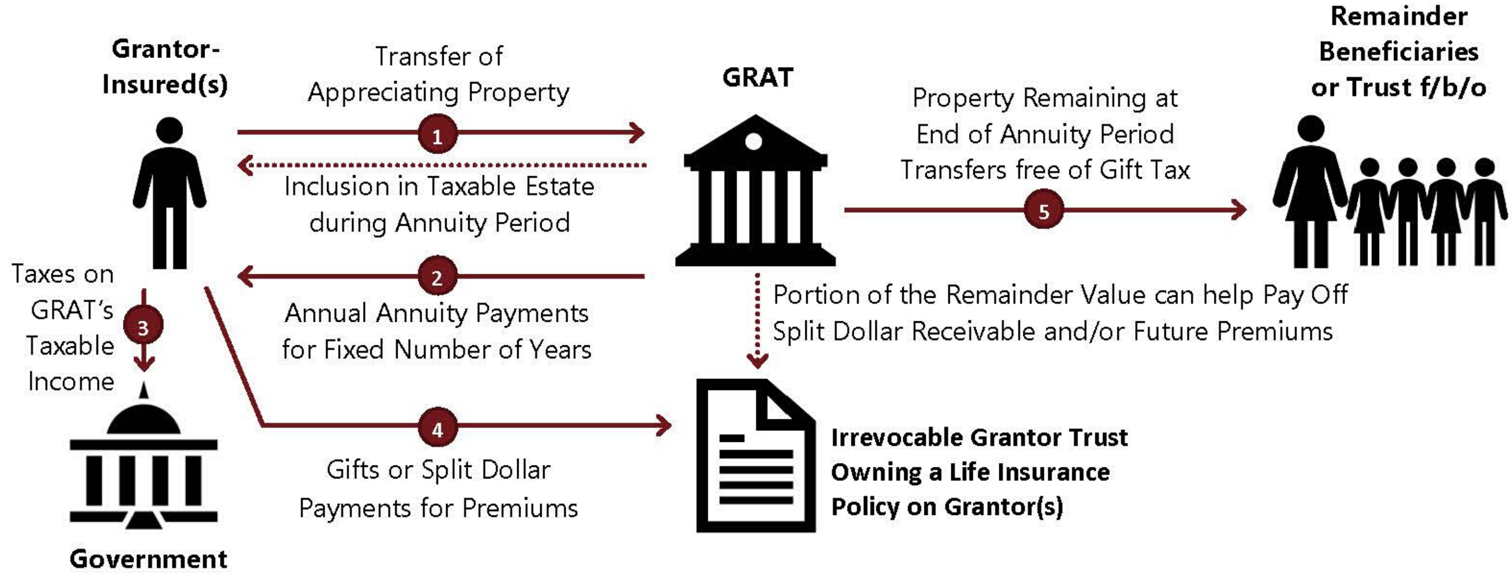
STRATEGY 3 GRANTOR RETAINED ANNUITY TRUST (GRAT)

HOW IT WORKS



1. **Grantor-Insured transfers property that is expected to appreciate in value to the GRAT.**

   The FMV of property transferred less the present value (PV) of the qualified retained annuity interest in step 2, discounted at the § 7520 Rate (0.6% for July 2020), equals the taxable gift to the Remainder Beneficiaries at inception.[15]

2. **Grantor-Insured receives a fixed annual annuity payment for a fixed number of years ("Annuity Period").**

   Payments can be made from GRAT income or principal including in-kind property interests. If valuation discounts are applied to the FMV of property gifted, any distribution of such property should reflect such discounts. Annuity interest can be set so its PV is equal to the FMV of property transferred to minimize the taxable gift.[16] A portion of or all the GRAT property is includible in the Grantor's taxable estate, subject to estate tax, if death occurs during the Annuity Period.[17]

3. **The Grantor is treated as the owner of GRAT property for income tax purposes under the grantor trust rules and personally responsible for taxes payable on the Trust's taxable income.[18]**

   Transactions between the Grantor and GRAT are disregarded for income tax purposes, thus the Grantor does not recognize income on the Annuity payments received nor on GRAT payments made with appreciated property.[19] Payment of the GRAT's income taxes has the effect of an additional gift to the GRAT but is not treated as such, which reduces the Grantor's taxable estate and allows more wealth to accrue to the Beneficiaries.[20]

4. **To help pay estate taxes on GRAT property includible in the Grantor's taxable estate during the Annuity Period, the Grantor can set up another Trust to own Life Insurance and make gifts or split dollar loans to pay premiums.**

   At a minimum, a term policy insuring the Grantor with a term at least as long as the GRAT Annuity Period should be acquired but a strong case can be made for a permanent policy extending beyond this period as illustrated below.

