Ultra-low interest rates

In October, a key IRS interest rate (the Section 7520 rate) fell from 2.0% in September to 1.4%, the lowest rate ever. (The high point for the Section 7520 rate was 11.6% in May 1989.) As recently as last May, the rate was 3.0%. Very low interest rates favor some estate planning techniques, but others lose their allure. Examples follow.

The *Grantor Retained Annuity Trust* (GRAT) has long been a favored tool for leveraging transfer tax exemptions. The trust creator gets income from an irrevocable trust for a set number of years, and the heirs take the trust assets when the term expires. Depending upon the size and terms of the trust, the lifetime $5 million gift tax exemption may be consumed. With this approach, future asset appreciation may be removed from the taxable estate at no additional gift tax cost. GRATs may be especially valuable in transferring assets that are hard to value. As interest rates fall, the discount rate applied to a retained income stream falls as well, making the retained income interest more valuable. That means the gift element of the transfer to a GRAT may be reduced to zero with the retention of a smaller annuity amount.

There have been proposals in Congress to restrict GRATs by requiring a minimum ten-year term for them. That idea could resurface in the coming years, so there is some urgency in implementing a GRAT sooner rather than later. On the other hand, some commentators have pointed out that GRATs may be even more effective at saving taxes if they lock in today's low interest rates by going long-term instead of short-term.

The *Charitable Lead Annuity Trust* also benefits from low interest rates. Here, a charity receives the income interest, and private beneficiaries take the remainder after a set number of years. A more valuable income stream yields a larger charitable deduction. Any growth in the value of trust assets beyond the Section 7520 rate will accrue to the private beneficiaries when the trust terminates, free of federal estate or gift tax. Should the economy improve markedly, the trust remainder could prove to be a windfall.

Given today's depressed real estate values, 2012 may be a good time for implementing a *Qualified Personal Residence Trust* (QPRT). The trust holds the home for a set number of years, and then passes it to the children when the trust term ends. However, for this strategy, low interest rates are pushing the other way. The retained interest in the home is worth more, which means a longer term is needed to bring the gift element of the QPRT down to the desired level.

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