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Estate Planning in a Low Interest Rate Environment

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As the crisis surrounding COVID-19 continues, most people have focused their attention on immediate critical issues, including concerns about health and safety for themselves and their loved ones, employment and their overall financial situation. Although estate planning might follow those items in a list of priorities for most people, the current situation presents planning considerations that may not be immediately apparent. A more present sense of one's own mortality may drive those who have not made plans before to begin the process of creating an estate plan. For those who have existing plans, are they up to date? And, how does the changing economic environment affect prior decisions?

One result of the current situation is that interest rates are lower now than they have been for some time. For example, the April 2020 Applicable Federal Rates (AFRs), which determine the minimum interest that must be charged for below-market loans and which are often used for intrafamily lending, have decreased to 0.91 percent for loans less than three years in duration, 0.99 percent for loans of three years or more and less than nine years, and 1.44 percent for loans of nine years or longer. In addition, the 7520 rate, equal to 120 percent of the midterm AFR and used for discounting remainder interests to present value, is 1.2 percent.

For families in which intrafamily lending has already occurred, the reduced interest rates provide an opportunity to amend the terms of existing promissory notes to capture the lower rate. **This has at least two practical effects:**

- First, it reduces the amount the borrower must repay, potentially easing the burden on a borrower in a situation where cash flow may be reduced.
- Second, in situations where a parent has already lent to a child who will later inherit from the parent, the decreased interest rate may help to facilitate wealth transfer, as the parent receives lower payments under the note and thus minimizes the assets being added back to the lender's taxable estate.

Situations where such loans might exist could include:

- A parent extended a loan to a child to help get through a difficult time.
- A parent may have loaned money to a child with the idea that the child could invest the money at a higher rate of return than the interest charged under the note, thus allowing

growth to occur in the child's estate instead of the parent's estate.

- More complex planning techniques, such as a sale to an intentionally defective trust, in which the seller's goal is to freeze the value of their estate for the price at which at asset was sold on an installment basis, allowing the future growth to occur outside of the seller's taxable estate.

In addition to addressing existing loans, other planning techniques, such as a grantor retained annuity trust (GRAT) or a charitable lead trusts (CLT), which rely on the 7520 rate, also become more attractive in a low interest rate environment, particularly for individuals who have estates potentially subject to the federal estate tax. A GRAT involves a transfer of assets to a trust in which the settlor retains an annuity payment for a term of years. At the end of the term, the remaining assets pass to the trust's beneficiaries without any estate tax implications. A CLT operates similarly, except that the payment for the specified term of years is made to a charity. In both cases, the ongoing payment is based on the 7520 rate. A lower rate results in a lower annual payment back to the settlor in a GRAT or the charity in the case of a CLT and a larger estate tax-free distribution to descendants in the future.

Although not everyone will need to use techniques such as a GRAT or a CLT, the current situation presents opportunities to individuals of varying economic circumstances to address intrafamily loans and wealth transfer that may not have been considered previously.

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