5. **GRAT property remaining at the end of the Annuity Period is transferred to Remainder Beneficiaries gift tax free.[21]**

   The value of the transfer to the GRAT is "frozen" in the Grantor's taxable estate for estate tax purposes at a value equal to the taxable gift at inception plus the future value of annuity payments received. For a GRAT to be successful in transferring wealth, property contributed must appreciate at a rate higher than the § 7520 Rate throughout the Annuity Period.[22] A portion of the remainder value can be transferred to the Life Insurance Trust to repay split dollar receivable owed to the Grantor-Insured(s) or pay future premiums, if applicable. Grantor's GST Exemption can be allocated to the value of GRAT property at the end of the Annuity Period but not sooner which can make GST planning with GRATs challenging.[23]

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STRATEGY 3: GRANTOR RETAINED ANNUITY TRUST (GRAT)

HOW IT BENEFITS FROM LOW INTEREST RATES

1. **A low § 7520 Rate results in a higher present value of the annuity interest, which helps reduce the taxable gift or the annuity payment required to achieve a specific taxable gift; and**
2. **Creates a lower wealth transfer "hurdle rate" allowing more appreciation and reinvested income from GRAT property to be transferred to Remainder Beneficiaries gift tax free.**

HYPOTHETICAL ILLUSTRATIVE EXAMPLES

Many GRATs are designed with shorter annuity periods, e.g. 2-10 years, to minimize the risk of inclusion in the Grantor's taxable estate, capitalize on shorter-term growth expectations for estate planning purposes and mitigate longer-term economic risk and uncertainty. The annuity amount is typically set so its PV is approximately equal to the property transferred to "zero out" the taxable gift and neutralize the risk depreciation over the annuity period. See below.

Assumes 5% income and 2% growth, 37% Grantor marginal tax rate, no valuation discount for simplicity sake and the following design parameters:

1	2	3	4	5	6
$10,000,000 FMV of Property Contributed	**0.6%** § 7520 Rate at Inception	**9-Year** Annuity Period	**$1,144,596** Annuity Amount	**$9,999,000** Present Value of the Annuity	**$1,000** Taxable Gift (1 minus 5)

Year	GRAT Growth	GRAT Income (Taxable to Grantor)	GRAT Annuity Payment Made from Income	GRAT Annuity Payment Made in Kind	Total GRAT Annuity Payment to Grantor	GRAT Remainder Value	Grantor's Tax Due on GRAT Income
1	200,000	500,000	-500,000	-644,596	-1,144,596	9,555,404	-185,000
2	191,108	477,770	-477,770	-666,826	-1,144,596	9,079,687	-176,775
3	181,594	453,984	-453,984	-690,611	-1,144,596	8,570,669	-167,974
4	171,413	428,533	-428,533	-716,062	-1,144,596	8,026,020	-158,557
5	160,520	401,301	-401,301	-743,295	-1,144,596	7,443,245	-148,481
6	148,865	372,162	-372,162	-772,434	-1,144,596	6,819,677	-137,700
7	136,394	340,984	-340,984	-803,612	-1,144,596	6,152,458	-126,164
8	123,049	307,623	-307,623	-836,973	-1,144,596	5,438,535	-113,820
9	108,771	271,927	-271,927	-872,669	-1,144,596	4,674,636	-100,613
Total	**1,421,714**	**3,554,285**	**-3,554,285**	**-6,747,078**	**-10,301,362**	**4,674,636**	**-1,315,085**

Click here for a sample analysis illustrating a 9-GRAT the remainder value of which funds a Life Insurance Trust.

Below is an analysis of the positive effect that a lower § 7520 Rate can have on GRATs for wealth transfer purposes when targeting the same taxable gift amount at inception and using the same assumptions as above.

	0.6% § 7520 Rate	**2%** § 7520 Rate	**3%** § 7520 Rate	**4%** § 7520 Rate	**5%** § 7520 Rate	**6%** § 7520 Rate	**7%** § 7520 Rate
FMV of Property Contributed	10,000,000	10,000,000	10,000,000	10,000,000	10,000,000	10,000,000	10,000,000
9-Year Annuity	**1,144,596**	**1,225,032**	**1,284,210**	**1,344,795**	**1,406,760**	**1,470,075**	**1,534,711**
PV of Annuity	9,999,000	9,999,000	9,999,000	9,999,000	9,999,000	9,999,000	9,999,000
Taxable Gift	1,000	1,000	1,000	1,000	1,000	1,000	1,000
Remainder Value	**4,674,636**	**3,711,174**	**3,002,338**	**2,276,648**	**1,534,435**	**776,046**	**1,838**

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STRATEGY 3: GRANTOR RETAINED ANNUITY TRUST (GRAT)

Due to the historically low § 7520 Rate, it could advantageous to structure GRATs for longer to lock in a very low wealth transfer hurdle rate for a longer period, allowing more long-term appreciation potential to be transferred away from the Grantor's taxable estate and gift tax free if he or she survives the GRAT Annuity Period, as illustrated below.

Assumes 5% income and 2% growth, 37% Grantor marginal tax rate, no valuation discount for simplicity sake and the following design parameters:

1	2	3	4	5	6
$10,000,000 FMV of Property Contributed	**0.6%** § 7520 Rate at Inception	**20 Years** Annuity Period	**$532,043** Annuity Amount	**$9,999,000** Present Value of the Annuity	**$1,000** Taxable Gift (1 minus 5)

Year	GRAT Growth	GRAT Income (Taxable to Grantor)	GRAT Annuity Payment Made from Income	GRAT Annuity Payment Made in Kind	Total GRAT Annuity Payment to Grantor	GRAT Remainder Value	Grantor's Tax Due on GRAT Income
1	200,000	500,000	-500,000	-32,043	-532,043	10,167,957	-185,000
2	203,359	508,398	-508,398	-23,646	-532,043	10,347,670	-188,107
3	206,953	517,384	-517,384	-14,660	-532,043	10,539,964	-191,432
5	214,914	537,286	-532,043	0	-532,043	10,965,875	-198,796
10	240,236	600,589	-532,043	0	-532,043	12,320,564	-222,218
15	275,750	689,375	-532,043	0	-532,043	14,220,586	-255,069
20	325,561	813,902	-532,043	0	-532,043	16,885,465	-301,144
Total	**5,007,524**	**12,518,809**	**-10,565,473**	**-75,394**	**-10,640,867**	**16,885,465**	**-4,631,959**

Click here for a sample analysis illustrating a 20-GRAT the remainder value of which funds a Life Insurance Trust.

