

DENVER BUSINESS JOURNAL

SEPTEMBER 4-10, 2009

ESTATE-PLANNING

A perfect storm for estate-planning techniques

BY RENEE MCGAW
DENVER BUSINESS JOURNAL

Low interest rates, along with last year's market crash, have created the ideal environment for a trio of estate-planning techniques.

"It's almost the perfect storm for those three things to start working really well," said Scott Sparks, a wealth management adviser at Northwestern Mutual in Denver.

"Interest rates are at historic lows," said Melissa Montgomery-Fitzsimmons, director of

Under the current estate tax rate, any amount passed on to your heirs above \$3.5 million is taxed at 45 percent. A provision enacted during the bush administration will drop that rate to zero in 2010.

wealth planning at First Western Trust Bank in Denver. "They really can't go much lower. This presents an opportunity for people to take advantage of the low-interest-rate environment, but they first have to get comfortable with not outliving their money. They need to know that they are going to be taken care of until age 100 before implementing these strategies."

Under the current estate tax rate, any amount passed on to your heirs above \$3.5 million is taxed at 45 percent. A provision enacted during the Bush administration will drop that rate to zero in 2010.

"It's a pretty sure bet that they will change the tax laws before 2010 arrives, because the government needs the revenue," Montgomery-Fitzsimmons said. "But until we know what those changes will be, these are the rules we have to play with."

Here are three strategies that work well when interest rates are low:

Grantor retained annuity trust (GRAT)

Under this strategy, an individual creates an irrevocable trust for a predetermined period of time, such as two or 10 years. Property transferred to the trust is paid back to the investor as annuity payments over the life of the GRAT. In addition, the grantor receives interest payments at an applicable federal rate that is set monthly by the IRS — financial planners often call it the "hurdle rate" — that is locked in for the life of the GRAT. In the end, the grantor should receive back exactly the amount that was placed



KATHLEEN LAVINE | BUSINESS JOURNAL

Melissa Montgomery-Fitzsimmons, director of wealth planning at First Western Trust Bank in Denver, says it's a "sure bet" tax laws will change before 2010.

in the trust, plus interest. If the property in the trust has appreciated at a rate above the hurdle rate, that excess appreciation is passed on to the grantor's heirs gift-tax and estate-tax-free.

GRATs work well when rates are low because they make it easier to accumulate extra appreciation. In July, the applicable federal rate set by the IRS was 2.7 percent, Sparks said. That's up somewhat from 2.0 percent in February, but still well below rates seen a few years ago.

"Only a couple of years ago, the applicable federal rate was in the 5 percent range," said Marti Brust, senior vice president and wealth advisor at UMB Asset Management in Denver. "Now that it's down in the 2-ish [percent] range, that means that the IRS is expecting the assets in the GRAT to grow less, which means that you can pass on more tax-free, assuming that the assets grow well in excess of that applicable federal rate."

But you've got to outlive the GRAT. If you

die before the end of the term, the assets will be included in your estate, wiping out the tax benefit.

That's why many people prefer to use shorter terms — for instance, a series of five two-year GRATs instead of one 10-year GRAT.

"It resets every two years," Montgomery-Fitzsimmons said. "So if you make it to year eight and pass away, you've gotten 80 percent of the benefit, instead of setting up a 10-year GRAT and getting zero benefit if you pass away."

At press time, Congress was considering legislation that would set a minimum 10-year term for GRATs. Even if that were to pass, it's unclear whether the new requirements would apply only to future GRATs, or if it would be applied retroactively.

Charitable lead annuity trust (CLAT)

A CLAT works the same way as a GRAT, but instead of the grantor receiving the annuity, it goes to a designated charity, Montgomery-Fitzsimmons said.

At the end, whatever's left — that is, the appreciation minus the interest rate paid to the grantor — goes to heirs estate-tax-free. A family foundation can be named as the charitable recipient.

Intentionally Defective Grantor Trust (IDGT)

Again, it's similar to a GRAT. But in this case, the grantor sells an asset to the trust and receives an installment note at the applicable federal rate. In essence, you're lending the trust the money to buy an asset that may appreciate far more than it was originally worth, and that appreciation will be passed on to heirs minus the amount returned to your estate through the installment note.

Although the asset is no longer part of the grantor's estate, he or she continues to pay income taxes on it. "By paying the taxes, you are grossing up the amount that the trust can earn and ultimately pass down to kids or grandkids," Montgomery-Fitzsimmons said.

The fact that most assets, such as stocks or real estate, have lost value in the past year means that they may rise sharply when the economy begins to recover. At the same time, grantors can lock in relatively low interest rates.

"But all these things that you're doing are relatively complex, so good counsel is always recommended both on the legal side and on the financial side," Sparks said.