YOUR FINANCIAL FUTURE

Your Guide to Life Planning

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Wealth Transfer in a Low-rate Environment

For those fortunate few individuals whose personal wealth exceeds the current estate-tax exemption threshold -- $5.43 million for 2015 rising to $5.45 million for 2016 -- today's historically low interest rate environment offers potentially powerful wealth transfer opportunities.

Recent low rates of interest have affected two important factors used to value wealth transfers involving trusts -- the applicable federal rate (AFR) and the Section 7520 rate -- both of which are published and calculated each month by the Internal Revenue Service (IRS). These rates reflect what the IRS assumes the assets in a trust will earn over the life of the portfolio. They are sometimes referred to as "hurdle" rates because if investment returns outperform the interest rate, the difference may be passed tax free to trust beneficiaries.

Given current conditions, the following strategies may prove especially attractive.

Grantor Retained Annuity Trusts (GRATs). A GRAT is an irrevocable trust that is used to shift the growth and appreciation of assets from one generation to the next, often with little or no gift-tax consequence. In a typical GRAT, a donor or "grantor" places stock or other assets in the trust for a specified term during which he or she takes back principal in the form of annuity payments that are calculated using the low IRS-prescribed interest rate.

Any appreciation in trust assets above that interest rate passes to the GRAT's remainder beneficiaries outside of the transfer-tax system. Thus, the lower the interest rate, the greater the potential gift that can pass out of the donor's taxable estate to heirs.

How might a GRAT play out today? Given current conditions, an individual could transfer more shares of depressed stock into a GRAT. Then, if the market rebounds and outperforms the hurdle rate for an extended period, that difference could represent considerable wealth that would transfer to heirs.

Charitable Lead Annuity Trusts (CLATs). For those who wish to combine charitable giving with the transfer of wealth to family members, a CLAT offers an alternative solution to a GRAT. In this case, periodic annuity payments are made to a charity of choice, not the grantor. At the end of the trust's term, any remaining assets are then paid out to the non-charitable beneficiaries, typically family members, tax free.

Sale of Assets to a Family Trust. Another potentially attractive technique is to sell (rather than give) assets that are likely to appreciate in value to a family trust for the benefit of children. The grantor receives a promissory note with AFR interest. Because the grantor is essentially making a loan to himself or herself, the interest received on the note is not considered taxable income. As the property increases in value, the note remains static, while appreciated assets pass to heirs.

The current environment may present an attractive opportunity for those gifting assets as well as those receiving them. Be sure to explore these and other wealth transfer options with your tax and legal advisors as part of your overall planning strategy.

This communication is not intended as tax and/or legal advice and should not be treated as such. Each individual's situation is different. You should contact your tax professional to discuss your personal situation.

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indices are unmanaged and cannot be invested into directly.