Below is another example of the positive effect that a lower § 7520 Rate can have on GRATs for wealth transfer when targeting the same taxable gift amount at inception and using the same 20-year GRAT assumptions above.

	0.6% § 7520 Rate	**2%** § 7520 Rate	**3%** § 7520 Rate	**4%** § 7520 Rate	**5%** § 7520 Rate	**6%** § 7520 Rate	**7%** § 7520 Rate
FMV of Property Contributed	10,000,000	10,000,000	10,000,000	10,000,000	10,000,000	10,000,000	10,000,000
20-Year Annuity	**532,043**	**611,506**	**672,090**	**735,744**	**802,346**	**871,758**	**943,835**
PV of Annuity	9,999,000	9,999,000	9,999,000	9,999,000	9,999,000	9,999,000	9,999,000
Taxable Gift	1,000	1,000	1,000	1,000	1,000	1,000	1,000
Remainder Value	**16,885,465**	**13,627,854**	**11,144,190**	**8,534,660**	**5,804,291**	**2,958,680**	**3,870**

A longer duration GRAT can potentially transfer more wealth gift tax free but causes more inclusion risk of its property being subject to estate tax due to a longer Annuity Period during which Grantor may die. However, depending on the annuity amount and § 7520 Rate at death, the portion of GRAT property subject to estate tax may be less than 100%:

	0.6% § 7520 Rate at Death	**2%** § 7520 Rate at Death	**3%** § 7520 Rate at Death	**4%** § 7520 Rate at Death	**5%** § 7520 Rate at Death	**6%** § 7520 Rate at Death	**7%** § 7520 Rate at Death
Maximum Amount Includible in Estate $532,043 Annuity ÷ § 7520 Rate at Death	**88,673,833** or FMV of GRAT property if less	**26,602,150** or FMV of GRAT property if less	**17,734,767** or FMV of GRAT property if less	**13,301,075** or FMV of GRAT property if less	**10,640,860** or FMV of GRAT property if less	**8,867,383** or FMV of GRAT property if less	**7,600,614** or FMV of GRAT property if less

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THE CASE FOR PERMANENT LIFE INSURANCE NOTWITHSTANDING A TEMPORARY NEED SPECIFIC TO A GRAT

Life Insurance can help provide liquidity for estate taxes on GRAT property if the Grantor dies during the Annuity Period. If Permanent Life Insurance is not otherwise being considered, Term Life Insurance is often purchased, which may expire before death since most Term policies generally do not pay a death claim, either due to the insured outliving the term, converting the policy to permanent, or otherwise.

Permanent Life Insurance may provide more long-term value and flexibility than Term, such as liquidity for estate taxes on other estate property, protection to compliment future "bet to live" estate planning techniques, mitigation of capital gain tax on post-mortem dispositions by a Trust or Beneficiary, cash value accumulation that can provide a line of credit during life, the ability to monetize the policy by selling it in the secondary market if it is no longer needed, and more.

In addition to these potential planning benefits, a strong case can be made by analyzing the "incremental" internal rate of return (IRR) on premiums paid at death. Since the Term policy's temporary coverage may be required, regardless, to hedge the inherent GRAT mortality risk, it can be viewed as a "sunk cost" and this portion of the premium and death benefit can be disregarded in calculating the IRR on the cost and benefit of a Permanent policy as illustrated below.

In other words, since the Term cost will be incurred regardless, what is the long-term IRR on the additional (incremental) cost and benefit of a Permanent policy the client would pay and receive? The below example demonstrates this potentially attractive long-term benefit after the Term policy expires expressed as an incremental IRR at death.

Assumes a female, age 55, standard plus non-tobacco, 33-year LE, best 20-year level term policy vs. no-lapse guarantee permanent policy to age 100 with return of premium death benefit, 25% average income tax rate for tax-equivalent calculation.

