Estate and Gift Tax Alert

Market Volatility Plus Low Interest Rates Heighten Estate Planning Benefits

September 26, 2011

We have previously alerted you regarding two estate planning strategies - the gift to a grantor retained annuity trust (GRAT) and the sale/loan to a grantor trust - that have outstanding potential to leverage today's depressed asset values and low interest rates into estate planning benefits for your heirs. Both strategies involve transferring future appreciation on assets in excess of a "hurdle rate" set by the Internal Revenue Service (IRS), with minimal gift tax costs or risks if structured properly. These strategies may be even more attractive right now because **the hurdle rates are headed for all-time lows in October 2011.**

Gift to a GRAT

A GRAT is a trust to which a "grantor" transfers assets in exchange for the right to receive a fixed annuity for a specified term of years. Over the GRAT's term, the GRAT repays the grantor, in the form of fixed annuity payments, property equal in value to the initial value of the transferred assets plus an assumed rate of return, often referred to as the GRAT's "hurdle rate." This hurdle rate is based on the IRS's published Applicable Federal Rate (AFR) in effect for the month in which the GRAT is funded. Generally, if the grantor survives the specified term and the GRAT's assets appreciate in excess of the hurdle rate, that excess appreciation will pass to the GRAT beneficiaries (such as trusts for the grantor's children) and be removed from the grantor's taxable estate, with minimal or no transfer taxes.

There is no downside risk to a GRAT other than transaction costs if the GRAT assets do not perform as well as expected. If the GRAT assets appreciate at a rate lower than the hurdle rate, the assets will simply be repaid to the grantor through the required annuity payments. Although there is no estate planning benefit under such circumstances, the grantor will be in substantially the same position as if the GRAT had never been created in the first instance.

The upside potential, however, is significant, and it increases as the hurdle rate decreases. October 2011 will be an especially advantageous time for GRAT planning because the hurdle rate for a GRAT funded in that month will be a historic low of **1.4 percent.** The GRAT will succeed in passing wealth to the beneficiaries effectively free of transfer taxes if and to the extent that the GRAT's return on investments exceeds this exceptionally low rate.

Installment Sale, or Loan, to a Grantor Trust

A grantor trust is a trust structured so that all of the trust's income, gains and deductions are reported on the grantor's personal income tax return. After creating the grantor trust, generally for the grantor's descendants, the grantor sells assets[1] or loans cash to the trust in exchange for a promissory note bearing interest at a hurdle rate equal to the

[1] In the case of a sale, the grantor does not recognize any gain or loss because the sale is disregarded for income tax purposes.

www.twitter.com/akin_gump

© 2011 Akin Gump Strauss Hauer & Feld LLP This document is distributed for informational use only; it does not constitute legal advice and should not be used as such.

published AFR for the note's term in effect for the month of the transaction. The grantor ultimately will receive back from the trust the principal balance of the note plus the AFR interest. As with a GRAT, the sale/loan will be successful if the assets sold to, or reinvestments of the cash loaned to, the trust appreciate at a rate higher than the hurdle rate, in which case such excess appreciation will pass to the trust without the imposition of transfer taxes. [2]

Like the hurdle rate applicable to a GRAT, the hurdle rate applicable to such sales or loans made in October 2011 will be extremely low: **0.16 percent** for a short-term (less than three years) note, **1.19 percent** for a mid-term (three to nine years) note, and **2.93 percent** for a long-term (greater than nine years) note. Assuming a sale or loan in October for a mid-term note, if the trust's investments appreciate in excess of 1.19 percent, the excess appreciation will pass to the trust free of transfer taxes.

Additional complexity and risk may be involved in implementing the sale or loan strategy as opposed to the GRAT strategy, but, for a number of reasons, including that the hurdle rate for short- and mid-term notes is lower than the GRAT hurdle rate and that under current law an increased federal gift exemption is available to offset federal gift tax on gifts made in 2011 and 2012, the potential benefit to the grantor's estate plan and the grantor's heirs may be greater.

*   *   *

The combination of market volatility and all-time low interest rates provides an exceptional opportunity to transfer assets to heirs at a reduced tax cost. The professionals in Akin Gump Strauss Hauer & Feld LLP's private client services practice are ready to assist you and your family in making the most of these extraordinary times. Please contact us if you wish to hear more about these or any other planning strategies.

CONTACT INFORMATION

If you have any questions concerning this alert, please contact —

Irene A. Steiner
isteiner@akingump.com
212.872.8015
New York

Elizabeth E. Harris
eharris@akingump.com
212.872.7407
New York

Anta Cisse-Green
acissegreen@akingump.com
212.872.7473
New York

[2] It may be necessary to make an initial gift to the grantor trust prior to the sale/loan in order to establish the trust as "credit-worthy" and the bona fides of the sale/loan arrangement.

© 2011 Akin Gump Strauss Hauer & Feld LLP This document is distributed for informational use only; it does not constitute legal advice and should not be used as such.