	"Sunk Cost" Term Policy			Permanent Policy Incremental Analysis					
1	2	3	4	5	6	7	8	9	10
Year	**Guaranteed Premium**	**Guaranteed Death Benefit**	**Income Tax-Equivalent IRR at Death**	**Guaranteed Premium**	**Guaranteed Death Benefit with Return of Premium**	**Income Tax-Equivalent IRR on Death Benefit**	**Incremental Guaranteed Premium**	**Incremental Guaranteed Death Benefit**	**Incremental Income Tax-Equivalent IRR at Death**
			On 2 and 3				*5 minus 2*	*6 minus 3*	*On 8 and 9*
1	**27,342**	**10,000,000**	**48631.9%**	143,705	10,143,705	9,278.3%	**116,363**	**143,705**	**31.3%**
3	**27,342**	**10,000,000**	**771.8%**	143,705	10,431,716	372.0%	**116,363**	**431,116**	**14.6%**
5	**27,342**	**10,000,000**	**267.3%**	143,705	10,718,527	145.4%	**116,363**	**718,527**	**9.5%**
10	**27,342**	**10,000,000**	**85.9%**	143,705	11,437,054	48.5%	**116,363**	**1,437,054**	**5.1%**
20	**27,342**	**10,000,000**	**31.7%**	143,705	12,874,109	17.1%	**116,363**	**2,874,109**	**2.6%**
21	**Policy Lapses**		**-100.0%**	143,705	13,017,814	15.9%	**143,705**	**13,017,814**	**18.0%**
30			**-100.0%**	143,705	14,311,163	9.2%	**143,705**	**14,311,163**	**10.5%**
33	**Life Expectancy**		**-100.0%**	143,705	14,742,279	8.0%	**143,705**	**14,742,279**	**9.1%**
35			**-100.0%**	143,705	15,029,690	7.3%	**143,705**	**15,029,690**	**8.3%**
40			**-100.0%**	143,705	15,748,217	5.9%	**143,705**	**15,748,217**	**6.7%**

ADDITIONAL POTENTIAL ADVANTAGES IN THE CURRENT ENVIRONMENT

- **Many privately held business interests or income-producing assets may have experienced temporary declines in fair market value (FMV) due to the economic impact of the COVID-19 pandemic; and**
- **If such assets are expected to substantially rebound in value as the economy recovers over the next couple years, now may be an opportunistic time to consider gifting assets to a GRAT; because**
- **The temporarily reduced FMV can help reduce the annuity payments necessary to zero out the taxable gift and subsequent growth can be shifted outside the Grantor's taxable estate and transferred to Beneficiaries gift and estate tax free at the end of the Annuity Period.**

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COMPARISON – GRANTOR RETAINED ANNUITY TRUST VS. INSTALLMENT SALE TO IRREVOCABLE GRANTOR TRUST

A common question is when is a GRAT ideal vs. an Installment Sale and vice versa? As with many techniques, neither is always better, rather they are different with contrasting planning purposes or applications based on individual priorities and circumstances. Below is a high-level, non-exhaustive list of some of the key pros and cons of each. Note, the technicalities of these strategies can be quite complicated and are beyond the scope of this piece.

	Grantor Retained Annuity Trust	Installment Sale to Irrevocable Grantor Trust	Advantage Generally Goes To
Tax and Legal Authority	Statutory authority and safe harbors codified by IRC § 2702 and regulations thereunder	Primary guidance from Revenue Rulings and Letter Rulings, which do not carry the force of law and are not binding on a court, and court cases; possibly more susceptible to challenge[24]	**GRAT**
Wealth Transfer Hurdle Rate	§ 7520 Rate (120% of the Mid-Term AFR rounded to nearest 0.20%; 0.60% for June 2020)	Short-, Mid- or Long-Term AFR based on note's term (0.18%, 0.45% or 1.17% for July 2020)	**< 9 Year Term = Installment Sale** **> 9 Year Term = GRAT**
Payment Structure and Flexibility	Fixed annuity payments amortized over the Term (maximum annual increase of 20% over prior year[25])	Can be amortized, interest-only with a balloon payment or somewhere in between (as well as self-canceling at death if structured properly[26])	**Installment Sale**
Valuation Consider-ations	If the valuation of property transferred to the GRAT is redetermined due to a gift tax audit, the GRAT annuity payments automatically adjust accordingly to minimize unexpected gift tax consequences[27]	If the valuation of property sold is redetermined due to audit to be more than the consideration paid by the Trust, or if the note is treated as equity instead of debt, a portion or all the sale amount could be treated as a taxable gift with potential gift or estate tax consequences[28]	**GRAT**
Gift Tax Consider-ations for Transfers to the Trust	The value of the taxable gift can be zeroed out and is not subject to a minimum amount[29]	Generally, Grantor must make a minimum taxable gift so that enough Trust equity exists in excess of the note; general rule of thumb is 10% equity or 1/9 the value of the note[30]	**GRAT (assuming sufficient trust equity does not exist, otherwise neutral)**
Estate Tax Consider-ations if Grantor Dies Prior to Termination	All or a portion of GRAT property is includible in the Grantor's taxable estate often exceeding the initial transfer depending on the design and § 7520 Rate at death relative to inception[31]	Only the FMV of the promissory note is generally includible in the Grantor's taxable estate (unless the note is self-canceling)[32]	**Longer term and § 7520 Rate rose since inception, possibly = GRAT** **Otherwise, typically = Installment Sale**
GST Exemption Allocation	GST Exemption can only be allocated to GRAT property at the end of the Annuity Period based on remaining GRAT value and available Exemption[33]	GST Exemption can be allocated to any taxable gifts made to the Trust at or after its creation	**Installment Sale**

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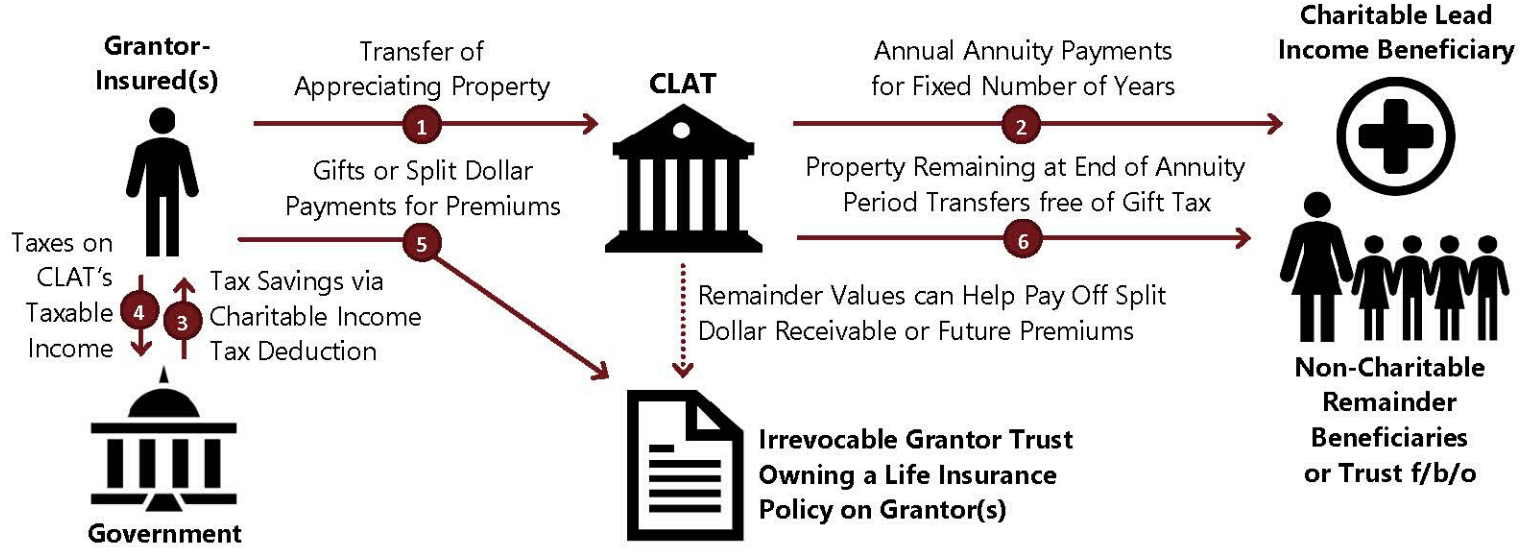
STRATEGY 4 CHARITABLE LEAD ANNUITY TRUST (CLAT)

HOW IT WORKS



1. **Grantor-Insured gifts property that is expected to appreciate in value to the CLAT.**

   The PV of the lead annuity interest in step 2, discounted at the § 7520 Rate (0.6% for July 2020), can be eligible for the charitable gift tax deduction.[34] The FMV of property gifted less this amount equals the taxable gift to Remainder Beneficiaries.

2. **Charitable Beneficiary receives fixed annual annuity payment for a fixed number of years ("Annuity Period").**

   Payments can be made from CLAT income or principal. Distributions of appreciated property in payment of the annuity may result in recognition of gain on such property.[35] If valuation discounts are applied to the FMV of property gifted, distributions of such property should reflect such discounts. The annuity interest can be set so its PV is equal to the FMV of property gifted to minimize the taxable gift to remainder Beneficiary and maximize the charitable income tax deduction to Grantor at inception.[36]

3. **Grantor-Insured can claim a charitable income tax deduction equal to the PV of the lead annuity interest.**

   To be eligible for the charitable income tax deduction, the CLAT must be a grantor trust with the Grantor being treated as the owner of Trust property for income tax purposes.[37] Because a gift to a CLAT is considered "for the use of" the charitable beneficiary, the amount of the deduction is limited to 30% or 20% of the Grantor's adjusted gross income (AGI), depending on the type of charitable beneficiary and property gifted, with any unusable amount carried forward for up to five years.

4. **The Grantor is treated as the owner of CLAT property for income tax purposes under the grantor trust rules and personally responsible for taxes payable on the Trust's taxable income.[38]**

   Payment of the CLAT's income taxes has the effect of an additional gift to the CLAT but is not treated as such, which reduces the Grantor's taxable estate and allows more wealth to accrue to the Remainder Beneficiaries.[39]

5. **To help pay estate taxes on other assets, replace wealth distributed to a charity or satisfy other needs, the Grantor can set up another Trust to own Life Insurance and make gifts or split dollar loans to pay premiums.**

6. **CLAT property remaining at the end of the Annuity Period is transferred to remainder Beneficiaries gift tax free.**

   For a CLAT to be successful in transferring wealth, property gifted must appreciate at a rate higher than the § 7520 Rate over the Annuity Period.[40] A portion of the remainder value can be transferred to the Life Insurance Trust to repay split dollar receivables owed to the Grantor-Insured(s) or pay future premiums, if applicable. Grantor's GST Exemption can be allocated at inception but the GST inclusion ratio is not determined until the end of the Annuity Period based on the value of CLAT property then and inflation adjustments over that time to the allocated Exemption amount at a rate equal to the initial § 7520 Rate; this can obfuscate GST planning.[41]

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STRATEGY 4: CHARITABLE LEAD ANNUITY TRUST (CLAT)

HOW IT BENEFITS FROM LOW INTEREST RATES

1. **A low § 7520 Rate results in a higher present value of the annuity interest, which helps to maximize the charitable income and gift tax deduction or reduce the annuity payment required to achieve a specific deduction; and**

2. **Creates a lower wealth transfer "hurdle rate" allowing more appreciation and reinvested income from CLAT property to be transferred to Remainder Beneficiaries gift tax free.**

HYPOTHETICAL ILLUSTRATIVE EXAMPLES

CLATs are often designed so that the annuity interest PV is roughly equal to the FMV of property contributed to maximize the charitable deduction and "zero out" the taxable gift or taxable income used to fund the transfer. Because eligibility for the income tax deduction depends on it being a grantor trust for income tax purposes, CLATs may seek to invest in tax-efficient (e.g. long-term capital gain or tax-exempt) assets to help minimize Grantor's income tax liability and achieve an efficient tradeoff of ongoing tax liability on CLAT taxable income for the upfront deduction. See below.

Assumes gift of cash invested in publicly traded stocks, 5% growth and 2% dividend, 20% capital gain tax rate, 3.8% net investment income tax rate, 33% average tax rate for potential income tax savings, and the following design parameters:

1	2	3	4	5	6	7	8
$10,000,000 FMV of Property Contributed	**$10,000,000** Cost Basis of Property Contributed	**0.6%** § 7520 Rate at Inception	**20 Years** Lead Annuity Period	**$532,043** Lead Annuity Amount	**$9,999,000** Annuity PV Value & Potential Charitable Deduction	**$1,000** Taxable Gift (1 minus 6)	**$3,333,000** Potential Income Tax Savings (6 x 33%)

Year	CLAT Growth	CLAT Dividend Income	Charitable Annuity Payment	CLAT Remainder Value	Portion of Payment Made from Dividend Income	Portion of Payment Made from Deemed Sale of Property	Realized Capital Gain on Deemed Sale of Property	Grantor's Tax Due on CLAT Taxable Income
1	500,000	200,000	-532,043	10,167,957	-200,000	-332,043	15,812	-51,363
5	537,286	214,914	-532,043	10,965,875	-214,914	-317,129	68,650	-67,488
10	600,589	240,236	-532,043	12,320,564	-240,236	-291,808	112,663	-83,990
15	689,375	275,750	-532,043	14,220,586	-275,750	-256,293	133,012	-97,285
20	813,902	325,561	-532,043	16,885,465	-325,561	-206,482	128,661	-108,105
Total	**12,518,809**	**5,007,524**	**-10,640,867**	**16,885,465**	**-5,007,524**	**-5,633,344**	**1,997,298**	**-1,667,147**

Click here to download the detailed analysis of the above values.

The below analysis shows the total charitable income tax deduction that Grantor can claim with a five-year carry-forward based on various levels of current AGI using the assumptions and values above and a 30% AGI limit, a 2% AGI inflation rate and no other charitable gifts made during the 6-year period:

	$1,000,000 Current AGI	**$2,000,000** Current AGI	**$3,000,000** Current AGI	**$4,000,000** Current AGI	**$5,000,000** Current AGI	**$6,000,000** Current AGI
Total Deduction Claimed over 6 Years	1,957,180	3,849,616	5,742,052	7,634,489	9,526,925	9,999,000
Unused Deduction Lost after 6 Years	8,041,820	6,149,384	4,256,948	2,364,511	472,075	0
Total Income Tax Savings over 6 Years	652,393	1,283,205	1,914,017	2,544,830	3,175,642	3,333,000

As shown, from an income tax perspective, CLATs can be more efficient for Grantors with higher AGI relative to the value of the charitable gift. Moreover, ideally, the higher the average income tax rate on AGI that is reduced by the deduction relative to the marginal tax rate attributable to the CLAT's taxable income, the more efficient the income tax tradeoffs. However, even if the taxes paid by the Grantor on the CLAT's taxable income outweigh the income tax savings on the deduction, the technique can still be effective because such payment of the CLAT's income taxes helps inflate the ultimate value to the Remainder Beneficiaries and is not treated as a taxable gift by the Grantor.

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STRATEGY 4: CHARITABLE LEAD ANNUITY TRUST (CLAT)

CLATs can benefit from low interest rates in similar ways as GRATs for wealth transfer. Moreover, a lower annuity payment from a lower § 7520 Rate can help reduce the need to distribute appreciated property to satisfy the payment, reducing the Grantor's income tax liability on any deemed sale of property. Below is an analysis of the positive effect that a lower § 7520 Rate can have on CLATs for wealth transfer and income taxes when targeting the same taxable gift amount and charitable income tax deduction at inception using the same assumptions as above.

	0.6% § 7520 Rate	2% § 7520 Rate	3% § 7520 Rate	4% § 7520 Rate	5% § 7520 Rate	6% § 7520 Rate	7% § 7520 Rate
FMV and Basis of Property Contributed	10,000,000	10,000,000	10,000,000	10,000,000	10,000,000	10,000,000	10,000,000
20-Year Annuity	**532,043**	**611,506**	**672,090**	**735,744**	**802,346**	**871,758**	**943,835**
Annuity PV and Charitable Income Tax Deduction	9,999,000	9,999,000	9,999,000	9,999,000	9,999,000	9,999,000	9,999,000
Taxable Gift	1,000	1,000	1,000	1,000	1,000	1,000	1,000
Remainder Value	**16,885,465**	**13,627,854**	**11,144,190**	**8,534,660**	**5,804,291**	**2,958,680**	**3,870**
Grantor's Total Tax Due on CLAT Taxable Income	**1,667,147**	**1,753,183**	**1,818,778**	**1,887,698**	**1,959,808**	**2,034,963**	**2,113,001**

Structuring the annuity to increase annually can result in a lower payment in the early years and higher payment in the later years compared to a level annuity. Such design can help maximize the remainder value by allowing more trust property to be invested early on, increasing overall potential for investment gains over the CLAT term. It can also reduce the need to distribute appreciated property to satisfy the payments in the early years which can reduce the Grantor's initial income tax liability on deemed sale of property and defer such taxes to later years. See the example below.

Assumes gift of cash invested in publicly traded stocks, 5% growth and 2% dividend, 20% capital gain tax rate, 3.8% net investment income tax rate, 33% average tax rate for potential income tax savings, and the following design parameters:

1	2	3	4	5	6	7	8
$10,000,000 FMV of Property Contributed	**$10,000,000** Cost Basis of Property Contributed	**0.6%** § 7520 Rate at Inception	**20 Years** Lead Annuity Period	**$58,756** Initial Annuity Amount with ***20% Annual Increase***	**$9,999,000** Annuity PV Value & Potential Charitable Deduction	**$1,000** Taxable Gift (1 minus 6)	**$3,333,000** Potential Income Tax Savings (6 x 33%)

Year	CLAT Growth	CLAT Dividend Income	Charitable Annuity Payment (20% Annual Increase)	CLAT Remainder Value	Portion of Payment Made from Dividend Income	Portion of Payment Made from Deemed Sale of Property	Realized Capital Gain on Deemed Sale of Property	Grantor's Tax Due on CLAT Taxable Income
1	500,000	200,000	**-58,756**	**10,641,244**	**-58,756**	0	0	**-47,600**
5	638,160	255,264	**-121,836**	**13,534,783**	**-121,836**	0	0	**-60,753**
10	844,173	337,669	**-303,168**	**17,762,131**	**-303,168**	0	0	**-80,365**
15	1,057,392	422,957	**-754,379**	**21,873,812**	**-422,957**	**-331,422**	168,729	**-140,822**
20	1,168,016	467,206	**-1,877,137**	**23,118,404**	**-467,206**	**-1,409,931**	867,632	**-317,691**
Total	**17,205,319**	**6,882,128**	**-10,969,043**	**23,118,404**	**-5,753,825**	**-5,215,218**	**2,978,900**	**-2,346,925**

Click here to download the detailed analysis of the above values.

With the increasing annuity design vs. level annuity, the **remainder value is $23.11MM vs. $16.89MM,** total **charitable payments** are **$10.97MM vs. $10.64MM** and total **Grantor income taxes** are **$2.34MM vs. $1.67MM.** GRATs, as covered in Strategy 3, can similarly benefit from such increasing annuity design.[42]

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ENDNOTES

[1] A split dollar loan is generally defined as any payment from the non-owner to the owner of the policy the repayment of which is to be made from, or secured by, the policy's cash value, death benefit or both and, if not treated as a loan under general Federal tax law principles, a reasonable person would expect such repayment to be made in full. See Treas. Reg. 1.7872-15.

[2] For the promissory note to be non-recourse the lender and borrower need to attest in writing that a reasonable person would expect the loan to be repaid in full and submit such representation with their tax returns for each taxable year in which a loan advance is made. If interest is paid or accrued at a rate less than the AFR, then the below-market loan rules will operate to impute transfers between the lender and borrower for income and gift tax purposes. The timing, amount and characterization of imputed transfers depend upon the relationship between the parties and whether the loan is a demand or term loan. See IRC § 7872 and Treas. Reg. 1.7872-15.

[3] Pledging a MEC as collateral is treated as a distribution, causing ordinary income recognition by the owner to the extent of the increase in gain each year the pledge is in effect. Under the grantor trust rules, the pledge should be disregarded and ignored for income tax purposes if between the grantor and the trust but policy disbursements from the carrier to the trust would be recognized. Proceeds received upon surrender, including any outstanding and unrepaid policy loans, would be taxable as ordinary income to the extent of gain. See IRC §§ 72, 7702A and Rev. Rul. 85-13.

[4] See IRC § 101.

[5] Assuming the policy never becomes a MEC and stays in force until death, withdrawals up to cost basis and any policy loans do not give rise to taxable income. See IRC §§ 72 and 7702A.

[6] See IRC §§ 1272-1274 and Rev. Rul. 85-13.

[7] See IRC § 101.

[8] See IRC See IRC § 1014 and Rev. Rul. 85-13.

[9] If property is to be transferred to a trust with no other assets in exchange for a note, a seed gift may be required for economic substance to minimize risk of the transaction being treated as a transfer with retained right to receive trust income for the purposes of IRC § 2036. The general rule of thumb is that which would result in 10% or more equity after the sale, or a gift equal to 1/9 the face amount of the note. See PLRs 9251004 and 9535026. Actual equity required may vary depending on collateral, liquidity, income to support debt payments and other factors. It's important for note to be properly structured as to be treated as debt and not equity to avoid it being treated as a taxable gift with estate tax consequences under IRC §§ 2036 and 2701-2702. Many practitioners suggest that the note's term be less than the seller's life expectancy and for payments to be made by the Trust. If interest is not charged at or above the AFR then the below market loan rules of IRC § 7872 and OID rules of IRC §§ 1272-1274 generally apply and will impute transfers between the seller and buyer for income and gift tax purposes.

[10] Third party qualified appraisers should be used and the valuation should be well documented. Many practitioners recommended to report the sale on a Form 709 Gift Tax Return to start the running of the state of limitations period.

[11] See Rev. Rul. 85-13. Note, if grantor trust status terminates during life, trust property subject to debt may give rise to recognition of gain by the grantor to the extent the trust's debt exceeds its basis in the property. See Treas. Reg. 1.1001-2(c) Ex. 5.

[12] See IRC § 671.

[13] See Rev. Rul. 2004-64. Also, under this Ruling, Grantor can be reimbursed for Trust income taxes paid at the Trustee's discretion but there must be no express or implied understanding that the Trustee will exercise this discretion in favor of Grantor.

[14] Term of the note generally needs to be less than the seller's life expectancy. A seed gift may be required if the trust does not already have enough assets. A common rule of thumb ratio is a gift equal to 1/9 the value of the promissory note.

[15] To be recognized in calculating the value of the taxable gift, the retained annuity must be treated as a Qualified Interest under IRC § 2702.

[16] It is generally advisable to report the transaction on a Form 709 Gift Tax Return to start the running of the statute of limitations period.

[17] The value includible in the Grantor's taxable estate under IRC § 2036(a) during the Annuity Period is that amount of the GRAT corpus necessary to yield the annual annuity payment to the Grantor assuming an investment yield equal to the § 7520 Rate at death without reducing or invading principal. This amount is calculated by dividing the annual annuity amount (adjusted for monthly payments) by the § 7520 Rate at death and is limited to the FMV of the GRAT corpus at death, if less.

[18] See IRC § 671.

[19] See Rev. Rul. 85-13.

[20] See Rev. Rul. 2004-64.

[21] The remainder beneficiary takes a basis in the remaining property received equal to the GRAT's basis immediately before the transfer.

[22] If GRAT property underperforms, Grantor could exercise a power of substation and swap underperforming property for that which may be expected to grow at a higher rate.

[23] See IRC § 2642(f) and Treas. Reg. 26.2632-1(c)(1).

[24] See Rev. Rul. 85-13, PLRs 9251004 and 9535026 and Tax Court cases, *Karmazin v. Comm'r, Woelbing v. Comm'r, Wandry v. Comm'r,* and *Nelson v. Comm'r.*

[25] See Treas. Reg. § 25.2702-3(b)(1)(ii)(A).

[26] The nuances of and considerations for self-cancelling installment notes are complicated and beyond the scope of this piece.

[27] See Treas. Reg. § 25.2702-3(b)(2).

[28] Defined value formula clauses, such as what was upheld by the Tax Court in Wandry v. Commissioner, T.C. Memo 2012-88 (2012), are often used to help minimize the risk unanticipated gift tax consequences arising from a revaluation of property transferred in exchange for a note. However, these clauses are still susceptible to challenge as is evident by Nelson v. Commissioner, T.C. Memo 2020-81 (2020), a recent case in which the Court ruled in favor of the IRS.

[29] See Walton v. Commissioner, 115 T.C. 589, 115 T.C. No. 41 (2000).

[30] See endnote 9.

[31] See endnote 17.

[32] See Treas. Reg. 20.2031-4 for guidance on the valuation of promissory notes for estate tax purposes.

[33] See IRC § 2642(f) and Treas. Reg. 26.2632-1(c)(1).

[34] See IRC § 2522(c)(2)(B).

[35] See Priv. Ltr. Rul. 200920031, Rev. Rul. 83-75 and Kenan v. Comm'r, 114 F2d 217, 25 AFTR 607 (2d Cir. 1940). The grantor could exercise a power of substitution to "swap" a low-basis CLAT asset with a high-basis personal one or cash that the CLAT could then use to make the annuity payment. However, this could be treated as an act of self-dealing under the private foundation rules applicable to CLATs. Giving such power to a non-adverse party trustee may preclude such treatment.

[36] It is generally advisable to report the transaction on a Form 709 Gift Tax Return to start the running of the statute of limitations period.

[37] See IRC § 170(f)(2)(B).

[38] See IRC § 671 and Rev. Rul. 85-13.

[39] See Rev. Rul. 2004-64. Note, it is possible that tax reimbursements to the Grantor by the Trustee could be treated as an act of self-dealing.

[40] See footnote 23 regarding the power to substitute property in response to underperforming property.

[41] See IRC § 2642(e).

[42] Increasing GRAT annuities are subject to a maximum increase over the prior year of 20%. See Treas. Reg. § 25.2702-3(b)(1)(ii)(A).

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